Knight

Leonard J. Amoruso
General Counsel

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

April 25, 2010

Ms. Elizabeth M. Murphy
Secretary
Office of the Corporate Secretary
U.S. Securities and Exchange Commission
100 F Street, N.W.
Washington, D.C. 20549-1090

Re: **Securities Exchange Act Release No. 34-61358**
File No. S7-02-10, Concept Release on Equity Market Structure

Dear Ms. Murphy:

Knight Capital Group, Inc.[1] ("Knight") welcomes the opportunity to comment on the U.S. Securities and Exchange Commission's (the "Commission") Concept Release on Equity Market Structure (the "Release").

INTRODUCTION

Knight commends the Commission for taking the meaningful step of soliciting the opinions and insights of various participants in the U.S. equity markets. We are eager to participate and provide insight where possible, given our vantage point as the largest market maker of U.S. equities.

As a starting point, Knight believes that the U.S. equity market is the best functioning and fairest market globally. This has been achieved through fact-based decisions, prudent rulemaking, structural transparency and timely and efficient disclosure, all of which are products of a competitive and fair market structure that allows choice and fosters innovation.

[1] Knight Capital Group, Inc., through its subsidiaries, is a major liquidity center for foreign and domestic equities, options, fixed income securities, and currencies. On active days, Knight can execute in excess of five million trades, with volume exceeding ten billion shares. Knight's clients include more than 3,000 broker-dealers and institutional clients. Currently, Knight employs more than 1,100 people worldwide. For more information, please visit: www.knight.com.

.

As a guiding principle for discussions around the market structure changes in U.S. equity markets, Knight believes in choice, innovation and competition – and, this will form the framework for our comments on the Release.

Regulatory fine tuning is necessary in a market as dynamic as U.S. equities. Given the many market structure changes that have taken place in recent years, a holistic examination of the U.S. equity market structure is timely, relevant and necessary. Furthermore, Knight believes that Regulation of Non-Public Trading Interest, Elimination of Flash Order Exception from Rule 602 of Regulation NMS and the approved Amendments to Regulation SHO are market microstructure proposals which should not be considered independently, but rather folded into the broader discussions and decisions relating to the Release.[2] Changes made to any small part of the market ecosystem should be postponed until a complete analysis of the current market structure is accomplished, which should include roundtable discussions with all affected market participants (e.g., investors, broker/dealers, institutions, exchanges, ECNs, ATSs and off-exchange liquidity providers, regulators, academics, and industry experts). As Commissioner Casey noted on January 13, 2010 in at the SEC Open Meeting, "[w]e should strive to avoid playing a game of Whac-a-Mole in this area, where we solve one problem and inadvertently create a new one."

Additionally, Knight would like to suggest that any proposed change be subject to rigorous analysis, study and piloting before considering final approval of any outstanding proposals that would impact U.S. equity market structure.

As a subtext to many of the discussions around U.S. equity market structure, there is a sense among some market constituents that the goals of short-term market participants, such as traders, and long-term market participants, such as investors, are not aligned. We disagree with this assessment and believe that whether an investor's (or trader's) time horizon is measured in seconds, days, weeks, or years, each market participant desires the best execution possible. Others have also stated that technology and innovation have put certain classes of investors at a disadvantage. As noted previously, we disagree as well. In fact, we firmly believe that by all measures, there has never been a more equitable playing field for all investors when trading U.S. equities.[3] Technology and innovation have benefited the entire spectrum of equity market participants.

Moreover, the innovation and technology advances made in market structure should not be sacrificed for those who pine for a time when the market was simpler. U.S. equity

---

[2] SEC Release No. 34-60997 (November 13, 2009); SEC Release No. 34-60684 (September 18, 2009); SEC Release No. 34-60509 (August 17, 2009); SEC Release No. 34-59748 (June 19, 2009); SEC Release No. 34-61595 (February 26, 2010). It is noteworthy to point out that in the SEC's adopting release for the amendments to Regulation SHO, it noted that "[w]e are not aware. . . of any empirical evidence that the elimination of short sale price tests contributed to the increased volatility in the U.S. markets."

