KNIGHT CAPITAL GROUP, INC.
Form 10-K
March 02, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2008**

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

001-14223

Commission File Number

KNIGHT CAPITAL GROUP, INC.

(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of incorporation or organization)

22-3689303

(I.R.S. Employer Identification Number)

545 Washington Boulevard, Jersey City, NJ 07310

(Address of principal executive offices and zip code)

Registrant s telephone number, including area code: (201) 222-9400

Securities registered pursuant to Section 12(b) of the Act:

Class A Common Stock, $0.01 par value

Securities registered pursuant to Section 12(g) of the Act:

None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The aggregate market value of the Class A Common Stock held by nonaffiliates of the Registrant was approximately $1.32 billion at June 30, 2008 based upon the closing price for shares of the Registrant s Class A Common Stock as reported by the Nasdaq Global Select Market on that date. For purposes of this calculation, affiliates are considered to be officers, directors and holders of 10% or more of the outstanding common stock of the Registrant.

At February 27, 2009 the number of shares outstanding of the Registrant s Class A Common Stock was 92,880,705 and there were no shares outstanding of the Registrant s Class B Common Stock as of such date.

DOCUMENTS INCORPORATED BY REFERENCE

Definitive Proxy Statement relating to the Company s 2009 Annual Meeting of Stockholders to be filed hereafter (incorporated, in part, into Part III hereof).

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KNIGHT CAPITAL GROUP, INC.

FORM 10-K ANNUAL REPORT

For the Year Ended December 31, 2008

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FORWARD LOOKING STATEMENTS

Certain statements contained in this Annual Report on Form 10-K, including without limitation, those under Legal Proceedings in Part I, Item 3, Management s Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7 (MD&A), and Quantitative and Qualitative Disclosures About Market Risk in Part II, Item 7A, and the documents incorporated by reference herein may constitute forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are not historical facts and are based on current expectations, estimates and projections about the Company s industry, management s beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, readers are cautioned that any such forward-looking statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict including, without limitation, risks associated with (i) the costs, integration, performance and operation of businesses recently acquired, or that may be acquired in the future, by the Company, (ii) the unprecedented current market conditions and the resulting volatility, credit tightening and counterparty risk, as well as the negative effect on performance and assets under management in our Asset Management business and the suspension of redemptions and withdrawals of certain funds announced in the Form 8-K filed by the Company on October 30, 2008, (iii) the announcement that the assets of the Asset Management business will be sold as described in the Form 8-K furnished by the Company on January 27, 2009, and (iv) the announcement regarding estimated costs associated with the Company s exit from the Asset Management business as described in the Form 8-K filed by the Company on February 26, 2009. Since such statements involve risks and uncertainties, the actual results and performance of the Company may turn out to be materially different from the results expressed or implied by such forward-looking statements. Given these uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. Unless otherwise required by law, the Company also disclaims any obligation to update its view of any such risks or uncertainties or to announce publicly the result of any revisions to the forward-looking statements made in this report. Readers should carefully review the risks and uncertainties disclosed in the Company s reports with the U.S. Securities and Exchange Commission (SEC), including those detailed under Certain Factors Affecting Results of Operations in MD&A and in Risk Factors in Part I, Item 1A herein, and in other reports or documents the Company files with, or furnishes to, the SEC from time to time. This discussion should be read in conjunction with the Company s Consolidated Financial Statements and the Notes thereto contained in this report.

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PART I

Item 1. *Business*

Overview

Knight Capital Group, Inc., a Delaware corporation (collectively with its subsidiaries, Knight or the Company), is a leading financial services firm that provides electronic and voice access to the capital markets across multiple asset classes for buy-side, sell-side and corporate clients, and asset management for institutions and private clients.

The Company was organized in January 2000 as the successor to the business of Knight/Trimark Group, Inc. (the Predecessor). The Predecessor was organized in April 1998 as the successor to the business of Roundtable Partners, LLC, which was formed in March 1995. In May 2000, the Company changed its name from Knight/Trimark Group, Inc. to Knight Trading Group, Inc., and in May 2005 the Company further changed its name to Knight Capital Group, Inc. Our corporate headquarters are located at 545 Washington Boulevard, Jersey City, New Jersey 07310. Our telephone number is (201) 222-9400.

Financial information concerning our business segments for each of 2008, 2007 and 2006, respectively, is set forth in Management s Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7 (MD&A) and the Consolidated Financial Statements and Notes thereto located in Part II, Item 8 entitled Financial Statements and Supplementary Data.

Available Information

Our Internet address is www.knight.com. We make available free of charge, on or through the Investor Relations section of our corporate website under SEC Filings , annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, Forms 3, 4 and 5 filed on behalf of directors and executive officers, and any amendments to those reports filed or furnished pursuant to the Securities Exchange Act of 1934, and our proxy statement as soon as reasonably practicable after such materials are electronically filed with, or furnished to, the SEC. Also posted on our corporate website is our Code of Business Conduct and Ethics (the Code) governing our directors, officers and employees. Within the time period required by the SEC, we will post on our corporate website any amendments and waivers to such Code applicable to our executive officers and directors, as defined in the Code.

Our Board of Directors (the Board) has standing Finance and Audit, Compensation and Nominating and Corporate Governance committees. Each of these Board committees has a written charter approved by the Board. Our Board has also adopted a set of Corporate Governance Guidelines. Copies of each committee charter, along with the Corporate Governance Guidelines, are posted on the Company s website. None of the information on our corporate website is incorporated by reference into this report.

All of the above materials are also available in print, without charge, to any person who requests them by writing or telephoning:

Knight Capital Group, Inc.

Communications, Marketing and Investor Relations

545 Washington Boulevard, 3rd Floor

Jersey City, NJ 07310

(201) 222-9400

Unless otherwise indicated, references to the Company, Knight, We, Us, or Our shall mean Knight Capital Group, Inc. and its subsidiaries.

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Operating Segments

The Company has three operating segments, Global Markets, Asset Management and Corporate.

Global Markets Our Global Markets segment provides market access and trade execution services in nearly every U.S. equity security and a large number of international securities, fixed income, foreign exchange, futures and options. Our approach to trading combines deep liquidity with robust trading technology and capital facilitation, when necessary, to deliver high quality trade executions consistent with client-defined measures.

Asset Management Our Asset Management segment, which we are currently in the process of preparing to exit, consists of our 51% ownership of Deephaven Capital Management Holdings LLC (Deephaven Holdings), the parent company of Deephaven Capital Management LLC and its subsidiaries (collectively, Deephaven), a global, multi-strategy alternative investment manager. Assets under management were $2.0 billion as of December 31, 2008, down from $3.9 billion as of December 31, 2007. For information regarding our plan to exit from our Asset Management segment, refer to the Deephaven and Subsequent Events sections in MD&A.

Corporate Our Corporate segment includes investment income earned on strategic investments and our corporate investment as a limited partner or non-managing member in funds managed by Deephaven and all corporate overhead expenses. Corporate overhead expenses primarily consist of compensation for certain senior executives and other individuals employed at the corporate holding company, legal and other professional expenses related to corporate matters, directors fees, investor and public relations expenses and directors and officers insurance.

The following table sets forth: (i) Revenues, (ii) Expenses, (iii) Minority interest expense, (iv) Other income and (v) Pre-tax earnings (loss) after minority interest expense of our segments and on a consolidated basis (in millions):

	For the years ended December 31,		
	2008	2007	2006
Global Markets			
Revenues	$ 998.5	$ 739.9	$ 657.6
Expenses	641.1	559.6	507.3
Pre-tax earnings	357.5	180.4	150.3
Asset Management			
Revenues	33.3	118.2	214.9
Expenses	52.6	101.7	140.1
Pre-tax (loss) earnings	(19.4)	16.5	74.8
Minority interest expense	6.2		
Pre-tax (loss) earnings after minority interest expense	(25.5)	16.5	74.8
Corporate			
Revenues	1.1	27.1	66.9
Expenses	40.9	31.5	35.5
Other income	15.9	8.8	

Pre-tax (loss) earnings	(23.8)	4.3	31.4
Consolidated			
Revenues	1,032.9	885.2	939.5
Expenses	734.6	692.7	682.9
Other income	15.9	8.8	
Pre-tax earnings	314.3	201.2	256.5
Minority interest expense	6.2		
Pre-tax earnings after minority interest expense	$ 308.1	$ 201.2	$ 256.5

* Totals may not add due to rounding.

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Global Markets Segment

Business Segment Overview

We provide market access and trade execution services in nearly every U.S. equity security and a large number of international securities, fixed income, foreign exchange, futures and options. Our approach to trading combines deep liquidity with robust trading technology and capital facilitation, when necessary, to deliver high quality trade executions consistent with client-defined measures. Our hybrid market model features an array of electronic and voice services that allow buy and sell-side clients to interact with the market based on their specific needs and preferences. This model allows us to attract a larger base of clients with diverse investment styles and strategies, while at the same time, capture a greater share of client order flow. To do so, our model requires that we manage risk and deploy capital effectively as well as maintain efficient and reliable trading technology. Substantially all of our Global Markets revenues and profitability come from our operations in the U.S.

The majority of our Global Markets revenue is derived from trade executions, making markets and providing market access services in U.S. equities. Generally, market-makers display the prices at which they are willing to bid, meaning buy, or offer, meaning sell, securities and adjust their bid and offer prices in response to the forces of supply and demand for each security. As a market-maker operating in Nasdaq, the over-the-counter (OTC) market for New York Stock Exchange (NYSE), NYSE Alternext and NYSE Arca listed securities, the OTC Bulletin Board, and the Pink Sheets, we provide trade executions by offering to buy securities from, or sell securities to, institutions and broker-dealers. When acting as principal, we commit our own capital and derive revenues from the difference between the price paid when securities are bought and the price received when those securities are sold. We conduct the vast majority of market making activity as principal, through the use of automated quantitative models. Our traders offer execution services for complex trades and a variety of order types. We also provide trade executions for institutions on an agency or riskless principal basis, generating commissions or commission equivalents, respectively. Also, our trading strategy employs the use of high velocity algorithmic trading models which interact with street flow.

Our domestic Global Markets activities are primarily transacted out of the following subsidiaries: Knight Equity Markets, L.P. (KEM), Knight Capital Markets LLC (KCM), Knight Direct LLC (Knight Direct), Hotspot FX, Inc. and its subsidiaries (collectively, Hotspot), Knight BondPoint, Inc. (Knight BondPoint) and Knight Libertas Holdings LLC (formerly known as Libertas Holdings LLC) and its subsidiaries (collectively, Knight Libertas). KEM, KCM, Knight Direct, Knight BondPoint and one Knight Libertas subsidiary are broker-dealers registered with the SEC and members of the Financial Industry Regulatory Authority (FINRA). Knight BondPoint and Knight Libertas domestic subsidiary are also registered with the Municipal Securities Rulemaking Board (MSRB). One Hotspot subsidiary is a Futures Commission Merchant (FCM) registered with the Commodity Futures Trading Commission (CFTC) and is a member of the National Futures Association (NFA).

Our international Global Markets activities are primarily operated through Knight Equity Markets International Limited (KEMIL), a U.K. registered broker-dealer authorized and regulated by the U.K. Financial Services Authority (FSA). KEMIL provides execution services for institutional and broker-dealer clients in U.S., European and international equities. Each of Hotspot and Knight Libertas has a U.K. subsidiary which is regulated by the FSA. Knight Libertas also has a Hong Kong registered broker-dealer that is regulated by the Securities and Futures Commission (SFC). We recently received regulatory approval for a newly-formed broker-dealer in Hong Kong that will focus on equity execution services for buy-side clients. We intend to continue to expand our business and product offerings in Europe and Asia in 2009.

