



Knight Capital Group, Inc.
545 Washington Boulevard
Jersey City, New Jersey 07310
Tel 201.222.9400
Fax 201.557.6853
Toll Free 800.544.7508
www.knight.com

Michael T. Corrao
Managing Director
(Tel) 356-1705
(Fax) 557-6922

January 13, 2012

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: **SR-FINRA-2011-058 (34-65568)**
Proposed Rule Change to Amend FINRA Rule 6433 (Minimum Quotation Size Requirements for OTC Equity Securities)

Dear Ms. Murphy:

Knight Capital Group, Inc. (Knight)¹ respectfully submits this letter as a supplement to its previous submission,² and in response to FINRA's recent submissions relating to its proposed amendments to FINRA Rule 6433³. At the outset, Knight agrees with the views set forth in the recent comment letter submitted by OTC Markets, and respectfully incorporates them by reference.⁴

As we have noted previously, we continue to support FINRA's fundamental goal to make additional limit orders display eligible under FINRA Rule 6460. However, as we previously stated in our comment letter,⁵ Knight firmly believes that the proposed change will have serious negative consequences to the marketplace and investors, including:

- Significant reduction in liquidity;
- Inferior pricing; and,
- Increased vulnerability to gaming and front running.

As a major participant in the over the counter (OTC) market, Knight is deeply concerned about the negative consequences that are likely to result when concepts and rules from the NMS market are appropriated and misapplied to the OTC market despite the vastly different trading characteristics the securities that inhabit these distinct and disparate marketplaces. As FINRA correctly points out, beyond the top tier of liquidity in the NMS market, there is a definite need for liquidity provision by risk taking businesses. This is much more the case with OTC equities.

¹ Knight Capital Group, Inc., through its subsidiaries, is a major liquidity center for foreign and domestic equities, fixed income securities, and currencies. On active days, Knight can execute in excess of ten million trades, with volume exceeding 15 billion shares. Knight's clients include more than 3,000 broker-dealers and institutional clients. Currently, Knight employs more than 1,300 people worldwide. For more information, please visit: www.knight.com.

² See, Comment letter by Knight Capital Group, Inc. (November 16, 2011).

³ Specifically, our letter is in response to Marc Menchel's (FINRA's General Counsel) email of November 30, 2011, and the letter from Stephanie M. Dumont, Senior VP, FINRA, December 23, 2011.

⁴ See, letter submitted by Daniel Zinn, General Counsel, OTC Markets Group, Inc. dated December 29, 2011.

⁵ Supra, footnote 2.

We believe that a robust and thorough review by the Securities and Exchange Commission (“SEC”) as to rule filings by Exchanges and self-regulatory organizations (SROs), like FINRA, as well as the related public comments, is critical to the rule-making process. It is fundamental to any such review that the SEC properly evaluate the costs and benefits associated with such filings, and that there be a comprehensive analysis of empirical data to insure the proposed rule has a sound basis and is, in fact, designed to improve market quality or cure a deficiency in market structure. Indeed, SEC Commissioners have stated time and again that the hallmark of effective regulation is the careful analysis of data, to insure that one first understands the problem that needs to be solved and that the proposed rules are carefully designed to accomplish those objectives. To conclude otherwise, or to support a notion that an Exchange or SRO can submit a rule filing which could impact market structure on nothing more than speculation and conjecture, will inevitably lead to unintended consequences which will undoubtedly cause far more harm than good.⁶ Nevertheless, Knight continues to believe that there remains an opportunity to create an environment that serves the needs of the market’s two most crucial constituents: investors and issuers.

With regard to Rule 6433, we respectfully disagree strongly with the view that the implementation of the proposed rule change will not have a negative impact on liquidity. There has been absolutely no data or analysis submitted to support this conclusion. Indeed, it is well understood that the OTC market and the NMS market are vastly different marketplaces.

Additionally, we think it is important to reflect upon the analysis conducted in connection with the tier size reductions in NMS securities conducted in 1997-1998 and the adoption of the “Actual Size” pilot.⁷ In fact, prior to the implementation of the “Actual Size” pilot, the analysis of the potential impact of the Actual Size Rule conducted by FINRA and filed with the SEC actually took the form of two studies. The first was a June 1997 study which analyzed standard measures of market quality, including spread, volatility, liquidity, and depth. That study also examined investors’ ability to access market maker capital through SOES and proprietary automatic execution systems. The study suggested that for pilot stocks, investors continued to have reasonable and substantial access to market maker capital through automatic execution systems. The second study, completed in March 1998, examined the impact of the pilot on spreads, volatility, aggregate depth, liquidity and the effective depth of liquidity. Those studies provided a sound basis for expansive and important rulemaking. The process and analysis conducted by FINRA in connection with that market structure change was not only appropriate, but representative of the manner in which responsible rule-making should be handled. Careful analysis and study are critical. We respectfully submit that FINRA should consider something similar for the significant market structure change it is currently proposing.

