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

Re: **Securities Exchange Act Release No. 59748**
File No. S7-08-09, Amendments to Regulation SHO

Dear Ms. Murphy:

Knight Capital Group, Inc.[1] (Knight) welcomes the opportunity to comment on the Securities and Exchange Commission's (Commission) proposed amendments to Regulation SHO.

The proposed rules generally set forth several different approaches to implement restrictions when attempting to execute a short-sale. These approaches include a price test that would apply on a market wide and permanent basis ("short-sale price test") or circuit breaker test, where a price test or a ban on short-selling would be imposed on a particular security during severe market declines in that security ("circuit breaker test"). There are two different price tests that are proposed which include: (i) a restriction that would require trading centers to establish and enforce written policies and procedures reasonably designed to prevent the execution or display of a short-sale in a covered security at a down-bid ("Modified Up-Tick Rule")[2] or (ii) a requirement that short-sales

[1] Knight is the parent company of Knight Equity Markets, L.P., Knight Capital Markets LLC, Knight Direct LLC, Knight BondPoint, Inc., and Knight Libertas LLC all of whom are registered with SEC and various self-regulatory organizations. Knight Capital Europe Limited and Hotspot Fxi Europe Limited are authorized and regulated by the Financial Services Authority. Knight Equity Markets Hong Kong Limited is authorized and regulated by the Securities and Futures Commission. Knight through its affiliates is a major liquidity center for the U.S. securities markets. We trade nearly all equity securities. On active days, Knight can execute in excess of four million trades, with volume exceeding three billion shares. Knight's clients include more than 2,600 broker-dealers and institutional clients. Currently, Knight employs more than 1,000 people worldwide. For more information, please visit www.knight.com

[2] A down-bid price is defined as a price that is less than the current national best bid or, if the last differently priced national best bid was greater than the current national best bid, a price that is less or equal to the current national best bid. A "covered security" is defined as an "NMS stock" under Rule 600(b) (47) of Regulation NMS.

in a covered security that are subject to real-time trade reporting pursuant to an effective transaction plan be executed at an up-tick.[3]

The Commission has long held the view that short-selling provides the market with important benefits, including market liquidity and pricing efficiency.[4] In fact, legitimate short-selling plays an indispensable role in any modern capital market system. Over the years, short-selling has provided millions of investors with needed liquidity, helped to expose corporate scandals, and rationalized pricing in the marketplace.[5]

Importantly, illicit and manipulative behavior (whether effected through short-selling, long selling or buying) has always been prohibited. Knight believes that the Commission should continue to do everything in its power to protect investors from abusive short-sale practices. In fact, the Commission has done much to address this important goal by introducing rules that protect against abusive short-selling (including, naked shorting, alleged rumor-mongering and market manipulation). For example, SEC Rule 204T squarely addressed the issue of abusive "naked" short-selling.[6]

Knight is concerned that further restrictions, like the ones currently being considered, could adversely affect liquidity and pricing efficiencies of the market.[7]

Market Structure

No matter the course pursued by the Commission, the ultimate goal of any further restrictions should be to prevent abusive short-selling and be implemented in a minimally invasive manner so as not to impede the proper function of the U.S. equity markets. Any course of action should incorporate the complex, ultra-low latency and extreme volumes that make up the U.S. equity market today, as well as consider the growth in volumes

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[3] An up-tick is a price that is not (i) below the price at which the last sale, regular way, was reported; or (ii) at a price that is not above the next preceding different price at which a sale of such security, regular way, was reported.

[4] Securities Exchange Act Release No. 54891 (Dec. 7, 2006).

[5] Short-sellers covering their positions also add to the buying interests available to sellers – thus, providing additional liquidity and price efficiencies to the market.

[6] A primary purpose of Regulation SHO was to curb the potential for manipulative naked short-selling by addressing fails-to-deliver (FTD) in equity securities. The recent reduction in FTDs in NMS Stocks subsequent to the implementation of Rule 204T is evidence that such rules are working.

[7] Recent studies by the Commission have indicated that price restrictions on short-selling had an effect on pricing efficiencies and liquidity. "Economic Analysis of the Short-sale Price Restrictions Under the Regulation SHO Pilot" (February 2007); see also, OEA Analysis Memorandum Re: "Analysis of Short-selling Activity during the First Weeks of September 2008." An example of the adverse affects that restrictions on short-selling may have was evident when the Commission's emergency halt on financial companies was implemented. While the markets initially went up for the stocks as short sellers covered their positions it became apparent that the ban had negative quantifiable effects on the market evidenced by the widening of spreads, loss of liquidity and almost double the intra-day volatility in the restricted names. See, Credit Suisse "What Happened When Traders' Shorts Were Pulled Down" (September 2008).

during the first decade of the twenty-first century.[8] Today's U.S. equity market is almost unrecognizable when compared to the market of just a few years ago. If the market's evolution of the last decade is any indication, changes over the next decade will be rapid and very difficult to imagine from our current vantage point.

The U.S. equity market today is the most sophisticated, liquid and efficient trading venue in the world. Rapid technical evolution combined with business model innovation and reasonable regulation across the spectrum of equity market participants has created a robust and dynamic marketplace. Recently, technology has been the area of greatest innovation. Raw computational power combined with the liquidity of about fifty equity trading centers, including newly created, innovative venues, has created a market where billions of shares trade each day with trades occurring in the micro-second time frame.[9] Consideration must be given to the post-Regulation NMS world that exists today. For example, quote sequencing would make a "price" test nearly impossible to implement.[10] Likewise, given the lattice-work of the fifty competing venues that create the robust market of post-Regulation NMS, it would be difficult to find a fair price on which to drive a "price" test.