Over the past four years, we have completed the following acquisitions (and subsequent sales of equity interests) of complementary businesses to strengthen our Global Markets business segment and expand and diversify our products and services:

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In June 2005, we acquired the business of Direct Trading Institutional, now operating as Knight Direct. The acquired business was a privately held firm specializing in providing institutions with direct market access trading through an advanced electronic platform, now known as Knight Direct EMS . Upon the close of the transaction, the Company made a $40 million initial cash payment. The transaction also contained a two-year contingency from the date of closing for the payment of additional consideration based on the profitability of the business. In the third quarters of 2007 and 2006, the Company paid $10.4 million and $12.7 million, respectively, in additional cash consideration based on the profitability of the business during each of the first two years of operation after the closing of the acquisition.

In October 2005, we acquired the business of the ATTAIN ECN (now operating as Direct Edge ECN), an alternative trading system that operates an electronic communications network (ECN). The Direct Edge ECN provides a liquidity destination with the ability to match and route trades in Nasdaq, NYSE, NYSE Alternext and NYSE Arca listed securities.

After the close of business on July 23, 2007 and September 28, 2007, Direct Edge Holdings LLC (Direct Edge Holdings), the parent company of Direct Edge ECN, issued equity interests to Citadel Derivatives Group LLC (Citadel) in exchange for cash. Immediately following the September 28, 2007 issuance to Citadel, the Company and Citadel sold a portion of their equity interests in Direct Edge Holdings to The Goldman Sachs Group, Inc. for cash. At the close of business on September 28, 2007 (the Deconsolidation Date) the Company deconsolidated Direct Edge Holdings as it no longer controlled Direct Edge Holdings as of that date. The results of Direct Edge ECN operations have been included in the Consolidated Statements of Operations for all periods presented from the original acquisition date through the Deconsolidation Date. The Company accounts for its interest in Direct Edge Holdings under the equity method for periods subsequent to the Deconsolidation Date. In December 2008, we sold part of our remaining interest in Direct Edge Holdings and as a result, as of December 31, 2008, we own 19.9% of Direct Edge Holdings.

In April 2006, we acquired, for $77.5 million in cash, Hotspot, an electronic foreign exchange marketplace that provides access to electronic foreign exchange spot trade executions through an advanced ECN-based platform.

In October 2006, we acquired, for $18.2 million in cash, Knight BondPoint, a firm that provides electronic access and trade execution products for the fixed income market.

In January 2008, we acquired EdgeTrade Inc. (EdgeTrade) for $58.2 million comprising $28.2 million of cash and approximately 2.3 million shares of unregistered Knight common stock. EdgeTrade was an agency-only trade execution and algorithmic software firm that allowed buy- and sell-side clients to more effectively source liquidity and manage the trading process as well as maintain anonymity, reduce market impact and lower transaction costs. EdgeTrade merged into Knight Direct in August 2008.

In July 2008, we acquired Knight Libertas, for an upfront payment of $50.3 million in cash and approximately 1.5 million shares of unregistered Knight common stock valued at $25.0 million. The transaction also has a three-year contingency from the date of closing for the payment of additional consideration based on the profitability of the business. Knight Libertas is a riskless principal fixed income broker-dealer specializing in high-yield and high-grade corporate bonds, distressed debt, asset- and mortgage-backed securities, convertible bonds and syndicated loans.

Clients and Products

Clients

Within Global Markets, we offer products and provide services via electronic and voice access points primarily to two main client groups: sell-side (also referred to as broker-dealers) and buy-side

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(also referred to as institutions). Our sell-side clients include global, national and regional broker- dealers and on-line brokers. Our buy-side clients include mutual funds, pension plans, plan sponsors, hedge funds, trusts and endowments. Based on our internal allocation methodologies, our institutional clients (which include our direct market access, soft dollar and commission recapture clients) and our broker-dealer clients each generated approximately 50% of our Global Markets revenues in 2008.

In 2008, our Global Markets business did not have any client that accounted for more than 10% of our U.S. equity dollar value traded.

Products and Services

Our strategy for our Global Markets segment is to continue to differentiate ourselves from competitors by providing high quality and competitive trade execution services with superior client service. Over the past several years, we have worked to expand our products and services.

For our buy-side clients, we offer comprehensive, unbundled trade execution services covering the depth and breadth of the market. We handle large, complex trades, accessing liquidity from our order flow as well as other sources. When liquidity is not naturally present in the equities market, we offer capital facilitation, when necessary, to complete our clients trades. Our institutional products include equity, fixed income, futures, options and foreign currency trade execution solutions, block trading, program trading, international equities, special situations/risk arbitrage, soft dollar and commission recapture programs through Donaldson & Co. (Donaldson), corporate access services, direct market access through Knight Direct EMS , EdgeTrade algorithms and internal crossing networks through our Knight Match product. The majority of our revenues from institutional clients are commissions on agency transactions or commission-equivalents on riskless principal transactions.

We seek to provide sell-side clients with high quality and competitive trade executions that enable them to satisfy their fiduciary obligations to their customers to seek and obtain the best execution reasonably available in the marketplace. Most of our equity order flow comes from providing market-making and trade execution services to our broker-dealer clients through our electronic trading platform, which includes access to our off-exchange liquidity through Knight Link. Our traders offer execution services for complex trades and a variety of order types. We execute the majority of the order flow with these clients as principal through the use of our automated quantitative models. The majority of the revenues we earn from broker-dealer clients are net trading revenues, generated from the difference between the price paid when we buy securities and the price received when we sell securities. We also provide fixed income trade executions to our broker-dealer clients. Additionally, we interact with street flow through our high velocity algorithmic trading models.

Global Markets Competition

During 2008, the securities markets endured unprecedented market conditions with high volatility, dramatic credit tightening and increased counterparty risk. These difficult conditions have continued into 2009, requiring us to continue to adapt to our clients needs amidst a changing landscape and competition. Our client offerings, including our trade execution services, compete primarily with similar products offered by domestic and international broker-dealers, exchanges, alternative trading systems, crossing networks, ECNs and dark liquidity pools. We also experience significant competition from various market participants with highly automated, electronic trading models. Another source of competition is broker-dealers who execute portions of their client flow through internal market-making desks rather than sending the client flow to third party execution destinations, such as Knight.

We compete primarily on the basis of our execution standards (including price, liquidity, speed and other client-defined measures), client relationships, client service, payments for order flow and technology. Over the past several years, regulatory changes, competition and the continued focus by regulators and investors on execution quality and overall transaction costs have resulted in a market environment characterized by narrowed spreads and reduced revenue capture metrics. Consequently, maintaining profitability has become extremely difficult for many firms similarly situated to Knight. Generally, improvements in execution quality, such as faster execution speed and greater price improvement, negatively impact the ability to derive revenues from executing client order flow. For example, we have made, and continue to make, changes to our execution protocols and quantitative models, which have had, or could have, a significant impact on our profitability. To remain profitable, some competitors have limited or ceased activity in illiquid or marginally profitable securities or, conversely, have sought to execute a greater volume of trades at a lower cost by increasing the automation and efficiency of their operations. Beginning in the second quarter of 2005, we significantly increased the amount of automation in our trade execution business by employing quantitative models and we now execute the vast majority of our trades on an automated basis through these models.

Competition for order flow in the U.S. equity markets continues to be intense and evolving rapidly as reflected in publicly disclosed execution metrics; i.e., SEC Rules 605 and 606. These rules, applicable to broker-dealers, add greater disclosure to execution quality and order-routing practices. Rule 605 requires market centers that trade national market system securities to make available to the public monthly electronic reports that include uniform statistical measures of execution quality on a security-by-security basis. Rule 606 requires broker-dealers that route equity and option orders on behalf of their customers to make publicly available quarterly reports that describe their order routing practices and disclose the venues to which customer orders are routed for execution. These statistics on execution quality vary by order sender based on their mix of business. This rule also requires the disclosure of payment for order flow arrangements as well as internalization practices. The intent of this rule is to encourage routing of order flow to destinations based primarily on the demonstrable quality of executions at those destinations, supported by the order entry firms fiduciary obligations to seek to obtain best execution for their customers orders.

Commission rates have been under pressure for a number of years, and the ability to execute trades electronically through various competitive trading venues (including both domestic and international broker-dealers, exchanges, alternative trading systems, crossing networks, ECNs and dark liquidity pools) has placed increased pressure on trading commissions. We believe the trend toward increased competition and the growth of these and other alternative trading venues will continue. We may experience competitive pressures in these and other areas in the future as some of our competitors seek to obtain greater market share by reducing prices. Competition for business with institutional clients is based on a variety of factors, including execution quality, research, reputation, soft dollar and commission recapture services, technology, market access (including direct market access and execution algorithms), client relationships, client service, cost and capital facilitation.

Also, other factors contributing to increasing competition for order flow are the significant mergers among U.S. market centers over the past several years and the launch of independent ECNs, dark liquidity pools and joint ventures with regional stock exchanges. The impact of these mergers and the launch of new competition and liquidity sources, as well as the expected consolidation of certain U.S. and international stock exchanges, will be seen in the coming years.

Global Markets Infrastructure

We have invested significant resources to expand our execution capacity and upgrade our trading systems and infrastructure and plan to make additional investments in technology and infrastructure in the future. Our ability to identify and deploy emerging technologies that facilitate the execution of trades, including developing and enhancing our quantitative models, is key to the successful execution of our business model. Technology has enhanced our capacity and ability to handle order flow faster and also has been an important component of our strategy to comply with government and industry regulations, achieve competitive execution standards, increase trading automation and provide

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superior client service. We continually enhance our use of technology and quantitative models to further refine our execution services. We also continue to develop and enhance our high velocity algorithmic trading models.

We use our proprietary technology and technology licensed from third parties to execute trades, monitor the performance of our traders, assess our inventory positions, manage risk and provide ongoing information to our clients. We are electronically linked to institutions and broker-dealers to provide immediate access to our trading operations and to facilitate the handling of client orders. Our business-to-business portal, along with our Knight Link, Knight BondPoint, Hotspot, and Knight Direct EMS platforms, provide our clients with an array of tools to interact with our Global Markets trading systems, marketplaces, and most U.S. equity, futures and options market centers. In addition, we clear the majority of our trade executions through unaffiliated clearing brokers with whom we are electronically linked.

Alternative trading and data center facilities are in place for our primary domestic Global Markets operations. These facilities have been designed to allow us to continue a substantial portion of our operations if we are prevented from accessing or utilizing our primary office locations for an extended period of time. While we employ significant steps to develop, implement and maintain reasonable business continuity plans, we cannot guarantee our alternative systems and facilities will provide full continuity of operations after a significant business disruption.

Asset Management Segment

Business Segment Overview

As of February 2009, we are in the process of preparing to exit our Asset Management segment. Due to unprecedented market conditions, pending redemptions and industry-wide changes in margin and finance requirements, and after evaluation of a number of strategic options, the Company concluded that it was in the best interests of investors of Deephaven and the Company to exit our Asset Management segment. For information regarding our plan to exit from our Asset Management segment, refer to the Deephaven and Subsequent Events sections in MD&A.

We have operated our Asset Management business through our 51% ownership in Deephaven Holdings, which owns Deephaven. Deephaven is the registered investment manager and sponsor of certain private, unregistered funds commonly referred to as hedge funds (the Deephaven Funds). Generally, hedge funds are defined as pools of capital that may invest in any asset class, including derivatives, and may use long and short positions, derivative instruments, and leverage in order to generate returns for investors. Deephaven is based in Minnetonka, MN, and also has offices in London and Hong Kong.

Below is a summary of assets under management at December 31, 2008, 2007 and 2006, and the blended fund returns for each of the years then ended:

	2008	2007	2006
Year-end assets under management (billions)	$ 2.0	$ 3.9	$ 4.2
Annual fund return to investors*	-32.6%	6.8%	22.8%

* Annual fund return represents the blended annual return across all assets under management.

We earn fees from managing the Deephaven Funds, which consist of management fees, calculated as fixed percentages of assets under management, and incentive allocation fees, which, in general, are calculated as a percentage of the funds annual profits, if any.

