



Leonard J. Amoruso  
Senior Managing Director and  
Chief Compliance Officer

Knight Capital Group, Inc.  
545 Washington Boulevard  
Jersey City, New Jersey 07310  
Tel 201.557.6892  
Fax 201.795.5038  
Email: lamoruso@knight.com  
www.knight.com

May 30, 2006

Nancy M. Morris  
Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, D.C. 20549-1090

Re: File No. SR-NSCC-2006-04  
National Securities Clearing Corporation; Notice of filing of Proposed Rule Change Relating to  
Trade Submission Requirements and Fees and Pre-Netting  
Release No. 34-53742 (April 28, 2006)

Dear Ms. Morris:

Knight Capital Group, Inc. (Knight)<sup>1</sup> welcomes the opportunity to offer our comments to the Securities and Exchange Commission (Commission) on the above referenced rule filing of the National Securities Clearing Corporation (NSCC).

Knight opposes this proposal in its current form and respectfully requests that the Commission reject this rule filing – particularly, the provision to eliminate all forms of “pre-netting” on trades submitted to NSCC. Knight does not take issue with the concerns advanced by the NSCC, rather we oppose strongly the “means” they propose to achieve their “ends.” In fact, we believe that there are far less disruptive and costly solutions which can achieve the stated goals of the NSCC.

Trade compression occurs when trades for the same security, on the same side are grouped together for clearing purposes. More specifically, it is a process by which an executing firm (the one locking-in a trade) compresses trades with a willing counter-party and reports the compressed (single) trade to the NSCC for locking-in purposes. Trade compression simplifies transaction processing and offers many advantages, including minimizing the number of transactions submitted for clearing and internal processing. Trade compression has been a growing part of the backbone of the U.S. capital markets for the last several years. In fact, as executing firms take on more and more of the correspondent clearing tasks for routing firms – through qualified special representative agreements (QSRS), and with ever

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<sup>1</sup> Knight is the parent company of Knight Equity Markets, L.P., Knight Capital Markets LLC, Direct Edge ECN LLC, Knight Equity Markets International Ltd., Direct Trading Institutional, L.P., and Hotspot FX, Inc. all of whom are registered with SEC or CFTC. Knight and its affiliates, make markets in equity securities listed on Nasdaq, the OTC Bulletin Board, and the New York Stock Exchange, American Stock Exchange, both in the United States and Europe. Knight also owns an asset management business for institutional investors and high net worth individuals through its Deephaven subsidiary. Knight is a major liquidity center for the Nasdaq and listed markets. We trade nearly all equity securities. On active days, Knight executes in excess of one million trades, with volume exceeding one billion shares. Knight’s clients include approximately 600 broker-dealers and 800 institutional clients. Currently, Knight employs more than 700 people.

increasing trading volumes, trade compression has been (and continues to be) a critical part of the clearing process and has helped to reduce dramatically transaction costs overall.

Hundreds of thousands (potentially millions) of trades are compressed each day. The results are huge clearing cost savings, which ultimately result in less transaction costs to the investor. In its filing, the NSCC has offered no valid basis for overturning this longstanding industry practice. In fact, such action effectively interferes with the legitimate rights of correspondents and clearing firms to process and settle trades in the most efficient and cost effective manner. Thus, the NSCC's effort to eliminate a well-established industry practice through regulatory fiat without fully vetting the impact on the industry is simply excessive and unfair.

### **Fee Structure**

As stated, the proposed resolution has significant implications to the cost of clearance for those firms which have negotiated clearing arrangements based on the economics of compression. NSCC states that the "proposed fee revisions are designed to offset the transaction costs that would otherwise result from requiring real-time trade input." However, the proposal fails to consider the economic inequity of its impact to all market participants. Those firms who currently compress their trades will be disadvantaged under the new fee structure based on the percent of total trades compressed today, while firms who do not currently compress trades will see a considerable decrease in their costs.