It is well understood that non-NMS securities, by their nature, are significantly less liquid than NMS securities. The limit order books in non-NMS securities provide significantly less liquidity than what was experienced and examined under the NMS “actual size” pilot study. The desire to impose a more NMS-

⁶ Additionally, we query how an SRO could even begin to evaluate its obligations under Section 15A(b)(9) of the Securities Exchange Act of 1934 (i.e., assess the rule filing’s “burden on competition”) unless it conducts a fundamental analysis of the proposal, available market data and related costs and benefits.

⁷ On January 10, 1997, the SEC approved, on a temporary basis, the Actual Size Rule for the first 50 securities subject to the Limit Order Display Rules and subsequently expanded the pilot to an additional 150 securities. Under the Actual Size Rule pilot, NASDAQ market makers were only required to display a minimum quotation size of one normal unit of trading (100 shares). The Pilot was expanded to all securities on June 15, 1998 after the production of two studies conducted by NASD’s. Release No. 34-40211; File No. SR-NASD-98-21

like market structure, while laudable, will have an adverse impact on both dealers and investors. Indeed we believe that the only possible benefits resulting from the proposed rule will accrue to firms that will provide little or no liquidity. It is likely that such firms will be eager to pick-off dealer liquidity at the expense of investors.

Importantly as well, despite assertions to the contrary, market makers generally do not charge competitors or broker dealer clients commissions or mark-up/mark-downs. It is not clear why this misconception persists. In fact, in 2011, less than 10% of Knight's executions in non-NMS securities included a commission or a mark-up/mark down. As part of the analysis we hope FINRA undertakes, we suggest that it evaluate the impact on the market where all market participants quote the default minimum tier size. FINRA's comment suggesting that "market participants concerned about costs can post more size" does not take into consideration market makers' cost⁸ to access that liquidity and disregards the likelihood that market participants will gravitate to posting quotations at the minimum tier size as they currently do today.

We once again include the figure that was included in Knight's previous comments. For the sake of clarity we have divided the chart into two separate sections:

Current Tiers	Current Size Requirement	Current Minimum dollar value of displayed liquidity by MM	Proposed Tiers	Proposed Size Requirement	Proposed Minimum dollar value of displayed liquidity by MM
0.0001 - .5	5000	\$0.50	0.0001 - .0199	10000	\$1
0.51 - 1.00	2500	\$1,275	0.02 - .2599	1000	\$20
1.01 - 10.00	500	\$505	0.26 - .5099	500	\$130
10.01 - 100	200	\$2,002	0.51 - .9999	200	\$102
100.01 - 200	100	\$10,001	1 - 174.99	100	\$100
200.01 - 500	25	\$5,000.25	175	1	\$175
500.01 - 1000	10	\$5,000.10			
1000.01 - 2500	5	\$5,000.05			
2500 +	1	\$2500 +			

Knight had also raised the issue of additional clearing burdens. While FINRA is correct regarding Knight's own internal costs for self-clearing additional trades, such costs will increase for non-self-clearing firms. Additionally, FINRA does not appear to have considered NSCC charges (which are

⁸ Many non-NMS securities experience significant clearing cost above and beyond the normal clearing cost of NMS securities. These costs can be considerably greater than the normal clearing costs. Part of the reason for the higher cost is due to the securities NSCC and DTC eligibility. Clearing that occurs outside of NSCC/DTC is significantly higher.

assessed to members on a per trade basis). While the per trade cost is relatively inexpensive, additional trades will result in increased clearing costs. Cost becomes an even more burdensome component for non-DTCC eligible securities (physicals), which is an important consideration with OTC securities.⁹ These costs are driven mostly by the number of settlements as opposed to the number of trades. If reduced quote size results in a more fragmented market, then more settlement counterparties are likely on each individual order.

We appreciate the opportunity to comment on this rule proposal and FINRA's response to our comments. We would welcome the opportunity for further discussion regarding current market structure and the impact of the proposed changes with FINRA, the Commissioners and SEC staff.

Sincerely yours,



Michael T. Corrao
Managing Director

cc: Mary L. Schapiro, SEC Chairman
Luis A. Aguilar, Commissioner
Daniel M. Gallagher, Commissioner
Troy A. Paredes, Commissioner
Elisse B. Walter, Commissioner
Robert W. Cook, SEC Division of Trading and Markets
Richard G. Ketchum, FINRA
Thomas R. Gira, FINRA

⁹ More than 90% of Knight's clearing costs in OTC equities come from physically settled stocks. Numerous players have dropped these types of securities in order to avoid these costs.