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Business Segment Structure

In 2003, the Company entered into long-term employment contracts with certain senior managers of Deephaven. These employment agreements, which became effective on January 1, 2004, had a three-year term which expired on December 31, 2006. The agreements provided for profit sharing bonuses based on the financial performance of Deephaven, which, for 2006, represented 50% of pre-tax earnings prior to the profit-sharing bonuses. The employment agreements also included an option for renewal by the Deephaven managers through 2009 under identical financial terms; however, the renewal option was not exercised.

In December 2006, the Company entered into new long-term employment agreements (the 2006 Employment Agreements) with three senior managers of Deephaven (the Deephaven Managers), two of whom were parties to the agreements entered into in 2003. The 2006 Employment Agreements, which became effective on January 1, 2007, were for three-year terms and included a right of renewal by the Deephaven Managers through 2012 under certain circumstances. The 2006 Employment Agreements provided profit-sharing bonuses based on the financial performance of Deephaven. According to the terms of the 2006 Employment Agreements, the Deephaven Managers were entitled to receive 50% of the first $60 million, and 75% thereafter, of pre-tax earnings prior to the profit-sharing bonuses. Upon entering the 2006 Employment Agreements, the Deephaven Managers received one million shares of Knight restricted common stock, which vest ratably over three years.

In connection with entering into the 2006 Employment Agreements, the Deephaven Managers were granted an option (the Option) to obtain a 49% interest in Deephaven Holdings to which our interests in Deephaven would be contributed. The Option became exercisable after January 1, 2008 upon Deephaven having met certain requirements regarding minimum assets under management and employee retention. On January 10, 2008, Deephaven Managing Partners, LLC (Deephaven Partners), an entity owned and controlled by the Deephaven Managers, provided notice to the Company that it was exercising the Option.

On February 1, 2008, after regulatory and contractual approvals were received, the Company completed the transaction whereby the Company contributed its interest in Deephaven to Deephaven Holdings and Deephaven Partners acquired a 49% interest in Deephaven Holdings in exchange for the termination of the Deephaven Managers 2006 Employment Agreements and associated profit sharing bonuses and an equity contribution of $1 million to Deephaven Holdings by Deephaven Partners (the Deephaven Transaction). The Deephaven Transaction did not affect or result in any change to Deephaven s role as investment manager to the funds it managed at that time or to the manner in which Deephaven carried out its duties as investment manager to those funds.

As part of the Deephaven Transaction, the Company and Deephaven Partners entered into a new Limited Liability Company Agreement (the New LLC Agreement) for Deephaven Holdings. In addition, the 2006 Employment Agreements terminated and were replaced by new long-term employment agreements between Deephaven Holdings and each of the Deephaven Managers (the New Employment Agreements). The New Employment Agreements did not include the profit-sharing bonuses provided for under the 2006 Employment Agreements; however, the Deephaven Managers continue to be entitled to participate in certain profit pools relating to specific Deephaven funds. Following the Deephaven Transaction, pre-tax earnings are allocated between the Company and, through Deephaven Partners, the Deephaven Managers in a similar manner as under the 2006 Employment Agreements. Profit-sharing bonuses under the 2006 Employment Agreements had been reported in Employee compensation and benefits on our Consolidated Statements of Operations. As a result of the Deephaven Transaction, beginning in February 2008, profits or losses that are allocated to the Deephaven Managers are instead reported as Minority interest expense on our Consolidated Statements of Operations and included as Minority interest on our Consolidated Statements of Financial Condition.

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Under the New LLC Agreement, we own 51% of the shares in Deephaven Holdings, and Deephaven Partners owns 49% of the shares. We are entitled to appoint a majority of the Board of Managers of Deephaven Holdings. Certain corporate actions require approval of a super-majority of members of the Board of Managers, including representatives of both Deephaven Partners and Knight. Neither party is permitted to transfer any of its interests in Deephaven Holdings to any unaffiliated third person without the consent of the other party. Any sale of Deephaven Holdings requires either (x) the consent of the holders of 75% of the shares or (y) if the aggregate consideration is in excess of $450 million, the approval of only Deephaven Partners (subject to a right of first refusal for the benefit of the Company). Pursuant to the New LLC Agreement, proceeds from any sale or liquidation of Deephaven or Deephaven Holdings will be allocated among the Company and Deephaven Partners based upon a formula that takes into account their capital accounts at the time of such sale or liquidation and relative profit sharing percentages over a defined period of time.

Clients and Products

Investors in the Deephaven Funds include banks, insurance companies, funds-of-hedge funds, corporate and public pension plan sponsors, trusts, endowments and private clients. Included within Deephaven s $2.0 billion of assets under management as of December 31, 2008 is a corporate investment as a limited partner or non-managing member of $47.2 million held by the Company and $35.8 million in the deferred compensation plans relating to certain employees and directors. Separately, certain officers, directors and employees of the Company held direct investments aggregating approximately $47.1 million as limited partners or non-managing members in the Deephaven Funds. As of December 31, 2008, two investors each accounted for more than 10% of the Deephaven Funds assets under management.

As of December 31, 2008, approximately 61% of the Deephaven Funds assets under management were in the Global Multi-Strategy Fund (GMS Fund), formerly known as the Deephaven Market Neutral Fund. The investment philosophy for the GMS Fund is to seek to produce returns for its investors using various investment strategies focusing on delivering attractive risk-adjusted rates of return. The performance of the GMS Fund is intended to be substantially non-correlated with the general debt and equity markets, as well as with a number of other non-traditional investment strategies. Within the GMS Fund, Deephaven generally employs a variety of investment strategies, including volatility-driven, fundamental equity, event-driven, credit-driven and global relative value macro/fixed income strategies, among others. The unprecedented market conditions, pending redemptions and industry-wide changes in margin and finance requirements led Deephaven to announce the suspension of redemptions in the GMS Fund and International Volatility Strategies Fund on October 30, 2008.

On January 31, 2008, Deephaven announced that it had concluded that it was in the best interests of investors in the Deephaven Event Fund (Event Fund) that the Event Fund return investors capital. As a result, redemptions in the Event Fund were suspended, and Deephaven began an orderly process to reduce trading positions to cash and return investors capital as promptly as reasonably practicable. Beginning February 1, 2008, and through the period of time Deephaven is returning investors capital, no management or incentive allocation fee will be charged to investors in the Event Fund. As of December 31, 2008, the Event Fund held approximately $86 million in assets under management, or approximately 4% of the Deephaven Funds assets under management.

Deephaven also manages other single-strategy funds as well as several separately managed accounts for institutional investors. As of December 31, 2008, these single-strategy funds and all separately managed accounts had, in aggregate, approximately $689.2 million, or approximately 35%, of the Deephaven Funds assets under management as of such date.

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Asset Management Competition

Historically, Deephaven competed primarily with other asset management companies that manage and sponsor multi-strategy, credit-driven, long short equity, event-driven and volatility-driven portfolios. As Deephaven launched single strategy funds, it competed with other asset management companies with similar investment strategies. Competition was primarily based on reputation, client relationships, the experience of the management team, investment strategies, risk profile, global presence, fee structures and historical fund returns.

Until 2008, there had been an on-going trend among fund management companies and institutions to allocate more of their assets to hedge fund investments. Due to the illiquidity in the credit market, steep decline in hedge fund performance and the unprecedented redemptions by investors in 2008, the hedge fund industry declined, as shown in the table below.

	Estimated number of hedge funds	Estimated total assets under management (millions)
1990	610	$ 38,910
1995	2,383	185,750
2000	3,873	490,580
2005	8,661	1,105,385
2006	9,462	1,464,526
2007	10,096	1,868,419
2008	9,176	1,407,095

Source: Hedge Fund Research, Inc. 2008 Industry Report

Asset Management Infrastructure

In managing the Deephaven Funds, Deephaven uses both an in-house developed proprietary order management system and a third-party portfolio management system. Deephaven has business continuity capabilities in place in the event it is unable to access or operate in its current locations. While Deephaven employs significant steps to develop, implement and maintain reasonable business continuity plans, we cannot guarantee its alternative systems and facilities will provide full continuity of operations after a significant business disruption.

Corporate Segment

Our Corporate segment includes the investment income earned on our strategic investments, our corporate investment as a limited partner or non-managing member in the Deephaven Funds and costs not associated with our other operating business segments, primarily corporate overhead expenses. Corporate overhead expenses primarily consist of compensation for certain senior executives and other individuals employed at the corporate holding company, legal and other professional expenses relating to corporate matters, directors fees, investor and public relations expenses and directors and officers insurance. The results from our Corporate segment for 2006 were positively impacted by realized gains from the sales of our strategic equity investments in the

International Securities Exchange, Inc. (ISE) and the Nasdaq Stock Market, Inc., and for 2007 and 2008 by gains resulting from the partial sales of equity interests in Direct Edge ECN.

Intellectual Property and Other Proprietary Rights

Our success and ability to compete are dependent to a degree on our intellectual property, which includes our proprietary trading and execution technology, trade secrets and client base. We rely primarily on trade secret, trademark, domain name, patent and contract law to protect our intellectual property. It is our policy to enter into confidentiality, intellectual property ownership and/or non-competition agreements with our employees, independent contractors and business partners, and to control access to and distribution of our intellectual property.

Government Regulation and Market Structure

Most aspects of the Company s business are subject to extensive securities regulation under federal, state and international laws. The SEC, CFTC, FSA, SFC, FINRA, NYSE, MSRB, NFA, other self-regulatory organizations (commonly known as SROs), and other regulatory bodies, such as state securities commissions, promulgate numerous rules and regulations that may impact our business. As a matter of public policy, regulatory bodies are charged with safeguarding the integrity of the securities and other financial markets and with protecting the interests of investors in those markets. Regulated entities are subject to regulations concerning all aspects of their business, including trade practices, best execution practices, capital structure, record retention and the conduct of officers, supervisors and registered employees. Failure to comply with any of these laws, rules or regulations could result in administrative or court proceedings, censures, fines, the issuance of cease-and-desist orders or injunctions, or the suspension or disqualification of the entity and/or its officers, supervisors or registered employees. We, and certain of our past and present officers, directors and employees, have in the past been subject to claims alleging the violation of such laws, rules and regulations. We are currently subject to several of these matters as further described in Part I, Item 3 Legal Proceedings herein. Certain aspects of the Company s public disclosure, corporate governance principles, internal control environment and the roles of auditors and counsel are subject to the Sarbanes-Oxley Act of 2002 and related regulations and rules of the SEC and Nasdaq.

Rule-making by the SEC, CFTC, FSA, SFC, FINRA, NYSE, MSRB, NFA, other SROs and corresponding market structure changes has an impact on the Company s regulated subsidiaries by directly affecting our method of operation and, at times, our profitability. Legislation can impose, and has imposed, significant obligations on broker-dealers, including those of our regulated subsidiaries. These increased obligations require the implementation and maintenance of internal practices, procedures and controls which have increased our costs and may subject us to regulatory inquiries, claims or penalties.

The regulatory environment in which we operate our Global Markets business is subject to constant change. Our business, financial condition and operating results may be adversely affected as a result of new or revised legislation or regulations imposed by the U.S. Congress, SEC, CFTC, FSA, SFC, FINRA, NYSE, MSRB, NFA, other SROs, other United States or foreign governmental regulatory authorities, and other regulatory bodies. Additional regulations, changes in existing laws and rules, or changes in interpretations or enforcement of existing laws and rules often directly affect the method of operation and profitability of regulated broker-dealers. We cannot predict what effect, if any, such changes might have. However, there were, and could be, significant technological and compliance costs associated with the obligations which derive from compliance with such regulations.

The market structure in which the Global Markets business operates is rapidly changing. The recent expansion of many regional exchanges, in which several exchanges have created their own alternative trading systems (e.g., ECNs) and now compete in the OTC and listed trading venues, as well as the consolidation of exchanges (e.g., Nasdaq s acquisition of the Boston and Philadelphia Stock Exchanges, as well as the NYSE s acquisition of the American Stock Exchange) and the global expansion of exchanges (e.g., Nasdaq and the OMX, and NYSE and Euronext), have altered the landscape of the marketplace and intensified competition.

