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June 4, 2012

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

Re: SEC Release No. 34-66924; File No. SR-FINRA-2012-023; Proposed Rule Change Relating to FINRA's Trading Activity Fee Rate for Transactions in Covered Equity Securities

Dear Ms. Murphy:

Knight Capital Group, Inc.¹ ("Knight") appreciates the opportunity to comment on FINRA's proposed increase in the Trade Activity Fee ("TAF") Rate for transactions in covered equity securities (the "Proposal").² We fully support FINRA's need to adequately fund its regulatory programs.³ However, as discussed below, the proposed increase of the TAF rate is significant, and fundamentally at odds with the impact of the large increase to FINRA members, particularly liquidity providers. We also believe that the Proposal will result in a disproportionate increase in trading costs for a small segment of market participants, mainly market makers and liquidity providers and, thereby, poses a significant risk of decreasing available liquidity. We oppose the proposed increase as well as the proposal that future TAF rate changes would now be filed for immediate effectiveness under 19(b)(3)(A).

Background

TAF fees are based on trading volume and are used to support FINRA's regulatory program. FINRA states that the proposed increases are necessary in light of declining share volume during

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 10 million trades, with volume exceeding 15 billion shares. Knight's clients include more than 3,000 broker/dealers and institutional clients. Knight employs more than 1,400 people worldwide. For more information, please visit: www.knight.com.

² SEC Release No. 34-66924 (May 4, 2012).

³ See Letter from John H. Bluhner, Executive Vice President and General Counsel, Knight Equity Markets, L.P., Antoine Kemper, Jr., Chief Executive Officer, GVR Company, LLC, and Lawrence Liebowitz, Executive Vice President and Head of Equity Trading, Schwab Capital Markets, L.P., to Robert Glauber, Chairman and Chief Executive Officer, NASD, and Mary L. Schapiro, Vice Chairman and President Regulatory Policy & Oversight, NASD (Oct. 6, 2003) (regarding an approval to increase NASD trade activity fees) ("2003 TAF Comment Letter"); Letter from Leonard J. Amoruso, Senior Managing Director and Chief Compliance Officer, Knight Capital Group, Inc., to Barbara Z. Sweeney, Office of the Corporate Secretary, NASD (Oct. 28, 2005) (comment on NASD Notice to Members 05-61 regarding Trading Activity Fee) ("2005 TAF Comment Letter").

2012. If adopted, the Proposal will amend Schedule A, Section 1 of the FINRA By-Laws by increasing the current TAF rate for covered equity securities from \$0.000095 per share to \$0.000119 per share and the corresponding per-transaction cap from \$4.75 to \$5.95; approximately a 25% increase for both. Since TAF was implemented in 2002, the per share fee amount has increased from \$0.00005 to the current rate of \$0.000095. The proposed increase of the TAF to \$0.000119 per share will represent an increase of approximately 138% since the adoption of the fee.

The Structure of TAF is Fundamentally at Odds with the Ability of Firms to Pay and is an Unstable Source of Funding FINRA's Regulatory Programs

Knight believes that FINRA's reliance on the TAF as a primary source of revenue for its regulatory programs is fundamentally flawed. As the Proposal notes, revenues derived from the TAF are subject to the volatility of trading in the equity markets. As a result, adequate funding of FINRA's regulatory program is based on FINRA's ability to accurately project share trading volume each year. However, as demonstrated by the Proposal, it will become increasingly harder for FINRA, or anyone for that matter, to accurately predict equity share trading volume given the volatility of our markets. Moreover, the irony of the Proposal is that it would increase the TAF at a time when firms are experiencing lower revenues themselves as a result of reduced volume. Competition has significantly reduced transaction costs incurred by investors since the implementation of the TAF, and FINRA trading firms already are operating on razor thin margins.⁴ As discussed below, the ability of firms to absorb these fee increases without a significant impact on their businesses is not elastic and, thus, the Proposal is a less than optimal source of stable regulatory funding.

Proposed Increase will Have a Disproportionate Impact on Liquidity Providing Trading Firms

The Proposal will also have a disproportionate impact on FINRA members providing liquidity in covered equity securities. Because the fee is based on share transaction volume, it is paid by FINRA's trading members, with the bulk by liquidity providers. Although the per transaction impact on a firm may seem small, in aggregate, the increased TAF rates would prove detrimental to business operations and market activity. Increases in TAF rates will inhibit existing liquidity providing trading firms from providing liquidity, and serve as a disincentive to firms considering becoming liquidity providers. In earlier letters on this topic, we have also noted that the TAF has a particularly disproportionate impact on those market participants providing liquidity in lower priced stocks.⁵

We also are concerned that the Proposal inequitably applies FINRA fees among its members. As noted, the TAF falls disproportionately on FINRA trading members, including those firms providing market liquidity in covered equity securities. While the TAF fee is assessed for a variety of transactions – including transactions in equity securities, TRACE reportable securities,

⁴ See Exchange Act Release No. 34-50,700 (Nov. 18, 2004) (noting that “[t]he intense intermarket competition for order flow” has caused transaction costs to greatly decrease, if not “all but disappear”).

