



February 22, 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. 34-61168;
File No. SR-FINRA-2009-090, Self-Regulatory Organizations; Financial
Industry Regulatory Authority, Inc; Notice of Filing Proposed Rule Change
Relating To Adopt FINRA Rule 5320 (Prohibition Against Trading Ahead of
Customer Orders) in the Consolidated FINRA Rulebook**

Dear Ms. Murphy:

Knight Capital Group, Inc. (Knight)¹ welcomes the opportunity to offer our comments to the U.S. Securities and Exchange Commission (Commission) in connection with the above referenced rule filing of the Financial Industry Regulatory Authority (FINRA). FINRA proposes to adopt NASD Interpretive Material 2110-2 (Trading Ahead of Customer Limit Orders) and NASD Rule 2111 (Trading Ahead of Customer Market Orders) with significant changes in the Consolidated FINRA Rulebook as new FINRA Rule 5320 (Prohibition Against Trading Ahead of Customer Orders).

Knight supports most aspects of this proposed rule change and we believe that it is a forward-looking initiative that will make the U.S. equity markets more efficient and effective. However, as described more fully below, we disagree with a few provisions of the proposed rule.

OTC equities

In its filing, FINRA seeks to carve-out OTC equity securities from the proposed rule. As stated in the proposed rule filing:

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 the 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 Capital Asia 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 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

“...FINRA is not proposing to similarly expand the no-knowledge interpretation with respect to OTC equity securities because the same types of changes in market structure and order handling practices have not occurred in that market; OTC equity securities are generally not traded at market centers with the same depth of liquidity and are not as susceptible to automated routing for best execution. Accordingly, the current no-knowledge standard, as set forth in the prior *Notice to Members*, would continue to apply to OTC equity securities.”

While we support fully FINRA’s proposal to adopt a no-knowledge interpretation for “walled off” market making desks, we do not believe that the rule should be bifurcated based upon the type of securities traded. It is our view that as long as a broker/dealer maintains the required information barriers, there should be equal Manning treatment of NMS and OTC securities. To hold otherwise appears illogical, as there is no reasonable basis to treat these securities differently for purposes of the instant rule proposal.

Moreover, the adoption of two different standards for exchange-listed and OTC equity securities appears inconsistent with the stated intention to harmonize FINRA and NYSE rules – with the proposed rule imposing the legacy NASD standard on OTC securities. It is also important to point out that such an approach introduces various compliance and operational inefficiencies.

Unique MPIDs

With respect to the “no-knowledge” provision in the proposal, FINRA indicates that it will *require* firms to utilize a unique MPID for their market making desks. We disagree with this requirement and respectfully suggest that FINRA consider making this decision *optional* by the member firm. An additional MPID creates further technology burdens on certain firms and adds unnecessary complexities to OATS and trade reporting requirements. We believe that the no-knowledge test has worked well in the past under Rule 92 and in previous NASD Manning interpretations without the need for a separate MPID.² Thus, we suggest that the proposal be amended to exclude the *requirement* for an additional MPID.

Operation of the Rule

The proposed rule also states:

“For purposes of determining the minimum price improvement standards for customer limit orders in OTC equity securities priced below \$1.00 where there is no published current inside spread, members may calculate a current inside spread by contacting and obtaining priced quotations from

² See NASD Notice to Members 03-74

at least two unaffiliated dealers and using the highest bid and lowest offer obtained in calculating the current inside spread.”

Imposing such a standard on securities priced below \$1.00 may lead to inferior customer executions.³ By way of illustration:

Assume there are no published quotes for ABCD, and the following quotations were obtained from at least two unaffiliated dealers (MMB and MMC):

MMA .002 bid x .005 offer
MMB .002 bid x .03 offer
MMC .0001 bid x .02 offer

As such, all three market makers have different price improvement requirements:

MMA would have to exclude its quote in determining the NBBO, thus creating an NBBO of .002 x .02 (.018 spread, .009 minimum price improvement).

MMB and MMC would be permitted to reap the benefits of MMA’s best offer .005 in calculating their effective NBBO of .002 x .005 (.003 spread, .0015 minimum price improvement).

Consequently, the market maker with the best quote would be disadvantaged in this scenario. This outcome would not occur in the NASDAQ, NYSE, OTCBB and Pink Sheet markets – because in those markets, market participants are not required to ignore their quote when calculating the NBBO. As a result, the current rule proposal unfairly impacts the market maker that is maintaining the tightest spread.

This proposal could also lead to a “negative Manning” gaming strategy. Consider in the same example the following:

MMA has the best quoted prices .002 x .005
MMA is willing to sell stock at .005

If MMA makes a sale at .005, it will then be obligated to provide Manning-protection to its book up to a price of .014 – thereby incurring a “negative Manning” by as much as .00899 per share. This particular outcome could cause numerous unintended consequences as the result of not utilizing all quotations to determine the true NBBO.

An additional operational issue that we suggest FINRA examine is the “negative Manning” situation that can arise when trading outside the inside market. More specifically, when a market maker is trading in a dealer system such as the Pink Sheets or

³ It is noteworthy to point out that the rule filing does not address the applicable standard for securities that are priced greater than \$1.00, but for which there are no published quotations.

the OTCBB and effecting an execution on a liability order presented by a competing market participant, a market maker should not be obligated to provide an execution to an order resting on its book which is priced inferior to the market maker's published quote.

By way of illustration:

The NBBO for ABCD is .06 bid x .07 offer
MMA is bid below the NBBO at .058

A competing participant, MMB offers 5,000 shares to MMA at .058 (below the NBBO).⁴

MMA has a firm quote obligation at .058.
MMA executes 5,000 shares at .058 pursuant to its firm quote obligation.
MMA now is required to protect any held order on its book priced down to .053 (NBBO spread is .01, Minimum Price improvement is .005).

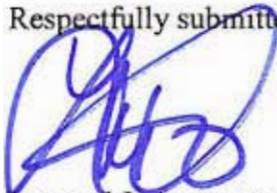
Accordingly, if rules yield "negative" Manning results, they should also provide exceptions which account for these unintended consequences (which, additionally, provide opportunities for gaming).

Conclusion

We applaud FINRA's work and effort in connection with the rule harmonization process and more specifically in addressing the complexities associated with Rule 92 and Manning. However, we respectfully request the Commission to consider the issues outlined in this letter, and require the necessary modifications to the proposed rule to insure market participants are treated reasonably and fairly.

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

Respectfully submitted,



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⁴ A slow or unavailable quote could be the basis for liquidity being sought outside the NBBO.

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
James Brigagliano, Deputy Director, SEC Division of Trading and Markets
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