We have foreign based subsidiaries and plan to continue to expand our international presence. The brokerage industry in many foreign countries is heavily regulated, much like the U.S. The varying compliance requirements of these different regulatory jurisdictions and other factors may limit our

ability to conduct business or expand internationally. For example, the Markets in Financial Instruments Directive (MiFID) adopted by the European Commission was implemented in November 2007. MiFID represents one of the more significant changes to take place in the operation of European capital markets. There were, and could be, significant technological and compliance costs associated with the obligations which derive from compliance with this regulation.

Deephaven became registered as an investment adviser with the SEC in 2006. Registration as an investment adviser has resulted in additional regulatory responsibilities and obligations on Deephaven s business. Deephaven is also registered with the CFTC and is a member of the NFA as a commodity pool operator and a commodity trading adviser. Due to the nature of Deephaven s client base, however, Deephaven is exempt from many of the CFTC and NFA regulations. Deephaven s U.K. subsidiary is regulated by the FSA and Deephaven s Hong Kong subsidiary is regulated by the SFC.

The Company believes that it is currently in material compliance with applicable regulations.

Net Capital Requirements

Certain of our subsidiaries are subject to the SEC s Net Capital Rule. This rule, which specifies minimum net capital requirements for registered broker-dealers, is designed to measure the general financial integrity and liquidity of a broker-dealer and requires that at least a minimum part of its assets be kept in relatively liquid form. In general, net capital is defined as net worth (assets minus liabilities), plus qualifying subordinated borrowings and certain discretionary liabilities, less certain mandatory deductions that result from excluding assets that are not readily convertible into cash and from valuing conservatively certain other assets. Among these deductions are adjustments, commonly called haircuts, which reflect the possibility of a decline in the market value of an asset before disposition, and non-allowable assets.

Failure to maintain the required net capital may subject a firm to suspension or revocation of registration by the SEC, and suspension or expulsion by FINRA and other regulatory bodies, and ultimately could require the relevant entity s liquidation. The Net Capital Rule prohibits payments of dividends, redemption of stock, the prepayment of subordinated indebtedness and the making of any unsecured advance or loan to a stockholder, employee or affiliate, if such payment would reduce the firm s net capital below required levels.

A change in the Net Capital Rule, the imposition of new rules or any unusually large charges against net capital could limit those operations that require the intensive use of capital and also could restrict our ability to withdraw capital from our broker-dealer subsidiaries. A significant operating loss or any unusually large charge against net capital could adversely affect our ability to expand or even maintain our present levels of business.

Certain of our foreign subsidiaries are subject to capital adequacy requirements set by their respective regulators.

During 2008, all of our broker-dealer subsidiaries were in compliance with their capital adequacy requirements. For additional discussion related to net capital, see Footnote 21 Net Capital Requirements included in Part II, Item 8 Financial Statements and Supplementary Data of this document.

Employees

At December 31, 2008, our headcount was 1,045 full-time employees, compared to 868 full-time employees at December 31, 2007. The increase in headcount is primarily related to the acquisitions of Knight Libertas and EdgeTrade, as well as the overall expansion of our Global Markets offerings in 2008. Of our 1,045 full-time employees at December 31, 2008, 924 were employed in the U.S. and 121

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outside the U.S., primarily in London. None of our employees is subject to a collective bargaining agreement. We believe that our relations with our employees are good.

Item 1A. *Risks Factors*

We face a number of risks that may adversely affect our business, financial condition and operating results. The risks described below are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

RISKS RELATED TO GLOBAL MARKETS BUSINESS

Conditions in the financial services industry and the securities markets may adversely affect our trading volumes and market liquidity

Our Global Markets operating segment is primarily transaction-based, and declines in trading volumes, prices and market liquidity would adversely affect our business and profitability. Declines in the volume of securities transactions and in market liquidity generally result in lower revenues from transaction execution activities. Lower price levels of securities and other instruments may also result in reduced revenue capture, and thereby reduced revenues from trade executions. Declines in market values of securities or other instruments can result in illiquid markets, losses on securities or other instruments held in inventory, the failure of buyers and sellers to fulfill their obligations and settle their trades, and increases in claims and litigation.

During 2008, and particularly during the second half of the year, the global financial services industry and securities markets experienced unprecedented and adverse conditions including substantially increased volatility, losses resulting from declining asset values, defaults on securities, and reduced liquidity. These events resulted in the failure of certain financial services firms, have led other firms to seek mergers with commercial banks and forced other firms to become bank holding companies that are regulated by the Federal Reserve Bank. While uncertainty surrounding the credit crisis and expectations for economic contraction has, in the short term, led to an increase in overall market volatility and increased trading volume in certain markets, this trend may not continue. If the levels of trading volume decrease as a result of events stemming from the current financial and credit crisis, our transaction-based revenues will decrease. Accordingly, any reduction in trading volumes or market liquidity could adversely affect our business and financial results in a material fashion.

Our future operating results may fluctuate significantly as a result of numerous factors, many of which are outside of our control

We may experience significant variation in our future results of operations. These fluctuations may result from numerous factors, many of which are outside of our control. These factors include, among other things, market conditions and the resulting volatility and credit and counterparty risks that may result; introductions of, or enhancements to, trade execution services by us or our competitors; the value of our securities positions and other instruments and our ability to manage the risks attendant thereto; the volume of our trade execution activities; the dollar value of securities and other instruments traded; the composition of our order flow; our market share with institutional and broker-dealer clients; the performance and size of, and volatility in, our quantitative market-making and program trading portfolios; the performance of our high velocity algorithmic trading models; the performance of our international operations and costs associated with international expansion; our ability to manage personnel, overhead and other expenses, including our occupancy expenses under our office leases and expenses and charges relating to legal and regulatory proceedings; the strength of our client relationships; changes in payments for order flow and clearing, execution and regulatory transaction costs; the addition or loss of executive management, sales, electronic and voice trading and technology professionals; legislative, legal and regulatory changes; legal and regulatory matters or proceedings; geopolitical risk; the amount and timing of capital expenditures, acquisitions and divestitures; the integration, performance and operation of acquired businesses; the incurrence of costs associated with acquisitions and dispositions; investor sentiment; technological changes and events; seasonality; competition; and market and economic conditions.

Such factors may also have an impact on our ability to achieve our strategic objectives, including, without limitation, increases in our market share, growth and profitability in our Global Markets segment. If demand for our services declines in our Global Markets business segment due to any of the above factors, and we are unable to adjust our cost structure on a timely basis, our operating results could be materially and adversely affected. As a result of the foregoing factors, period-to-period comparisons of our revenues and operating results are not necessarily meaningful and such comparisons cannot be relied upon as indicators of future performance. There also can be no assurance that we will be able to continue the rates of revenue growth that we have experienced in the past or that we will be able to improve our operating results.

The trading activities of our Global Markets business expose us to the risk of significant losses

We conduct our trading activities predominantly as principal, which subjects our capital to significant risks. These activities involve the purchase, sale or short sale of securities and other instruments for our own account and, accordingly, involve risks of price fluctuations and illiquidity, or rapid changes in the liquidity of markets that may limit or restrict our ability to either resell securities or other instruments we purchase or to repurchase securities or other instruments we sell in such transactions. From time to time, we may have large position concentrations in securities or other instruments of a single issuer or issuers engaged in a specific industry, which might result in higher trading losses than would occur if our positions and activities were less concentrated. The success of our trading activities primarily depends upon our ability to attract order flow, the performance and size of, and volatility in, our quantitative market-making and program trading portfolios, the performance of our high velocity algorithmic trading models, market interaction, the skill of our trading personnel, general market conditions, effective hedging strategies and risk management processes, the price volatility of specific securities or other instruments, and the availability and allocation of capital. To attract order flow, we must be competitive on price, size of securities positions and other instruments traded, liquidity offerings, order execution speed, technology, reputation, and client relationships and service. In our role as a market-maker, we attempt to derive a profit from the difference between the prices at which we buy and sell securities. However, competitive forces often require us to match the quotes other market-makers display and to hold varying amounts of securities in inventory. By having to maintain inventory positions, we are subject to a high degree of risk. There can be no assurance that we will be able to manage such risk successfully or that we will not experience significant losses from such activities. All of the above factors could have a material adverse effect on our business, financial condition and operating results.

Substantial competition could reduce our market share and harm our financial performance

We derive substantially all of our revenues from Global Markets activities. During 2008, the securities markets endured unprecedented market conditions with high volatility, dramatic credit tightening and increased counterparty risk. These difficult conditions have continued into 2009, requiring us to continue to adapt to our clients needs amidst a changing landscape and competition. We face direct competition in our Global Markets business primarily from global, national and regional broker-dealers, and also alternative trading systems, crossing networks, ECNs and dark liquidity pools. Competition is primarily on the basis of our execution standards (including price, liquidity, speed and other client-defined measures), client relationships, reputation, market structure, product and service offerings, and technology. A number of our Global Markets competitors have greater financial, technical, marketing and other resources than we do. Some of our competitors offer a wider range of services and financial products than we do and have greater name recognition and a more extensive

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client base. These competitors may be able to respond more quickly than we do to new or evolving opportunities and technologies, market changes, and client requirements and may be able to undertake more extensive promotional activities and offer more attractive terms to clients. Moreover, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties or may consolidate to enhance their services and products. It is possible that new competitors, or alliances among competitors, may also emerge and they may acquire significant market share.

As a result of the above, there can be no assurance that we will be able to compete effectively with current or future competitors, which could have a material adverse effect on our business, financial condition and operating results.

We could lose significant sources of revenues if we lose any of our significant clients

At times, a limited number of Global Markets clients have accounted for a significant portion of our order flow, revenues and profitability, and we expect a large portion of the future demand for, and profitability from, our Global Markets trade execution services to remain concentrated within a limited number of clients. None of our clients is contractually obligated to utilize us for trade execution services and, accordingly, these clients may direct their trade execution activities to other execution providers or market centers at any time. Some of these clients have purchased market-makers and specialist firms to internalize order flow. There can be no assurance that we will be able to retain these major clients or that such clients will maintain or increase their demand for our trade execution services. The loss, or a significant reduction, of demand for our services from any of these clients could have a material adverse effect on our business, financial condition and operating results.

The increased risk of defaults by counterparties may adversely affect our results of operations

During 2008, the market experienced unprecedented levels of defaults and uncertainty among participants in the financial services industry, with the failure of some firms and the bailout of other distressed institutions. We are at risk if issuers whose securities or other instruments we hold, customers, trading counterparties, counterparties under derivative contracts, clearing agents, exchanges, clearing houses or other financial intermediaries or guarantors default on their obligations to us due to bankruptcy, insolvency, lack of liquidity, adverse economic conditions, operational failure, fraud or other reasons. Such defaults could have a material adverse effect on our results of operations, financial condition and cash flows.

We conduct the majority of our trade executions as principal with broker-dealers, financial services firms and institutional counterparties located in the United States and abroad. We clear the majority of our trade executions through unaffiliated clearing brokers. Under the terms of the agreements between us and our clearing brokers, the clearing brokers have the right to charge us for losses that result from a counterparty s failure to fulfill its contractual obligations. No assurance can be given that any such counterparty will not default on its obligations, which default could have a material adverse effect on our business, financial condition and operating results. At any time, a substantial portion of our assets are held at one or more clearing brokers and, accordingly, we are subject to credit risk with respect to such clearing brokers. One firm clears the majority of our trades and holds the majority of our assets within our Global Markets segment. Consequently, we are reliant on the ability of our clearing brokers to adequately discharge their obligations on a timely basis. We are also dependent on the solvency of such clearing brokers. Any failure by the clearing brokers to adequately discharge their obligations on a timely basis, the insolvency of a clearing broker, or any event adversely affecting the clearing brokers could have a material adverse effect on our business, financial condition and operating results.

