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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. 34-60509**
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") most recent proposal relating to Regulation SHO (the "August 17th proposal").[2]

On April 10, 2009, the Commission proposed various amendments to Regulation SHO which would place further restrictions on short-sale executions. On June 18, 2009, Knight filed a comment letter with the Commission expressing its views on that proposal.[3] The Commission's August 17th proposal seeks additional feedback regarding an alternative price test which would only allow short selling at a price above the current national best bid (the "alternative uptick rule").

While we will not restate all of the issues raised in our previous letter, we believe that certain key points are worthy of reiteration. Most importantly is that we believe that pricing restrictions on the execution of short sales will have an adverse affect on the pricing efficiency and liquidity of the market and cause confusion to the investing public. While we fully support the Commission's continued efforts to root out manipulative and

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

[2] Dated: August 17, 2009.

[3] See, Knight's letter to the Commission dated June 18, 2009.

illegal behavior in the market (whether conducted through short-selling, long selling or buying), we believe that intelligent rule-making, robust surveillance and rigorous enforcement of rules continue to be the most effective ways to police and restrict these illicit activities. Rule-making should be based on careful analysis of empirical data, to insure that contemplated rules will accomplish their stated objectives. In fact, the Commission should be commended for taking meaningful steps toward addressing these issues by introducing rules that protect against abusive short-selling (including, naked shorting, alleged rumor-mongering and market manipulation). For example, SEC Rule 204 (now a permanent rule) has squarely addressed the issue of abusive "naked" short-selling.[4]

We also agree with the Commission's long held view that short-selling provides the market with important benefits, including market liquidity and pricing efficiency.[5] In fact, legitimate short-selling plays an indispensable role in any modern capital market system. As noted, Knight is concerned that further restrictions, like the alternative uptick rule, could adversely affect liquidity and pricing efficiencies in the market while offering little additional investor protection.[6]

Alternative Uptick Rule

Some market participants believe that the alternative uptick rule would likely be easier to implement. We disagree. Since the alternative uptick rule is a more restrictive test than the previously proposed tests, we believe that implementation will be more difficult and may introduce a new level of friction, confusion and inefficiency in the market. For example, the alternative uptick rule will:

a. Create inefficiencies in the routing and execution of short sale orders between market centers;[7]

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[4] A primary purpose of Regulation SHO was to curb the potential for manipulative naked short-selling by addressing fails-to-deliver in equity securities. The recent reduction in fails-to-deliver in NMS Stocks subsequent to the implementation of Rule 204 is evidence that such rules are working very effectively. 99.9% of trades now settle within T+3.

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

[6] 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.

[7] The most notable affect will be that an investor may not receive an execution on a short sale order in one market center that could have been executed in another market center. For example, assume Market Center A has 100,000 shares to sell short on the offer at $10.01 with a 1,000 shares displayed on the best offer at $10.01, and Market Center B receives a buy order of 100,000 shares at $10.01. Market Center B will send an intermarket sweep order for 1,000 shares to Market Center A at $10.01 and then Market Center B will be the best bid at $10.01. This will result in the investor in Market Center A only receiving an execution on 1,000 shares on his/her short sale order instead of the full 100,000 shares. If the investor had the 100,000 share short sale order in Market Center B, it would have received an execution on the full 100,000 shares. Under the alternative uptick rule, the investor would not be able to receive an execution at $10.01 if it

b. Prevent market participants from receiving the true market price on their orders and cause confusion among participants; [8]

c. Create a higher level of intra-day volatility as "price-pockets" are created by the inability of passive short liquidity to mitigate rapid moves up and down;[9] and

d. Make it easier for people to engage in "pump and dump" scams as short sellers will not be able to efficiently execute short sales in rising markets.[10]

These new inefficiencies could add additional transaction costs to investor executions. In fact, in its August 17th proposal, the Commission correctly noted,

> However, because the alternative uptick rule would restrict short selling to a greater extent than either the proposed modified uptick rule or the proposed uptick rule, it could also potentially lessen some of the benefits of legitimate short selling, including market liquidity and pricing efficiencyto a greater extent. Thus, there may be potential costs associated with the alternative uptick rule in terms of potential impact of such a price test on quote depths, spread widths, market liquidity, execution and pricing inefficiencies.[11]