[3] <u>The Economics of Trading in the 21st Century</u>. Angel, Harris, and Spatt (February 23, 2010). <u>Main Street Benefits of Our Modern Financial Markets</u>. Jones and Sirri (March 11, 2010).

market structure is complicated and evolves rapidly. It has produced innovative business models that have forced, through unrelenting competition, the decrease in costs and trading friction, faster response times and increased liquidity. We are deeply concerned that certain of the proposals discussed in the Release, if passed into rules, could have a dramatic impact on competition, liquidity and the overall efficiency of the marketplace (e.g., the proposed "Trade-At" rule). As we will discuss more fully below, the imposition of a Trade-At rule would set the market back more than a decade. It would take rigorous quantitative justification before any consideration for such a radical departure from current market structure should be considered. For example, one noteworthy statistic to consider in this context -- in 2009, Knight provided over $63 million in price improvement to client trades. There are other market participants that also internalize orders and provide price improvement. This money ends up directly in the pockets of investors and could be lost with a Trade-At rule.

As the top-ranked trader of both listed and Nasdaq equities, we spend a lot of time analyzing trading data.[4] Data such as the 605 and 606 reports represent one part of the trillions of bytes of data we consider in our efforts to provide better service to our clients and better evaluate the mechanics and efficiencies of the equities markets. The conclusions should be no surprise. In short, by all reasonable metrics, the U.S. equity market has never performed better, execution quality is at historic highs and transaction costs are at historic lows.[5]

We believe that the best metrics for assessing the adequacy of the U.S. equity markets are: execution speed, cost, fairness and access to liquidity. We would like to see, as one of the results of this exercise, a set of industry standard metrics that objectively and quantifiably addresses the on-going state of the market. This set of metrics would quantify speed, transaction cost (both implicit and explicit), access to market centers, fairness of the market for small and large investors and other quantifiable data. With these data points in hand, the Commission would be able to better evaluate execution quality on a regular and ongoing basis, as well as strengthen its investor protection mandates. Furthermore, disclosure of this data will provide all investors, both short-term and long-term, with information to help them and their brokers make intelligent routing decisions when executing orders.

Knight believes that all investors are benefiting greatly from the current market structure. The entire spectrum of market participants has the option to participate on a level playing field: from small investors to large, there exist numerous options to rent, buy or build the connectivity to this array of trading tools.

---

[4] According to AutEx volume rankings, 1Q 2010.

[5] The Economics of Trading in the 21st Century. Angel, Harris, and Spatt (February 23, 2010). Citing this study, "[v]irtually every dimension of U.S. equity market quality is now better than ever."

CONCEPT DISCUSSION

While the market appears to be performing at its highest level ever, participants cannot be complacent. The U.S. equity micro-market structure has evolved rapidly since the implementation of Regulation NMS. Each participant in the market ecosystem has a unique vantage point. We will focus our comments on those sections of the Release that we believe are of greatest concern and the areas in which changes could yield the most detrimental consequences either in transaction friction, increased cost, increased volatility or loss of liquidity **–** i.e., internalization, Trade-At, and sub-penny quoting.

INTERNALIZATION

Broker-dealer internalization, ATSs, dark pools and public venues all serve an important function. Between them is the competitive fabric of the U.S. equity market structure. Each business model serves the needs of a particular segment of investors and traders. All market participants benefit from the level of choice, innovation and service that the U.S. equity market structure offers. Conversely, all market participants would suffer if one business model were favored over the others.

In broad terms, internalization offers tremendous benefits to investors. Internalization offers retail and institutional investors a cheap, fast and safe method for executing their orders. Internalization exists because of client demand for best execution. It is an execution choice that enables investors to get the best possible price (many times better than what is displayed in the market), along with low transaction costs and minimal information leakage. As noted previously, one of the many quantifiable benefits of internalization include price improvement. That is, investors can receive prices that are better than what are displayed in the market. In 2009, Knight provided over $63 million in price improvement on 26.3 billion shares.[6] Of course, Knight is just one of many market participants that internalize and offer these benefits to investors.