We may not be able to keep up with rapid technological and other changes

The markets in which we compete are characterized by rapidly changing technology, evolving industry standards, frequent new product and service announcements, introductions and enhancements, and changing client demands. If we are not able to keep up with these rapid changes on a timely and cost-effective basis, we may be at a competitive disadvantage. The widespread adoption of new internet, networking or telecommunications technologies or other technological changes could require us to incur substantial expenditures to modify or adapt our services or infrastructure. Any failure by us to anticipate or respond adequately to technological advancements, client requirements or changing industry standards, or any delays in the development, introduction or availability of new services, products or enhancements, could have a material adverse effect on our business, financial condition and operating results.

Capacity constraints, systems failures and delays could harm our business

Our business activities are heavily dependent on the integrity and performance of the computer and communications systems supporting them and the services of certain third parties. Our systems and operations are vulnerable to damage or interruption from human error, natural disasters, power loss, computer viruses, intentional acts of vandalism, terrorism and other similar events. Extraordinary trading volumes or other events could cause our computer systems to operate at an unacceptably low speed or even fail. While we have invested significant amounts of capital in the last few years to upgrade the capacity, reliability and scalability of our systems, there can be no assurance that our systems will be sufficient to handle such extraordinary trading volumes. Many of our systems are, and much of our infrastructure is, designed to accommodate additional growth without redesign or replacement; however, we may need to make significant investments in additional hardware and software to accommodate growth. Failure to make necessary expansions and upgrades to our systems and infrastructure could lead to failures and delays. Such failures and delays could cause substantial losses for our clients and could subject us to claims from our clients for losses, including litigation claiming fraud or negligence. In the past, high trading volume has caused significant delays in executing some trading orders, resulting in some clients orders being executed at prices they did not anticipate. From time to time, we have reimbursed our clients for losses incurred in connection with systems failures and delays.

Capacity constraints, systems failures and delays may occur again in the future and could cause, among other things, unanticipated disruptions in service to our clients, slower system response times resulting in transactions not being processed as quickly as our clients desire, decreased levels of client service and client satisfaction, and harm to our reputation. If any of these events were to occur, we could suffer a loss of clients, including our largest clients, or a reduction in the growth of our client base, increased operating expenses, financial losses, litigation or other client claims, and regulatory sanctions or additional regulatory burdens.

We have developed business continuity capabilities that can be utilized in the event of a disaster or disruption. Since the timing and impact of disasters and disruptions are unpredictable, we have to be flexible in responding to actual events as they occur. Significant business disruptions can vary in their scope. A disruption might only affect the Company, a building housing the Company, a business district in which the Company is located, a city in which the Company is located or an entire region. Within each of these areas, the severity of the disruption can also vary from minimal to severe. The Company s business continuity facilities are designed to allow us to substantially continue operations if we are prevented from accessing or utilizing our primary offices for an extended period of time. While the Company has employed significant effort to develop, implement and maintain reasonable business continuity plans, the Company cannot guarantee our systems will fully recover after a significant business disruption in a timely fashion. If we are prevented from using any of our current trading operations or any third party services, or if our business continuity operations do not work effectively, we may not have complete business continuity. This could have a material adverse effect on our business, financial condition and operating results.

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Regulatory and legal uncertainties could harm our business

The capital markets industry in the United States is subject to extensive oversight under federal, state and applicable international laws as well as SRO rules. Broker-dealers and financial services firms are subject to regulations concerning all aspects of their business, including trade practices, best execution practices, capital structure, record retention and the conduct of their officers, supervisors and registered employees. Our operations and profitability may be directly affected by, among other things, additional legislation or regulation; changes in rules promulgated by the SEC, CFTC, FSA, SFC, FINRA, NYSE, MSRB, NFA and other regulatory bodies or SROs; and changes in the interpretation or enforcement of existing laws, regulations and rules. Failure to comply with these laws, rules or regulations could result in, among other things, administrative or court proceedings, censure, fines, the issuance of cease-and-desist orders or injunctions, loss of membership, or the suspension or disqualification of the market participant, broker-dealer or FCM, and/or their officers, supervisors or registered employees. Our ability to comply with applicable laws, regulations and rules is largely dependent on our internal systems to ensure compliance, as well as our ability to attract and retain qualified compliance personnel. We are currently the subject of regulatory reviews and investigations that may result in disciplinary actions in the future due to alleged noncompliance.

Various regulatory and enforcement agencies have been reviewing regulatory reporting obligations and best execution and trading practices as they relate to the financial services and capital markets industries. These reviews could result in enforcement actions or new regulations which could adversely affect our operations.

The SEC, CFTC, FSA, SFC, FINRA, NYSE, MSRB, NFA and other regulatory bodies and SROs are constantly proposing, or enacting, new regulations for the marketplace. For example, FINRA enacted rules in November 2008 regarding the OTC Bulletin Board markets which require that all non-Nasdaq securities be subject to limit order protection. It is difficult to assess what the market structure implications will be from any such new regulations, but there could be significant technological and compliance costs associated with the obligations that derive from such new regulations.

Regulatory or legal actions or proceedings, changes in legislation or regulation, and changes in market customs and practices could have a material adverse effect on the Company s business, financial condition and operating results.

Our business is subject to substantial risk from litigation, regulatory investigations and potential liability under federal, state and international laws, rules and regulations

Many aspects of our business involve substantial risks of liability. We are exposed to liability under federal and state securities laws, other federal and state laws and court decisions, as well as rules and regulations promulgated by the SEC, CFTC, FSA, SFC, FINRA, NYSE, MSRB, NFA, Department of Labor and other U.S. and non-U.S. regulatory bodies and SROs. We are also subject to the risk of litigation. From time to time, we, and certain of our past and present officers, directors and employees, have been named as parties in legal actions, regulatory investigations and proceedings, arbitrations and administrative claims and have been subject to claims alleging the violation of such laws, rules and regulations, some of which have resulted in the payment of fines and settlements. Moreover, we may be required to indemnify past and present officers, directors and employees in regards to these matters. We are subject to several of these matters as further described in Legal Proceedings in Part I, Item 3 herein. Certain corporate events, such as a reduction in our workforce, could also result in additional litigation or arbitration.

As we intend to defend vigorously any such litigation or proceeding, we could incur significant legal expenses. An adverse resolution of any current or future lawsuits, legal or regulatory proceedings

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or claims against us could have a material adverse effect on the Company s business, financial condition and operating results.

RISKS RELATED TO ASSET MANAGEMENT BUSINESS

The failure to close the sale of the Deephaven business could adversely affect our business

On January 27, 2009, Deephaven entered into an agreement pursuant to which it will sell substantially all of its assets to Stark & Roth, Inc. (Stark) and Stark will assume certain limited liabilities of Deephaven (the Stark Sale). The closing of the Stark Sale is currently subject to a number of conditions including (i) approval of GMS Fund investors, (ii) the absence of any material adverse effect on the business of Deephaven, and (iii) other customary conditions, including the absence of any law or government order prohibiting the transaction. If Deephaven is unable to close the Stark Sale, it will have to explore other alternatives for the orderly exit from the Asset Management business which may result in increased costs. These efforts will be complicated by a number of factors including, without limitation: claims that may arise as a result of the termination of the Stark Sale; the public announcement of the proposed Stark Sale putting the investment community on notice that Deephaven intends to wind-down its business as promptly as practicable which could adversely affect Deephaven s ability to continue to manage the Deephaven Funds; the public announcement of the proposed Stark Sale may have eliminated other options which Deephaven might have had in respect of managing the Deephaven Funds going forward; the public announcement of the proposed Stark Sale has resulted, and is expected to continue to result, in the termination of employment of Deephaven personnel and such loss of personnel could adversely affect Deephaven s ability to continue to manage the Deephaven Funds; the public announcement of the proposed Stark Sale may adversely impact the Deephaven Funds financing, brokerage and counterparty relationships; and Deephaven personnel having devoted a substantial part of their business time to negotiating and completing the Stark Sale may have diverted their attention from other aspects of managing the Deephaven business. If the Stark Sale is not consummated, there can be no assurance that an alternative can be found or that the financial terms or outcome of such alternatives will not be less favorable to Deephaven, Deephaven investors and us than those that would have resulted from the Stark Sale. If we are unable to exit the Asset Management business in an orderly fashion, it could have a material and adverse effect on our business, financial condition and operating results.

Even if the Stark Sale is consummated, Deephaven may still face liabilities and expects to incur significant costs relating to its business, the Stark Sale and the wind-down of its business

While the consummation of the Stark Sale is intended to facilitate Deephaven s orderly exit from the Asset Management business, Deephaven will still be subject to potential liabilities relating to its historical business operations and the Stark Sale. The stated purchase price in the Stark Sale is subject to reduction and offset in certain circumstances, and those reductions are expected to be significant. Under the terms of the Stark Sale, Stark is assuming few, if any, potential historical liabilities of Deephaven which means that Deephaven will continue to be responsible for any such liabilities. In addition, Deephaven and, in certain instances, the Company are responsible to indemnify Stark against certain potential liabilities and for breaches of representations, warranties and covenants under the sale agreement. Upon closing, Deephaven will continue to have oversight responsibility for the reduction to cash of the Deephaven Funds whose investors approve Stark, as a sub-advisor to Deephaven, and elect to reduce their investments to cash. Moreover, to the extent that investors in any other Deephaven Fund(s) (other than the GMS Fund) do not approve such an arrangement, Deephaven, either by itself or through a third-party, will have the obligation to reduce such Deephaven Fund(s) to cash and return such cash to investors. Following the completion of the Stark Sale, Deephaven will have limited personnel and assets to fulfill any potential obligations. Deephaven may also be subject to claims by, and liabilities to, various stakeholders or other parties, including Deephaven Fund investors, counterparties, regulatory authorities, owners and employees, resulting from the conduct of its business prior to the Stark Sale, the consummation of the Stark Sale and the terms offered to Deephaven Fund investors thereunder, and/or the wind-down of Deephaven s business including the terminations of employment of Deephaven personnel. In addition to these potential claims and liabilities, as announced in a Form 8-K filed on February 26, 2009, Deephaven expects that it will incur significant costs associated with the wind-down of its operations, including severance, deferred benefits, retention and other employee benefits, lease and contract termination costs, asset writedowns and professional fees and other associated costs. Any such liabilities and costs may be material and could have a material and adverse effect on Deephaven s and our financial condition and operating results.

The reduction to cash of the Deephaven Fund portfolios may result in further losses to Fund investors and resulting claims

Whether or not the Stark Sale closes, Deephaven currently intends to promptly reduce to cash a significant portion, if not all, of the assets under management in the various Deephaven Funds. If the Stark Sale closes, Stark would serve as sub-advisor to Deephaven to reduce to cash those Deephaven Funds whose investors approve such outcome. If the Stark Sale does not close, Deephaven will need to retain a third party to reduce the Deephaven Funds portfolios to cash. The attempt to reduce such investments to cash in a prompt manner may result in further losses to investors, including to the Company s corporate investment in the Deephaven Funds. These losses could be exacerbated if trading counterparties take advantage of their knowledge that Deephaven may be reducing positions in the market. Any such losses may result in claims by Deephaven Fund investors against Deephaven or the Company, whether or not the Stark Sale closes.

The wind-down of our Asset Management business could cause losses to the Company and could adversely affect our business and financial condition and results

Whether or not the Stark Sale closes, the Company intends to seek a prompt exit from the Asset Management business. Because there are expected to be liabilities at Deephaven in connection with its historical activities and such wind-down, the Company may incur material losses associated with the Deephaven business. Such potential losses are in addition to any potential losses on the Company s corporate investment in the Deephaven Funds. In addition, because the Company is the 51% owner of Deephaven Holdings, claims may be made against the Company relating to the Deephaven business, the Stark Sale and/or the wind-down of the business, including if Deephaven is unable to satisfy certain liabilities. There can be no assurance that any such potential losses or claims will not have a material adverse effect on our business, reputation, financial condition or results of operations.