⁵ See 2003 TAF Comment Letter at 2-3.

options and futures – the overwhelming majority of the fees are generated by transactions in equities (95%). Thus, liquidity providers who primarily engage in equities trading are penalized disproportionately. The net result is that these firms end up funding aspects of the FINRA regulatory program that do not apply to them which, we believe, may be inconsistent with Section 15A(b)(5) of the Exchange Act and Commission pronouncements. For example, Section 15A(b)(5) provides that the rules of a registered securities association must provide for the equitable allocation of reasonable dues, fees and other charges among its members and issuers and other persons using any facility or system which the association operates or controls. Moreover, the Commission has explained that “a reasonable reading of the Exchange Act indicates that [Congress] intended that regulatory funding be sufficient to permit SROs to fulfill their statutory responsibilities . . . and contemplated that such funding would be achieved through *equitable assessments* on the members, issuers, and other users of an SRO’s facilities.”⁶ In our view, imposing disproportionately high TAF payments on liquidity providing trading firms runs contrary to these principles.

A More Stable, Equitable and Transparent Source of Funding Should be Considered in Lieu of the Proposed Increase in the TAF

For the reasons discussed above, and given the importance of FINRA’s regulatory efforts of protecting investors and supporting market integrity, FINRA and the SEC should consider alternatives that would reduce FINRA’s reliance on the TAF as a means of achieving funding for its regulatory obligations. We believe that this effort should start with a comprehensive review of all of FINRA’s funding sources – the Personal Assessment, Gross Income Assessment, and the TAF, as well as any other funding sources – and a review of FINRA’s regulatory costs. To ensure fair and equal apportionment among regulatory costs, greater transparency should be afforded to members during this process. Although regulatory funding arrangements are necessary, these arrangements must be fair and equitably apportioned among SRO members, taking into account the activities and business of each member.⁷

The Proposal to File Future TAF Rate Changes for Immediate Effectiveness Under Section 19(b)(3)(A) of the Securities Exchange Act of 1934

Currently, FINRA files proposed rule changes to the TAF rate under Section 19(b)(2) of the Securities Exchange Act of 1934 which provides for a full notice and comment period. Under the proposed Rule change, future changes to the TAF rate would be filed for immediate effectiveness under Section 19(b)(3)(A) without a full notice and comment period. This proposed change to file for immediate effectiveness for TAF rate changes with limited or no opportunities for public comment raises particular concerns.

In eliminating the full notice and comment period, the sector of the industry heavily affected by the TAF rate increases will not have the opportunity to provide the appropriate check and

⁶ Exchange Act Release No. 34-50,700 (Nov. 18, 2004) (emphasis added)(Concept Release on Self-Regulation).

⁷ Exchange Act Release No. 34-50,700 (Nov. 18, 2004) (“the characteristics of an SRO’s membership base may affect the appropriate level of regulatory funding and how the funding is allocated”).

balance system now afforded the industry. This check and balance system is specifically designed to avoid spiraling increases in regulatory costs and corresponding TAF rate increases. Market structure changes do have an impact on trading costs which are very delicate and sensitive to change. A small seemingly insignificant change could in fact have profound negative consequences to a firm. Since market structure is not static, future changes to the TAF rates have to simultaneously consider the market structure and trading cost impact of any proposed change. A small change in the TAF rates could be the tipping point for certain liquidity providers to exit the market making business.

Conclusion

As previously noted, Knight is fully supportive of FINRA's need to be properly funded. However, the proposed increases in the TAF will unfairly penalize a small group of market participants that provide crucial liquidity. We believe that FINRA needs to reevaluate all funding efforts and consider alternatives that will insure that its funding needs are fairly allocated among all FINRA members.

For these reasons, we respectfully submit that the Commission disapprove both the proposed increase to the TAF and the proposal to permit future TAF rate changes to be filed without a comment period under Section 19(b)(3)(A).

We welcome the opportunity to discuss our comments with the Commission.

Respectfully submitted,



Leonard J. Amoruso

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