Internalization is available for all investor types and access has been significantly democratized by the extremely networked lattice structure of venues. To move away from this networked venue system, with its lit and dark venues that offer more execution flexibility, would be a step backward. From the point of view of smaller market participants, such as retail investors, the market has never been so inclusive and efficient. The readily available access to numerous venues has allowed small investors to reap the benefits of internalization via price improvement, enhanced liquidity, and improved spreads. Furthermore, we have seen no quantitative and qualitative justification offered for taking steps to change or slow internalization.

[6] Data is derived from Knight's internal calculation.

Some have raised the question as to whether payment for order flow negatively influences routing decision of brokers.[7] We completely disagree. First and foremost, brokers have best execution obligations. These obligations require them to send orders to those venues that help them satisfy these requirements. As noted earlier, "virtually every dimension of U.S. equity market quality is now better than ever."[8] This is due, in large part, because brokers demand execution venues to perform at very high standards. So, whether they require fast executions, enhanced liquidity (i.e., executing more shares than displayed in the market) or better pricing, the broker representing the investor order demands high caliber performance. Otherwise, the broker sends the order flow elsewhere.

TRADE-AT

Knight strongly opposes the concept of a Trade-At rule, as it would discourage the competition and innovation in the U.S. equity markets that have driven down trading costs, increased liquidity, increased speed of execution and decreased trading friction.

Trade-At would add significant costs to retail and institutional orders: implicitly by minimizing competition and competitive innovation, explicitly by forcing many users of lower cost alternative venues to pay access fees. It would minimize the opportunities for price improvement (and eliminate sub-penny price improvement) to retail orders as they would always trade at the NBBO. It would reduce liquidity provided by market makers as increased costs would outweigh their liquidity provision ability in most cases. It would vastly increase quote message traffic and quote flickering as firms would be forced to be at the NBBO (likely at the lowest permissible quantity) to service their customers. It would significantly diminish the ability of investors, including long-term investors, to use non-displayed trading venues (which typically do not place orders into the displayed markets) to handle their sensitive order flow. The requirement that such a venue either offer price improvement at least in the amount of the minimum increment in order to execute at the NBBO would be difficult given that many stocks trade in penny increments. Alternatively, the routing of ISOs to the full displayed size of NBBO quotations would significantly reduce the ability of such systems to offset customer orders and may well signal to other market participants that there may be additional order flow in the sending trading venue.

Furthermore, it would increase intra-day volatility as the stabilizing impact of the enhanced liquidity that comes with internalization would disappear. The formation of micro-price pockets (i.e., a rapidly flickering NBBO) would result in far more volatility as well as a corresponding increase in quote traffic, decreases in trade size, and operational strain on infrastructure.

[7] As posed in the Release page 21.
[8] See, footnote 5.

We believe there is a misguided perception that a Trade-At rule would bring more liquidity to the visible market. There is no data to prove this ephemeral thesis. Indeed, several data points reflect the fact that a majority of volume traded today occurs on lit markets. For decades, our markets have permitted orders to be executed on both exchanges and through other means (including, internalization, dark pools, etc.). Through rigorous competition and innovation, investors now experience the highest levels of execution quality in the history of our markets. To suggest a 180-degree turn in market structure without any empirical data or analysis to support it would be a very precarious step for our economy.[9]

Overall, Trade-At would stifle innovation and set the U.S. equity market back more than a decade as many of the new business models that have been introduced would no longer exist. We believe that the detrimental consequences of such a radical move far outweigh any possible benefit. The quantifiable benefits illustrated in the previous section would be lost with the introduction of a Trade-At rule.