Trading strategies within our Asset Management segment expose the business to significant risk

As of December 31, 2008, approximately 61% of the Deephaven Funds assets under management were in the GMS Fund. The investment philosophy for the GMS Fund is to seek to produce returns for its investors using various investment strategies focusing on delivering attractive risk-adjusted rates of return. The performance of the GMS Fund is intended to be substantially non-correlated with the general debt and equity markets, as well as with a number of other non-traditional investment strategies. Within the GMS Fund, Deephaven generally employs a variety of investment strategies, including volatility-driven, fundamental equity, event-driven, credit-driven and global relative value macro/fixed income strategies among others. The strategies employed by our Asset Management business could result in substantial risk of loss both to investors and to the Company s corporate investment in the Deephaven Funds. As the Asset Management business employs leverage as an integral part of its various strategies, the risk of loss and the volatility of the underlying Deephaven Funds portfolios are increased. There can be no assurance that we will be able to manage such risk successfully or that we will not experience significant losses from such activities which could have a material adverse effect on our business, financial condition and operating results.

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RISKS RELATED TO THE COMPANY

We have incurred substantial debt obligations under our Credit Agreement that could adversely affect our operations and financial condition

As of December 31, 2008, we have borrowed the maximum $140.0 million of indebtedness under our three-year credit facility (the Credit Agreement) we entered into in October 2007. The proceeds of the borrowings under our credit facility have been used to finance share repurchases, finance selective acquisitions and for general corporate purposes. Incurring substantial indebtedness may have adverse consequences on us, including increasing our vulnerability to general adverse economic and industry conditions; limiting our ability to compete with other less leveraged competitors and our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate; limiting our ability to borrow additional funds for working capital, capital expenditures, acquisitions, expansions and general corporate or other purposes; and exposing us to interest rate risk because the interest rate on borrowings under our credit facility is variable.

Moreover, our ability to repay or refinance our debt will depend on our successful financial and operating performance. In addition, the Credit Agreement contains customary representations, warranties, affirmative and negative covenants (including, among others, limitations on certain payments, investments and transactions) and events of defaults. The Credit Agreement also contains financial covenants tied to the maintenance of financial ratios and metrics. These obligations may limit certain activities of the Company, including, but not limited to, certain mergers, acquisitions or dispositions of assets, repurchases of shares and payment of dividends, in each case above certain threshold amounts as set forth in the Credit Agreement. Our ability to satisfy certain of these covenants can be affected by a number of factors, many of which are beyond our control, and there can be no assurances that we will be able to satisfy them.

We are highly dependent on key personnel

We are highly dependent on a limited number of key executives. Except for Thomas Joyce, our Chairman of the Board and Chief Executive Officer, who has an employment contract through December 2012, and the head of our institutional fixed income broker-dealer, no other key executive has an employment contract with the Company. Our success will be dependent to a large degree on our ability to retain the services of our existing key executives and to attract and retain additional qualified personnel in the future. Competition for such personnel is intense. The loss of the services of any of our key executives or the inability to identify, hire and retain necessary highly qualified executive management in the future could have a material adverse effect on our business, financial condition and operating results.

Our success also depends, in part, on the highly skilled, and often specialized, individuals we employ. Our ability to attract and retain management, sales, electronic and voice trading and technology professionals is important to our business strategy. The Company strives to provide high quality services that will allow it to establish and maintain long-term relationships with its clients. The Company s ability to do so depends, in large part, upon the individual employees who represent the Company in its dealings with such clients. There can be no assurance that the Company will not lose such professionals due to increased competition or other factors in the future. The loss of sales, trading or technology professionals, particularly senior professionals with broad industry expertise, could have a material adverse effect on the Company s business, financial condition and operating results.

Acquisitions, strategic investments and strategic relationships involve certain risks

Over the last several years, we have undertaken several strategic acquisitions, including the completed acquisitions of EdgeTrade and Knight Libertas. We intend to continue to pursue opportunistic strategic acquisitions of, or investments in, businesses and technologies. Acquisitions may entail numerous risks, including difficulties in assessing values for acquired businesses, intangible assets and technologies, difficulties in the assimilation of acquired operations and products, diversion of management s attention from other business concerns, assumption of unknown material liabilities of acquired companies, amortization of acquired intangible assets which could reduce future reported earnings, and potential loss of clients or key employees of acquired companies. We may not be able to integrate successfully any operations, personnel, services or products that we have acquired or may acquire in the future. Strategic investments may also entail some of the risks described above. If these investments are unsuccessful, we may need to incur charges against earnings. We have also established a number of strategic relationships. These relationships and others we may enter into in the future may be important to our business and growth prospects. We may not be able to maintain these relationships or develop new strategic alliances.

International expansion involves certain risks

The Company is expanding its international presence which may expose the Company to cultural, regulatory and governmental risks. The financial services industry in many foreign countries is heavily regulated, much like the U.S. The varying compliance requirements of these different regulatory jurisdictions and other factors may limit our ability to successfully conduct or expand our business internationally. Additionally, the expansion into international locations involves substantial operational and execution risk. We may not be able to manage these risks effectively.

Risks and uncertainties regarding the Company s stock repurchase program

As of December 31, 2008, the Company had $249.6 million remaining under its $1.0 billion stock repurchase program. The pursuit and completion of the Company s stock repurchase program is uncertain and subject to a variety of risks, including, without limitation, whether or not the Company will complete the stock repurchase program during any particular time frame or at all, whether the Company s cash flow from earnings and cash on hand will be sufficient to fund the stock repurchase program, and the effect of pursuing the program on the Company s balance sheet (including the potential use of cash on the Company s balance sheet and possible incurrence of debt to finance the program). In addition, the pursuit of the program is subject to the impact of market conditions, trading restrictions, legal requirements and alternative requirements for available cash. It is possible that pursuing the program will limit the ability of the Company to pursue other needs and opportunities that may arise, such as capital expenditures, acquisitions and other opportunities to grow our business.

The market price of our common stock could fluctuate significantly

Our Class A Common Stock, and the U.S. securities markets in general, have experienced significant price fluctuations in recent years. The price of our Class A Common Stock could decrease substantially. Since the market price of our Class A Common Stock tends to fluctuate significantly, we may become the subject of securities class action litigation which may result in substantial costs and a diversion of management s attention and resources. Our future quarterly operating results may not consistently meet the expectations of securities analysts or investors, which could have a material adverse effect on the market price of our Class A Common Stock.

Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

Our corporate headquarters are located in Jersey City, New Jersey. We lease approximately 266,000 square feet at 545 Washington Boulevard under a lease that expires in October 2021. We also collectively lease approximately 121,000 square feet for our other office locations in the U.S. and abroad.

In 2008, the Company recorded a net benefit of $1.3 million related to lease losses, primarily due to the adjustment of previously recognized lease losses with respect to our 545 Washington Boulevard property in Jersey City, N.J. The Company entered into two sub-lease agreements in 2007 for 21,171 square feet for which it had previously recorded a lease loss accrual. The lease loss accrual was adjusted based on the difference between the actual terms of the sub-leases and the assumptions used in the calculation of the lease loss accrual. At December 31, 2008, we have approximately 50,000 square feet of unoccupied space remaining in Jersey City and the Company has engaged a real estate broker to sub-lease this excess space. The balance of the lease loss accrual from the unoccupied space was derived from assumptions and estimates based on lease terms of an anticipated sub-lease agreement, which assumed a sub-lease would commence at the beginning of 2010, anticipated market prices along the Jersey City waterfront and estimated up-front costs, including broker fees and build-out allowances. We continually monitor the market and space to assess the reasonableness of our applicable assumptions.

Item 3. *Legal Proceedings*

From time to time, we and certain of our past and present officers, directors and employees have been named as parties to legal actions, arbitrations, administrative claims and regulatory reviews and investigations arising in connection with the conduct of our businesses. We are subject to several of these matters at the present time. Although there can be no assurances, at this time the Company believes, based on information currently available, that the outcome of each of the matters will not have a material adverse effect on the consolidated financial condition of the Company, although they might be material to operating results for any particular period, depending, in part, upon operating results for that period.

Legal

Eagletech Communications Inc. et al. v. Citigroup, Inc. et al. In this case, which was initially filed in the Circuit Court, Broward County, Florida, the plaintiffs generally allege that the Company and approximately 20 securities firms participated in a scheme to manipulate Eagletech stock using methods such as naked short selling. Pursuant to an Order dated June 25, 2008, the Court dismissed with prejudice four of plaintiffs federal claims against Knight and remanded plaintiffs remaining claims to the Clerk of the Circuit Court of the Seventeenth Judicial Circuit in and for Broward County, Florida. On or about July 25, 2008, plaintiffs filed a Notice of Appeal. On February 17, 2009, plaintiffs voluntary request to dismiss the Notice of Appeal was granted. The plaintiffs remaining claims are proceeding in state court.

Last Atlantis Capital LLC et al. v. Chicago Board Options Exchange, Inc. et al. In January 2004, thirty-five securities firms, including the Company and its former operating subsidiary, Knight Financial Products LLC (collectively the market-maker defendants), as well as four options exchanges, were named in a complaint filed in the United States District Court for the Northern District of Illinois. The plaintiffs in the action allegedly submitted orders to buy and sell options on the four named options exchanges, and the market-maker defendants were prospective and/or actual counterparties to those orders. The plaintiffs allege that during the period beginning on September 11, 2000 the market-maker defendants, among other things, failed to provide a competitive and orderly market for the purchase and sale of the options and issued false and misleading price quotations that deceived the plaintiffs. The plaintiffs allege that this conduct violated certain sections of the Sherman and Clayton Acts, the federal securities laws and Illinois state law, and also should result in common law liability. The plaintiffs requested unspecified monetary damages and injunctive relief. On or about March 30, 2005, the court dismissed the complaint with prejudice and entered judgment against the plaintiffs. Plaintiffs moved to vacate the judgment and for reconsideration of the dismissal. The court then permitted plaintiffs to file an amended complaint and to add additional parties as plaintiff. Defendants moved to dismiss the amended complaint. In September 2006, the District Court dismissed, with prejudice, the

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federal causes of action in the consolidated complaint, and dismissed without prejudice, for lack of jurisdiction, the state law causes of action in the consolidated complaint. Judgment was entered by the court in September 2006. Thereafter, plaintiffs filed post-trial motions seeking reconsideration of the court s decision and requesting the court to vacate its judgment. On March 23, 2007, the court granted plaintiffs motion for reconsideration in part, by allowing them to file an amended complaint against the market-maker defendants, but not against the options exchanges. The amended complaint, filed April 5, 2007, alleges federal claims based on the Securities Exchange Act of 1934 and state law claims based on Illinois statutory and common law. On May 25, 2007, the Company and Knight Financial Products LLC answered the amended complaint, denying liability. On June 13, 2007, the court established a discovery schedule. On November 27, 2007, the defendants moved for reconsideration of the March 23, 2007 order permitting plaintiffs to file the amended complaint, and for dismissal of the amended complaint. On February 7, 2008, the court reconsidered its March 23, 2007 order and dismissed certain defendants but not others. Knight Financial Products LLC was not among the dismissed defendants, and remains in the case. Discovery is proceeding and the Company is defending this action vigorously.

Regulatory

We own subsidiaries including regulated entities that are subject to extensive oversight under federal, state and applicable international laws as well as SRO rules. Changes in market structure and the need to remain competitive require constant changes to our systems and order handling procedures. We make these changes while continuously endeavoring to comply with many complex laws and rules. Compliance, surveillance and trading issues common in the securities industry are monitored by, reported to, and/or reviewed in the ordinary course of business by our primary regulators, the SEC, CFTC, FSA, SFC, FINRA, NYSE, MSRB, and NFA. As a major order flow execution destination, we are named from time to time in, or are asked to respond to a number of regulatory matters brought by U.S. regulators, foreign regulators and SROs that arise from our trading activity. The Company is currently the subject of various regulatory reviews and investigations. In some instances, these matters may rise to a SEC, CFTC, FSA, SFC, FINRA, NYSE, MSRB, NFA, other SRO disciplinary action and/or civil or administrative action.