Although the NSCC has indicated that the proposed fee changes will be "revenue-neutral to NSCC," the fees under the proposal will not be expense-neutral for all existing market participants. The increase in expenditures will be significant and may ultimately result in higher costs to the individual investor. By way of illustration, the increased costs and burdens will be borne heavily by those firms that engage in high volume trading (those who add vast amounts of liquidity to the marketplace), as well as by electronic communication networks (ECNs). As it stands today, ECN profitability (or lack thereof) is measured in fractions of a penny per share. Thus, it is essential for them to keep their costs at a low level – to do otherwise, would eliminate completely their viability. Prohibiting ECNs from legitimately compressing trades would thrust upon them significantly higher clearing costs and erode whatever little profitability they now garner – unless, of course, they affiliate in some manner with an Exchange (like ArcaEx or Instinet). ECNs that are affiliated with an Exchange can utilize that relationship to report matched trades to NSCC – effectively eliminating the clearing costs associated with those trades.

Consequently, the majority of the costs associated with this NSCC proposal will likely be borne by those firms that contribute a significant amount of liquidity to the marketplace and those ECNs who remain independent.

### **No where else to go**

Virtually all broker-to-broker equity trades are reported to the NSCC for post-trade processing and settlement. In effect, the NSCC has a monopoly in this arena. U.S. broker/dealers cannot simply move their post-trade reporting to another competitor. None exist. If market participants are forced to deal with the NSCC in this regard, we submit that the NSCC should be required, at a minimum, to fully explore less invasive, equally effective measures prior to causing the imposition of millions of dollars of increased costs upon the industry and investors.

## Less invasive ways to achieve the same goal

As stated previously, we do not object to the principle concerns proffered by the NSCC. However, the reasons provided by the NSCC for reducing “systemic risk” can be addressed in a more cost effective and far less disruptive manner.

### Business Continuity

In its filing, the NSCC stated that, “[w]ithout real-time submission, should an event occur after trade execution that disrupts trade input (the so-called ‘9/11 risk’), submission of trade data could be significantly delayed or even lost.” Prior to 9/11, this may have been true. However, the Commission and other self-regulatory organizations (SROs) addressed this problem. For example, on April 7, 2004, the Commission approved rules proposed by the NASD and NYSE (File Nos. SR-NASD 2002-108 and SR NYSE-2002-35) which require NASD and NYSE members to develop business continuity plans that establish procedures relating to an emergency or significant business disruption. These rules, which require all broker-dealers to comply, address data back-up and recovery, mission critical systems and alternate communications. As a result, while some minimal risk may remain that there could be a loss of trade data, that risk has been reduced considerably (if not completely eliminated) by the responsible actions of the SEC and SROs.

### Straight-through processing

While this may be a worthwhile goal at some point in the future, it is our understanding that this initiative remains under consideration by the NSCC and that the methodology and operation of a shortened settlement cycle is still under review.

### Risk Mitigation

In addition to the points noted above, we believe that market participants could provide the NSCC with real-time trade data while continuing to compress trades. These are not mutually exclusive processes. As a result, the best of both worlds can indeed be achieved. Market participants can submit real-time trade files to the NSCC so they may monitor for risk, and the marketplace can continue to compress and clear trades in the most cost effective and efficient manner.

### Trade Reconciliation

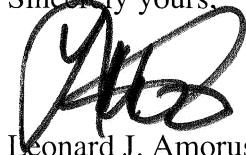
As noted above, shortened settlement cycles are still on the drawing board. These initiatives should be fully vetted and discussed (which could take years) before eliminating trade compression.

## Conclusion

We commend the efforts of the NSCC to make improvements to the marketplace, but emphasize urgently that the inequities described above will result in a far more disruptive clearing process, and impose millions of dollars in additional clearing costs which may be passed ultimately on to the investor. With so many viable, less invasive alternatives available, we believe the NSCC can achieve its stated goals without all of the negative consequences discussed above. We would be happy to work with the NSCC and other industry participants to address these issues.

Thank you again for providing us with the opportunity to comment on these rule proposals. Knight would welcome the opportunity to discuss our comments with the Commission.

Sincerely yours,



Leonard J. Amoruso

cc Chairman Christopher Cox  
Commissioner Paul S. Atkins  
Commissioner Roel C. Campos  
Commissioner Cynthia A. Glassman  
Commissioner Annette L. Nazareth  
Robert L. D. Colby, Deputy Director, Division of Market Regulation  
Karen Saperstein, General Counsel, NSCC