MINIMUM PRICE VARIATION (MPV)-SUB-PENNY PRICING

Knight has serious concerns that the introduction of sub penny pricing would have a deleterious effect on the quality of the U.S. equity markets. In the three previous instances in which the Commission conducted a cost/benefit analysis, the detrimental effects of sub-penny quoting were shown to far outweigh the benefits to market structure.[10]

One concern revolves around the opportunities this opens up for traders to “micro-penny” orders. Currently, in order to “step in front” of a competing limit order on an exchange, a trader needs to post another order for 100 shares a full penny better than the existing order. This offers a full dollar of price improvement to the liquidity taker (providing some meaningful economic value) while requiring the new provider to risk at least that one dollar (assuming that they could potentially liquidate that position at the price of the previous limit order) in order to be first in line for incoming market orders. If the MPV were lowered to .001, the improvement to the incoming market order (and correspondingly the amount risked by the new provider) would only be 10 cents. We believe that this is insufficient improvement to the market to force the prior quote to yield priority.

---

[9] Over the years, the Commission has considered essential elements of the Trade-At proposal in connection with the concept of a central limit order book (“CLOB’). In each case the CLOB was evaluated, it was recognized that in order to create a competitive, choice-driven market, a move in the direction of the CLOB would hinder competition and innovation. See, SEC Release No. 14416 (Jan. 26, 1978).

[10] Order Directing the Exchanges and NASD to Submit a Phase-In Plan to Implement Decimal Pricing In Equity Securities and Options, Release No. 34-42914, June 8, 2000; Request for Comment on the Effects of Decimal Trading in Subpennies, Release No. 34-44568, July 18, 2001; Regulation NMS, Release No. 34-51808, June 9, 2005.

This will also reduce the incentive for the original liquidity provider to post at all, potentially causing many stocks to suffer from very thin limit order books. Indeed, many institutions we've discussed this issue with are very concerned that sub penny quotations will cause the posted sizes at the NBBO to drop dramatically.

There are also operational and technological concerns to consider. One of the many attractive features of the U.S. markets today is the transparency around prices and the ease in which one can develop software to process the public pricing feeds. Recoding all of the existing software to properly handle these prices will require considerable expense and risk to both sell-side and buy-side firms. Furthermore, it will introduce further opportunity for operational risk and human error, as some prices need to be keyed in out to three decimal places. These costs and risks of moving to sub-penny pricing far outweigh any possible perceived benefit given the lack of a clear advantage of the proposed change to the current system.

ACCESS FEES

Access fees have been at the core of nearly every debate that has taken place around market structure for almost two decades – taking hold after the SEC Order Handling Rules were adopted in 1996.[11] It was certainly not anticipated at that time, when spreads were multiples of what they are now, that this "communications charge" would become such a large component of the cost associated with a trade, or a profit center which had become the basis for routing and trading practices. As spreads have narrowed over the years, a $0.003/share access fee has become a significant cost associated with the trade. Indeed, in a one penny spread environment, access fees have the effect of increasing the economic spread by 60% (assuming $0.003 on each side of the quote).

We therefore suggest that the Commission re-evaluate access fees in connection with its review of equity market structure to insure it continues to serve its intended purpose.

[11] Order Execution Obligations, Release No. 34-37619A (September 6, 1996), footnote 272.

CONCLUSION

In conclusion, Knight believes that an intelligent regulatory regime combined with innovation has yielded a fair U.S. equity market structure. The ongoing, incremental regulatory changes are crucial to subtly adjusting a fast-paced and innovative equity market. We appreciate the consideration of the many small parts of the market within the context of the Release.

In determining whether to adopt new rules in connection with this market structure analysis, we respectfully urge the Commission to evaluate carefully all available empirical evidence, consider thoroughly the potential for unintended consequences, and insure that the benefits associated with any such proposal far exceed the costs.

Thank you for providing us with the opportunity to comment on the Release. We would welcome the opportunity to discuss our comments with the Commission.

Respectively submitted,

Leonard J. Amoruso

cc SEC Chairman Mary L. Schapiro
SEC Commissioner Kathleen L. Casey
SEC Commissioner Elisse B. Walter
SEC Commissioner Luis A. Aguilar
SEC Commissioner Troy A. Paredes
Robert W. Cook, Director, SEC Division of Trading and Markets
Mr. James Brigagliano, Deputy Director, Division of Trading and Markets
Mr. David Shillman, Associate Director, Division of Trading and Markets
Mr. Henry Hu, Director, Division of Risk, Strategy, and Financial Innovation