In March 2005, NASD (now known as FINRA) announced that it had charged Kenneth Pasternak, former CEO of Knight Securities, L.P. (KSLP) (now known as KEM), and John Leighton, former head of KSLP s institutional sales desk, in an administrative complaint alleging supervisory violations in connection with fraudulent sales to institutional customers in 1999 and 2000. Pursuant to a decision dated April 11, 2007, the majority of a NASD Hearing Panel found that Pasternak and Leighton failed to supervise KSLP s Institutional Sales Department reasonably during the period of January 1999 to September 2000 in violation of NASD rules. Pasternak and Leighton were each fined $100,000. Pasternak was suspended from acting in all supervisory capacities for two years and Leighton was barred from acting in all supervisory capacities. In May 2007, Pasternak and Leighton each filed a Notice of Appeal from the NASD Hearing Panel s decision and the NASD filed a Notice of Cross-Appeal from the NASD Hearing Panel s decision. This matter was heard on July 28, 2008 by a sub-committee of FINRA s National Adjudicatory Council (the NAC), and we expect the NAC will issue its decision before the end of 2009.

In August 2005, the SEC announced that it had filed a civil fraud action in the United States District Court for the District of New Jersey against Kenneth Pasternak and John Leighton. Pursuant to an Order filed on June 24, 2008, the Court ordered that judgment be entered in favor of Pasternak and Leighton and against the SEC. The SEC s time to appeal this ruling has expired.

In 2006, the Company received a request from the staff of the SEC for voluntary production of certain documentation related to options activities of its former subsidiary, Knight Financial Products LLC, during the period of time that the subsidiary conducted the Derivative Markets business prior to its

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sale by the Company in December 2004. The Company believes this request is part of a broader review by the staff of the SEC regarding certain trading practices in the options industry during the period from 1999 to 2005. The Company responded to this request and is cooperating with the staff of the SEC and certain regional exchanges to resolve this matter. For further information regarding this matter, see Footnote 14 Discontinued Operations and Regulatory Charges and Related Matters, in Part II, Item 8 Financial Statements and Supplementary Data included in this document.

Other Matters

In addition to the matters described above, in the normal course of business, the Company has been named, from time to time, as a defendant or respondent in various legal actions, including arbitrations, class actions and other litigation arising in connection with its business activities. Certain of these legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. From time to time, Deephaven may be a plaintiff in suits filed in federal or state courts taken in support of activist or other investments made by one of the funds managed by Deephaven. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases in which claimants seek substantial or indeterminate damages, the Company cannot predict with certainty the eventual loss, or range of loss, or the range of potential recovery, related to such matters. The Company is contesting liability and/or the amount of damages in each pending matter.

Item 4. ***Submission of Matters to a Vote of Security Holders***

None.

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PART II

Item 5. *Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*

Our Class A Common Stock is listed on the Nasdaq Global Select Market under the symbol NITE . Public trading of our Class A Common Stock commenced on July 8, 1998. The following table sets forth, for the past two years, the high and low quarterly closing sales price per share of the Class A Common Stock as reported by the Nasdaq Global Select Market:

2008	High	Low
First Quarter	$ 17.76	$ 12.52
Second Quarter	19.34	15.00
Third Quarter	18.02	13.72
Fourth Quarter	16.59	11.84
2007		
First Quarter	21.47	15.13
Second Quarter	18.26	15.85
Third Quarter	16.80	11.65
Fourth Quarter	14.49	12.24

The closing sale price of our Class A Common Stock as reported by the Nasdaq Global Select Market on February 26, 2009, was $17.36 per share. As of that date there were approximately 416 holders of record of our Class A Common Stock based on information provided by our transfer agent. The number of stockholders does not reflect the actual number of individual or institutional stockholders that hold our stock because certain stock is held in the name of nominees. Based on information made available to us by our transfer agent, there are approximately 36,500 beneficial holders of our Class A Common Stock. Restricted stock awards are included in the calculation of holders of record while restricted stock unit awards are not included.

We have never declared or paid a cash dividend on our Class A Common Stock. The payment of cash dividends is within the discretion of our Board of Directors and will depend on many other factors, including, but not limited to, our results of operations, financial condition, capital requirements, restrictions imposed by financing arrangements, general business conditions and legal requirements.

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Comparative Stock Performance Graph

The graph below compares the total cumulative return of the Knight Class A Common Stock from December 31, 2003 through December 31, 2008, to the Standard & Poor s 500 Index and the SNL Broker/Dealer Index. The graph assumes that dividends were reinvested and is based on an investment of $100 on December 31, 2003.

			Period Ending			
Index	**12/31/03**	**12/31/04**	**12/31/05**	**12/31/06**	**12/31/07**	**12/31/08**
Knight Capital Group, Inc.	100.00	74.69	67.46	130.76	98.23	110.16
SNL Broker/Dealer Index	100.00	106.77	128.86	182.19	163.61	54.90
S&P 500 Index	100.00	110.88	116.33	134.70	142.10	89.53

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The following table contains information about our purchases of Class A Common Stock during the fourth quarter of 2008 (in thousands, except per share amounts):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1)	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs
October 1, 2008 - October 31, 2008				
Common stock repurchases				$ 254,254
Employee transactions(2)	21			
Total	21	$ 13.69		
November 1, 2008 - November 30, 2008				
Common stock repurchases	301		301	$ 249,616
Employee transactions(2)	5			
Total	306	$ 15.39	301	
December 1, 2008 - December 31, 2008				
Common stock repurchases				$ 249,616
Employee transactions(2)	154			
Total	154	$ 15.42		
Total				
Common stock repurchases	301		301	
Employee transactions(2)	180			
Total	481	$ 15.33	301	

Totals may not add due to rounding.

(1) On April 4, 2002, the Company s Board of Directors announced the authorization of a stock repurchase program, which allowed for the purchase of Class A Common Stock up to a total amount of $35 million. This repurchase program was increased by an aggregate of $965 million to a total of $1 billion by resolutions of the Company s Board of Directors adopted on July 16, 2002, May 12, 2003, April 20, 2004, August 8, 2004, April 19, 2005, October 18, 2005, April 18, 2006 and July 17, 2007. The Company may repurchase shares from time to time in the open market, accelerated stock buyback programs, tender offers, privately negotiated transactions or by other means. Repurchases may also be made under a Rule 10b5-1 plan. The timing and amount of repurchase transactions will be determined by the Company s management based on its evaluation of market conditions, share price, legal requirements and other factors. The program may be suspended, modified or discontinued at any time without prior notice. The Company cautions that there are no assurances that any further repurchases will actually occur. The repurchase program has no set expiration or termination date.

(2) Represents shares of common stock withheld in satisfaction of tax withholding obligations upon vesting of restricted stock.

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Equity Compensation Plan Information

The following table sets forth certain information as of December 31, 2008, regarding the Company s equity compensation plans for stock-based awards.

Plan Category	**Number of securities to be issued upon exercise of outstanding options, warrants and rights**	**Weighted-average exercise price of outstanding options, warrants and rights**	**Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column(a)(1)**
	(In thousands, except weighted-average exercise price)		
	(a)	**(b)**	**(c)**
Equity compensation plans approved by security holders	4,748	$ 13.32	9,838
Equity compensation plans not approved by securityholders			
Total	4,748	$ 13.32	9,838

(1) Securities remaining available for future issuance under equity compensation plans approved by security holders include 1.6 million shares under the Knight Capital Group, Inc. 1998 Long Term Incentive Plan, 5.1 million shares under the Knight Capital Group, Inc. 2003 Equity Incentive Plan and 3.1 million shares under the Knight Capital Group, Inc. 2006 Equity Incentive Plan. These plans are discussed further in Footnote 11, Stock-Based Compensation to the Company s Consolidated Financial Statements included in Part II, Item 8 Financial Statements and Supplementary Data.

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Item 6. ***Selected Financial Data***

The following selected consolidated financial data are qualified by the Consolidated Financial Statements of Knight Capital Group, Inc. and the Notes thereto included elsewhere in this document. The following should be read in conjunction with the Consolidated Financial Statements and the discussion under Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this document. The Consolidated Statements of Operations Data for 2008, 2007 and 2006 and the Consolidated Statements of Financial Condition Data at December 31, 2008 and 2007 have been derived from our audited Consolidated Financial Statements included elsewhere in this document. The Consolidated Statements of Operations Data for 2005 and 2004 and the Consolidated Statements of Financial Condition Data at December 31, 2006, 2005 and 2004 are derived from Consolidated Financial Statements not included in this document.

	For the years ended December 31,				
	2008	2007	2006	2005	2004
Consolidated Statements of Operations Data(1):	(In thousands, except per share amounts)				
Revenues					
Commissions and fees	$ 538,875	$ 435,966	$ 393,226	$ 276,117	$ 253,298
Net trading revenue	446,707	286,199	243,761	165,614	250,993
Asset management fees	46,344	116,777	213,888	89,227	77,658
Interest, net	7,579	17,560	16,364	9,199	4,986
Investment (loss) income and other, net	(6,607)	28,718	72,219	74,541	16,441
Total revenues	1,032,898	885,220	939,458	614,698	603,376
Transaction-based expenses					
Execution and clearance fees	107,402	120,261	106,908	99,427	111,788
Soft dollar expense	60,749	49,838	53,369	43,566	37,405
Payments for order flow and ECN rebates	43,639	54,564	42,191	21,220	36,632
Total transaction-based expenses	211,790	224,663	202,468	164,213	185,825
Revenues, net of transaction-based expenses	821,108	660,557	736,990	450,485	417,551
Other direct expenses					
Employee compensation and benefits	370,778	346,476	352,353	229,460	244,550
Communications and data processing	47,461	36,956	33,120	32,513	28,896
Depreciation and amortization	27,494	22,075	20,641	16,355	14,248
Occupancy and equipment rentals	20,494	14,083	13,536	13,554	16,852
Professional fees	19,483	19,360	20,568	19,555	14,915
Business development	18,221	15,997	14,343	6,419	8,269
Interest expense	5,014	182	337	180	339
Writedown of assets and lease loss accrual, net	1,236	(2,470)	8,480	10,055	3,810
Regulatory charges and related matters				5,703	79,342
Other	12,617	15,418	17,101	11,541	6,844
Total other direct expenses	522,798	468,077	480,479	345,335	418,065
Other Income					
Non-operating gain from subsidiary stock issuance	15,947	8,757			
Income (loss) from continuing operations before income taxes and minority interest	314,257	201,237	256,511	105,150	(514)
Income tax expense	130,193	77,560	98,165	38,912	9,258
Income (loss) from continuing operations before minority interest	$ 184,064	$ 123,677	$ 158,346	$ 66,238	$ (9,772)
Minority interest expense	6,153				

Income (loss) from continuing operations	$ 177,911	$ 123,677	$ 158,346	$ 66,238	$ (9,772)
(Loss) income from discontinued operations, net of tax	$	$ (1,437)	$	$ 122	$ 100,904
Net income	$ 177,911	$ 122,240	$ 158,346	$ 66,360	$ 91,132
Basic earnings per share from continuing operations	$ 2.01	$ 1.27	$ 1.56	$ 0.64	$ (0.09)
Diluted earnings per share from continuing operations	$ 1.94	$ 1.23	$ 1.49	$ 0.62	$ (0.08)
Basic earnings per share from discontinued operations	$	$ (0.01)	$	$	$ 0.90
Diluted earnings per share from discontinued operations	$	$ (0.01)	$	$	$ 0.86
Basic earnings per share	$ 2.01	$ 1.26	$ 1.56	$ 0.64	$ 0.81
Diluted earnings per share	$ 1.94	$ 1.21	$ 1.49	$ 0.62	$ 0.77
Shares used in computation of basic earnings per share	88,407	97,050	101,420	103,456	112,423
Shares used in computation of diluted earnings per share	91,760	100,796	106,243	106,882	117,636

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	December 31, 2008	2007	2006	2005	2004
Consolidated Statements of Financial Condition Data:					
Cash and cash equivalents	$ 440,621	$ 222,435	$ 214,760	$ 230,591	$ 445,539
Securities owned, held at clearing brokers, at fair value	476,111	412,565	711,775	380,367	254,473
Investment in Deephaven sponsored funds	47,152	83,732	187,573	281,657	215,330
Total assets	2,014,575	1,755,813	2,028,215	1,416,016	1,394,020
Securities sold, not yet purchased, at fair value	385,003	335,280	693,071	345,457	221,421
Long term debt	140,000	70,000			
Total stockholders equity	1,027,358	885,378	962,487	823,448	851,202

(1) - Certain prior year amounts have been reclassified to conform to current year presentation.