Pilot Test

Knight continues to believe strongly that the Commission should first consider a limited pilot in order to gather data on any alterative approach.[12] Such analysis would allow the Commission to consider thoroughly the empirical evidence it is seeking in the proposed rule release.[13] When short-sale restrictions were last debated, the process that the Commission initiated to consider the removal of short-selling restrictions was scientifically rigorous. The Commission constructed a strategy for developing, testing, piloting and finally implementing Regulation SHO. The pilot was well conceived and

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routed his/her order to Market Center A (or any other market center) because that would be the new national best bid.

[8] The example above indicates a situation where both the buyer and the seller are not receiving executions at the true market price of the stock, and the confusion that can result from the alternative uptick rule.

[9] A price-pocket occurs when a stock instantly jumps higher as absent natural liquidity is unable to be replaced by active short liquidity. Conversely, large passive shorts will create rapid moves to the downside as buyers will remove their bids in response to passive short orders or sellers may become more active by hitting bids in response to the passive short orders in the market.

[10] The inability for short sellers to add liquidity in a rising market will increase volatility in the market, especially in less liquid companies.

[11] SEC Release 34-60509 (August 17, 2009) at pp. 6-7 (citations omitted).

[12] 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.

[13] For example, the 60% increase in the S&P 500 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.

comprehensive. 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 uptick rule may have done very little to add to the efficiency of the evolved market.[14]

As stated in our previous letter, we continue to believe that a change to Regulation SHO is not necessary. However, if the Commission were to determine it is vital to the ongoing integrity of the U.S. capital markets, then the approach that may have the least negative impact on liquidity and price discovery is the modified uptick rule where market centers set policies and procedures to ensure that short sales are executed on an up-bid when a circuit breaker is triggered.[15] Due to the operational and technology difficulty in monitoring a stock-by-stock circuit breaker, Knight suggests that the Commission instead consider a "market-wide" circuit breaker.[16] Such circuit breaker would go into effect if, for example, the Dow Jones Industrial Average were to fall substantially below the previous night's close.[17] Coupling a circuit breaker with the modified uptick rule would be the least intrusive to the structure of the equity markets and insure that the new restriction is only used during extreme market conditions and does not become a part of the daily fabric of the market.

Exemptions

As we have stated in our previous comment letter, it is crucial that the proper exemptions for any imposed restrictions on short-selling be maintained. Under a more restrictive short sale rule as contemplated in the SEC proposals, any route that does not include an exemption for *bona fide* market makers and hedging activities would damage the U.S. equity market. It is widely agreed that market makers provide critical liquidity for orders of all types, from the small retail investor order, to the larger, 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. Furthermore, exemptions should also include exchange trade funds (ETFs), as they have become such an integral

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

[15] If this 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.

[16] A stock-by-stock circuit breaker would be very difficult to implement (an individual equity circuit breaker has never been tested nor utilized). As such, prior to a final decision, we would suggest the Commission examine the thesis that a circuit breaker on an individual stock would accomplish its stated goal of protecting the integrity and creating a renewed confidence in the U.S. equity market. Furthermore, a stock-by-stock circuit breaker would require a complicated operational structure to tag impacted stocks. Additionally, this route requires an efficient means of indicating to all investors and market participants that short sale restrictions have been established for that particular security.

[17] While it is best to be determined statistically, a move of 5% in the Dow would likely capture those instances when the market is under significant pressure.

and liquid part of the U.S. equity market, as well as for option market makers who rely on the ability to short stock to hedge their options positions.[18]

Conclusion

We commend the Commission for its continued focus on market integrity issues, including short sale restrictions. We continue to respectfully urge the Commission to consider a thorough analysis of the costs and benefits of any proposal prior to final rule implementation so as to insure that the overall impact on the market and liquidity does not significantly overshadow any potential added protection.

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 LJK

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
James Brigagliano, co-Acting Director, SEC Division of Trading and Markets
Daniel M. Gallagher, co-Acting Director, SEC Division of Trading and Markets

[18] The ability for option market makers to sell short has been a significant factor in the reduction of transaction costs paid by investors who trade options.