Regardless of the final approach, it is *crucial* that the proper exemptions for any imposed restrictions on short-selling be maintained. Any route that does not include an exemption for *bona fide* market makers would damage the U.S. equity market, as market makers provide necessary liquidity for orders of all types, including large, potentially market moving institutional orders. Short-selling is a tool that allows market makers to provide liquidity to millions of U.S. investors and helps maintain an orderly market. Indeed, in the proposed release, the Commission notes that market liquidity is often provided by market makers and block positioners that effect short-sales to offset temporary imbalances in the buying and selling interests of stocks. This reduces the risk that the price paid by investors is artificially high because of a temporary imbalance.[11]

Finally, investor confidence in the U.S. equity market is an intangible component of investors' decision to invest in U.S. stocks. It is not clear, however, if at any time during the tumultuous and steeply declining market of 2008 and early 2009, whether there was an issue of confidence in the structure and functioning of the U.S. equity market. Indeed, we believe that during these periods of upheaval the U.S. equity markets performed extraordinarily well. In our view, the U.S. equity market remained liquid and efficient while other markets did not function as effectively.

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[8] Knight estimates the number of trades per day has increased 1,700% and the number of quotes has increased 14,280% in U.S. equities between January 2000 and January 2009.

[9] For example, Direct Edge traded 15 million shares per day in Q1 2005 and 2 billion per day in Q1 2009.

[10] Knight believes that if the data feeds indicated whether a bid was an up-bid, it would be possible to implement the Modified Up-Tick Rule as a policies and procedures rule.

[11] Securities Exchange Act Release No. 59748 at page 9.

Knight's Recommendation

Although Knight believes that a change to Regulation SHO is not necessarily warranted, the approach which may have the least negative impact on liquidity and price discovery is the circuit breaker approach with the Modified Up-Tick (bid test) – with the appropriate exceptions, including for *bona fide* market making.[12]

However, given the general agreement over the dearth of empirical evidence in support of the proposed restrictions on short-sales, Knight recommends that the Commission consider first proceeding with a limited pilot in order to gather such data.[13] Such analysis would allow the Commission to consider thoroughly the empirical evidence it is seeking in the proposed rule release.[14]

More specifically, when short-sale restrictions were last debated the process that the Commission initiated to consider the removal of short-selling restrictions was well timed and effective. The Commission constructed a strategy for developing, testing, piloting and finally implementing Regulation SHO. The tactics were equally strong: opinions from across the universe of market participants were collected, and a pilot was run for over two years. The pilot was well conceived and entirely thorough. Empirical evidence from the pilot confirmed numerous academic and research oriented studies that cast doubt on the effectiveness of 10a-1, suggesting that the previous up-tick rule may have done very little to add to the efficiency of the market.[15]

Nevertheless, if at the end of this process the Commission decides to reintroduce a new regime of short-selling restrictions, Knight believes that a circuit breaker, based on the opening price of the trading session (with a Modified Up-Tick (bid test) restriction), is probably the least intrusive to the structure of the equity markets. However, since an individual equity circuit breaker has never been utilized, again, we believe that the first step, prior to a final decision, is a process to test the thesis that a circuit breaker on an individual stock would prove effective in accomplishing its stated goal of protecting the integrity and creating a renewed confidence in the U.S. equity market.

Furthermore, as the Commission considers the various alternatives on the table, Knight believes it is crucial that a solution be designed to be utilized only during times of great

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[12] If a price test is decided to be used, a central data feed must be published to market participants to advise them when there is an up-bid or up-tick.

[13] Similar to the pilot the SEC conducted in 2005 where a limited number of stocks would be subject to the proposed short-selling regulations for a defined period of time.

[14] For example, the recent 40% increase in the stock market from the lows in March 2009 when there were no short-selling restrictions could indicate that there may not be a need for any new rules. Market participants, therefore, would benefit from a thorough vetting of data to determine whether there is any empirical evidence that would support the proposed rules.

[15] "Economic Analysis of the Short-sale Price Restrictions Under the Regulation SHO Pilot" (February 2007).

market stress. Whatever the ultimate decision, the implemented restriction should not become a part of the daily fabric of the market, but a tool for extreme market conditions. For instance, following the Crash of 1987 an equity market circuit breaker was implemented. The circuit breaker was prudently designed to halt trading should the overall market decline more than 10% in one trading session. In the 22 years since implementation, the circuit breaker has only been used once -- on October 27, 1997.

Conclusion

Despite the fact that there tends to be an instinctive reaction during periods of great volatility and falling markets that short-selling of equities is a primary culprit, Knight believes that a more holistic approach needs to be considered. Restrictions on short-selling are one part of the bigger question that encompasses a number of disparate but crucial pieces. These include:

- Can disclosure rules be utilized to provide the public with information so that they can have a better understanding of the true effect short-selling has on the market?

- Are we leveraging technology in the most effective way possible in the process of promulgating rules that prevent and detect inappropriate short-selling?

- Are we considering that equities are just one part of a diverse set of securities that exist across the capital structure of companies? Can we restrict short-selling in equities and ignore the huge derivatives market, particularly the credit default swap (CDS) market, where evidence suggests that shorting of companies took place, with little or no restrictions?

Thank you for providing us with the opportunity to comment on these rule proposals. Knight 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
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