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Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Executive Overview

We are a leading financial services firm that provides electronic and voice access to the capital markets across multiple asset classes for buy-side, sell-side and corporate clients. We also have provided asset management services for institutional and private clients through our Asset Management segment, which we are in the process of preparing to exit. We continually apply knowledge and innovation to the trade execution process to build lasting client partnerships through consistent performance and superior client service. We have three operating segments, Global Markets, Asset Management and Corporate.

Global Markets Our Global Markets segment provides market access and trade execution services in nearly every U.S. equity security and a large number of international securities, fixed income, foreign exchange, futures and options. Our approach to trading combines deep liquidity with robust trading technology and capital facilitation, when necessary, to deliver high quality trade executions consistent with client-defined measures.

Asset Management Our Asset Management segment consists of our 51% ownership of Deephaven Capital Management Holdings LLC (Deephaven Holdings), the parent company of Deephaven Capital Management LLC and its subsidiaries (collectively, Deephaven), a global, multi-strategy alternative investment manager. Assets under management were $2.0 billion as of December 31, 2008, down from $3.9 billion of assets under management as of December 31, 2007.

Due to unprecedented market conditions, pending redemptions and industry-wide changes in margin and finance requirements, and after evaluation of a number of strategic options, the Company concluded that it was in the best interests of investors in the Deephaven Funds and the Company s shareholders to exit our Asset Management segment. For information regarding our plan to exit from our Asset Management segment, refer to the Deephaven and Subsequent Events sections within this Management s Discussions and Analysis of Financial Condition and Results of Operations (MD&A).

Corporate Our Corporate segment includes investment income earned on strategic investments and our corporate investment as a limited partner or non-managing member in funds managed by the Asset Management segment (the Deephaven Funds) and all corporate overhead expenses. Corporate overhead expenses primarily consist of compensation for certain senior executives and other individuals employed at the corporate holding company, legal and other professional expenses related to corporate matters, directors fees, investor and public relations expenses and directors and officers insurance.

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The following table sets forth: (i) Revenues, (ii) Expenses, (iii) Minority interest expense, (iv) Other income and (v) Pre-tax earnings (loss) after minority interest expense of our segments and on a consolidated basis (in millions):

	For the years ended December 31, 2008	2007	2006
Global Markets			
Revenues	$ 998.5	$ 739.9	$ 657.6
Expenses	641.1	559.6	507.3
Pre-tax earnings	357.5	180.4	150.3
Asset Management			
Revenues	33.3	118.2	214.9
Expenses	52.6	101.7	140.1
Pre-tax (loss) earnings	(19.4)	16.5	74.8
Minority interest expense	6.2		
Pre-tax (loss) earnings after minority interest expense	(25.5)	16.5	74.8
Corporate			
Revenues	1.1	27.1	66.9
Expenses	40.9	31.5	35.5
Other income	15.9	8.8	
Pre-tax (loss) earnings	(23.8)	4.3	31.4
Consolidated			
Revenues	1,032.9	885.2	939.5
Expenses	734.6	692.7	682.9
Other income	15.9	8.8	
Pre-tax earnings	314.3	201.2	256.5
Minority interest expense	6.2		
Pre-tax earnings after minority interest expense	$ 308.1	$ 201.2	$ 256.5

* Totals may not add due to rounding.

Consolidated Revenues in 2008 increased $147.7 million, or 16.7% from 2007, consolidated Expenses increased $41.8 million or 6.0% from 2007 and Other income increased $7.2 million, or 82.1% from 2007. Overall, Consolidated Pre-tax earnings after minority interest expense in 2008 increased $106.9 million, or 53.1% from 2007.

The changes in our Pre-tax earnings after minority interest expense by segment from 2007 to 2008 are summarized as follows:

Global Markets Our Pre-tax earnings from Global Markets increased in 2008 by $177.1 million, or 98.2%, from 2007. The increase is primarily due to higher average daily U.S. equity dollar value traded, greater trade volumes and improved trading performance and margins.

Asset Management Our Pre-tax results after minority interest expense from Asset Management decreased in 2008 by $42.0 million from the results in 2007. The decrease is primarily due to lower incentive allocation fees as a result of significantly lower fund returns and lower management fees as a result of a decrease in assets under management, offset in part by a decrease in profitability-based bonuses. Asset Management revenues in 2008 were also adversely impacted by the announced closing of the Event Fund, as described further under the headings Deephaven and Subsequent Events in this MD&A.

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Corporate Our Pre-tax results from our Corporate segment in 2008 decreased by $28.2 million from 2007, primarily due to losses on our corporate investment as a limited partner or non-managing member in the Deephaven Funds offset, in part by an increase of $7.2 million in pre-tax gains in Other income from the additional partial sale of our equity interest in Direct Edge during 2008.

Certain Factors Affecting Results of Operations

We may experience significant variation in our future results of operations. These fluctuations may result from numerous factors, many of which are outside of our control. These factors include, among other things, introductions of or enhancements to trade execution services by us or our competitors; the value of our securities positions and other instruments and our ability to manage the risks attendant thereto; the volume of our trade execution activities; the dollar value of securities traded; the composition of our order flow; volatility in the securities markets; our market share with institutional and broker-dealer clients; the performance and size of, and volatility in, our quantitative market-making and program trading portfolios; the performance of our high velocity algorithmic trading models; the performance of our international operations and cost associated with our international expansion; our ability to manage personnel, overhead and other expenses, including our occupancy expenses under our office leases and expenses and charges relating to legal and regulatory proceedings; the strength of our client relationships; changes in payments for order flow and clearing, execution and regulatory transaction costs; the level of assets under management and fund returns; performance of the asset management investment strategies; the addition or loss of executive management, sales, electronic and voice trading, technology and asset management professionals; legislative, legal and regulatory changes; legal and regulatory matters; geopolitical risk; the amount and timing of capital expenditures, acquisitions and divestitures; the integration, performance and operation of acquired businesses; the incurrence of costs associated with acquisitions and dispositions; investor sentiment; technological changes and events; seasonality; competition; and market and economic conditions.

Such factors may also have an impact on our ability to achieve our strategic objectives, including, without limitation, increases in our market share, growth and profitability in our Global Markets segment. If demand for our services declines due to any of the above factors, and we are unable to adjust our cost structure on a timely basis, our operating results could be materially and adversely affected. As a result of the foregoing factors, period-to-period comparisons of our revenues and operating results are not necessarily meaningful and such comparisons cannot be relied upon as indicators of future performance. There also can be no assurance that we will be able to continue the rates of revenue growth that we have experienced in the past or that we will be able to improve our operating results.

Trends

Global Economic Trends

Our businesses are affected by many factors in the global financial markets and worldwide economic conditions. These factors include the growth level of gross domestic product in the U.S., Europe and Asia, and the existence of transparent, efficient and liquid equity markets and level of trading volumes.

Economic growth continued to slow during 2008, with weakness becoming more broadly based across global economies in the second half of 2008. The U.S. economy entered a recession in the beginning of 2008 which intensified as the year progressed. Much of the slowdown was attributable to weakness in credit markets brought on by contraction in the housing market and the associated increase in mortgage defaults. Liquidity and credit concerns were further exacerbated with the

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changing landscape of the U.S. financial services industry. Global financial markets continued to experience substantially increased levels of volatility due to concerns about the outlook for global growth, inflation, declining asset values, and credit markets continued to experience illiquidity and wider credit spreads.

Trends Affecting Our Company

We believe that our businesses are affected by the aforementioned global economic trends as well as more specific trends. Some of the specific trends that impact our operations, financial condition and results of operations are:

Broker-dealer clients continue to focus on statistics measuring the quality of equity executions (including speed of execution and price improvement). In an effort to improve the quality of their executions as well as increase efficiencies, market-makers have increased the level of automation within their operations. Over the past several years, the greater focus on execution quality has resulted in greater competition in the marketplace, which, along with market structure changes and market conditions, has negatively impacted the revenue capture metrics of the Company and other market-making firms.

Equity transaction volumes executed by broker-dealers have fluctuated over the past few years due to retail investor sentiment, market conditions and a variety of other factors, resulting in a shift of product mix. Equity transaction volumes may not be sustainable and are not predictable.

There has been consolidation among market centers over the past several years, and several regional exchanges have entered into joint ventures with broker-dealers to create their own alternative trading systems (i.e., ECNs) and compete within the OTC and listed trading venues. In addition, there are many new entrants into the market, including Alternative Trading Systems (ATSs) and dark liquidity pools. Further, many broker-dealers are offering their own internal crossing networks. These factors continue to create further fragmentation in the marketplace.

Market structure changes, competition and market conditions have triggered an industry shift toward market-makers charging explicit commissions or commission equivalents to institutional clients for executions in OTC securities. For the majority of our institutional client orders, we charge explicit fees in the form of commissions or commission equivalents. Institutional commission rates have fallen in the past few years due to competitive forces and increased electronic trading, and may continue to fall in the future.

Market structure changes, competition and technology advancements have also led to a dramatic increase in electronic message traffic. These increases in message traffic place heavy strains on the technology resources, bandwidth and capacities of market participants.

Due to regulatory scrutiny over the past several years relating to equity sell-side research and the continued focus by investors on execution quality and overall transaction costs, more institutional clients allocate commissions to broker-dealers based on the quality of executions. In the past, a significant portion of institutional equity commissions were allocated to broker-dealers in exchange for either research or soft dollar and commission recapture programs.

There has been continued scrutiny of market-makers, specialists and hedge funds by the regulatory and legislative authorities. New legislation or modifications to existing regulations and rules could occur in the future and could materially impact the Company s revenues and profitability. For example, in November 2008, FINRA enacted rules regarding the OTC Bulletin Board markets which required that all non-Nasdaq securities be subject to limit order protection. Also, further amendments to Regulation SHO and related short sale rules, could make it much more difficult for market makers to sell securities short.

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There continues to be growth in electronic equity trading, as evidenced by increased volumes in direct market access platforms, algorithmic and program trading, and ECNs and dark liquidity pools. In addition, electronic trading continues to expand to other asset classes, including options, currencies and fixed income. The expansion of electronic trading may result in the growth of innovative electronic products and competition for order flow.

The macro-economic environment and market conditions have had an adverse impact on the profitability of alternative asset management business, such as Deephaven, resulting in volatile earnings and increased investor redemptions across the industry.

Income Statement Items

The following section briefly describes the key components of, and drivers to, our significant revenues and expenses.

Revenues

Our revenues consist principally of Commissions and fees and Net trading revenue from Global Markets and Asset management fees from Asset Management.

Revenues on transactions for which we charge explicit commissions or commission equivalents, which include the majority of our institutional client orders, are included within Commissions and fees. Commissions and fees are primarily affected by changes in our equity transaction volumes with institutional clients, changes in commission rates, the growth of Knight Direct, Hotspot, Knight BondPoint and Knight Libertas and the level of our soft dollar and commission recapture activity.

Trading profits and losses on principal transactions are included within Net trading revenue. These revenues are primarily affected by changes in the amount and mix of U.S. equity trade and share volumes, our revenue capture, dollar value of equities traded, our ability to derive trading gains by taking proprietary positions, changes in our execution standards, development of, and enhancement to, our quantitative market-making models, performance of our high velocity algorithmic trading models that interact with street flow, volatility in the