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February 28, 2003

Leonard J. Amoruso
Chief Legal and Compliance Officer
Knight Securities
Newport Tower
525 Washington Blvd
Jersey City, NJ 07310

Re: IM-4613 – Autoquoting Restrictions

Dear Mr. Amoruso:

This letter responds to your letter, dated February 21, 2003, and discussions with staff of The Nasdaq Stock Market, Inc. ("Nasdaq"), wherein you request a determination that the computer generated quoting ("CGQ") system to be employed by Knight Securities, L.P. ("KLSP") is consistent with NASD IM-4613, Nasdaq's policy prohibiting autoquoting and computer generated quoting, as those terms are defined in IM-4613.

We understand the facts to be as follows:

Knight Trading Group, Inc. ("Knight") is headquartered in Jersey City, New Jersey, and is the parent company of KSLP, Knight Capital Markets LLC, Knight Financial Products LLC, and Knight Securities International, Ltd. Knight and its subsidiaries make markets in equities listed on Nasdaq, the OTC Bulletin Board, the New York Stock Exchange, Nasdaq Europe, the London Stock Exchange, and in options on individual equities, equity indices, fixed income instruments and certain commodities in the United States and Europe. Knight also maintains an asset management business for institutional investors and high net worth individuals through its Deephaven Capital Management subsidiary. Knight's clients include the leading brokerage firms, and more than 1,300 broker-dealers and 1,000 institutional clients. Currently, the seven-year-old company employs more than 1,100 people worldwide.

Your letter states that KSLP's quotes are determined, *inter alia*, by individual market makers and *bona fide* market making interest. In addition, you state that KSLP has developed software designed to assist its traders to track the inside market by automatically placing quotes at the inside market or better. Thus, you assert, the effect of KSLP's CGQ system is to increase the liquidity available at the inside market or improve the inside market prices – both of which serve to further Nasdaq's ultimate goal of providing the deepest pool of liquidity available to the investing public at the best possible prices.

You also state that KSLP's system does not employ techniques that track changes to the inside market for the purpose of generating quotes to keep KSLP's prevailing quote away from the inside market. The KSLP software is specifically designed to result in KSLP participating at or better than the national best bid and offer.

Response

In general, NASD IM-4613(c) defines Computer Generated Quoting as "the practice of effecting, without a physical entry, a quote update that is not designed to keep a market maker's quote away from the Nasdaq and/or national best bid/best offer."¹ Computer Generated Quoting is prohibited because the high quote traffic produced by these systems can have deleterious effect on Nasdaq's systems. However, if properly controlled and monitored, these system can contribute to market quality. Accordingly, paragraph (c)(3) of IM-4613 provides Nasdaq the authority to permit market makers to utilize CGQ systems under certain conditions. In establishing the conditions, Nasdaq must consider the market maker's impact on Nasdaq's capacity, in conjunction with the overall impact on Nasdaq's capacity of currently authorized CGQ systems. In addition, these conditions must be designed to protect investors and the public interest.

Your letter states that KSLP's system is designed to assist its traders to track the inside market by automatically placing quotes at the inside price or better. You also state that KSLP's system does not employ techniques that track changes to the inside market for purposes of generating quotes to keep KSLP's quote away from the inside market. KSLP's software is specifically designed to result in KSLP participating at or better than the national best bid and offer. Based on these assertions, Nasdaq finds that the described system complies with the definition of the term "Computer Generated Quoting."

KSLP is permitted to use the CGQ system described above, subject to the following conditions:

¹ Excluded from the definition of Computer Generated Quoting are those autoquoting activities permitted under paragraph (b) of IM-4613.

- (1) KSLP will begin its CGQ activities starting with 500 Nasdaq securities that it will select in coordination with Nasdaq staff. KSLP will be permitted to expand the number of securities in which it employs its CGQ system only after consultation with Nasdaq. Expanding the number of securities must be consistent with Nasdaq's determination that there will be no material adverse impact on Nasdaq's system capacity;
- (2) KSLP will provide Nasdaq, at all times, a current list of securities (in an electronic, ASCII text format) for which it is employing, or intends to employ, its CGQ system;
- (3) KSLP will quote in a manner consistent with the autoquoting restriction set forth in Amendment 12 to the Nasdaq/UTP Plan, a copy of which is attached;
- (4) From 9:30 a.m. to 9:35 a.m. Eastern Time and from 3:55 p.m. to 4:00 p.m. Eastern Time, KSLP's quote updates will not exceed the following parameters:
 - 30 quotes per second in aggregate for all securities, measured over each 15 second interval; and
 - a maximum of three quote updates per second for each security;
- (5) From 9:35:01 a.m. to 3:54:59 p.m. Eastern Time, KSLP's quote updates will not exceed the following parameters:
 - 50 quotes per second in aggregate for all securities, measured over each 15 second interval; and
 - a maximum of three quote updates per second for each security;
- (7) KSLP must be able to suspend its CGQ system quickly upon request from Nasdaq; and
- (8) To demonstrate compliance with the parameters above, KSLP's system must measure quote update rates. Data concerning the quote update rates must be supplied to Nasdaq upon request.

The foregoing interpretive relief is limited to the specified period beginning on the date of this letter and ending on April 30, 2003.

However, Nasdaq is implementing a pilot program during which market makers with approved CGQ systems can utilize their systems without any quote update limitations. The pilot program is scheduled to expire at the close of business on March 21, 2003, unless extended by Nasdaq in writing. At the end of the pilot program, KSLP must comply with the existing quote update caps, unless Nasdaq otherwise amends the caps in writing.

Specifically, during the pilot program, the following quote update limitations are suspended:

- (1) From 9:30 a.m. to 9:35 a.m. Eastern Time and from 3:55 p.m. to 4:00 p.m. Eastern Time, the Firm's quote updates will not exceed the following parameters:
 - 30 quotes per second in aggregate for all securities, measured over each 15 second interval; and
 - a maximum of three quote updates per second for each security; and

- (2) From 9:35:01 a.m. to 3:54:59 p.m. Eastern Time, the Firm's quote updates will not exceed the following parameters:
 - 50 quotes per second in aggregate for all securities, measured over each 15 second interval; and
 - a maximum of three quote updates per second for each security.

All other conditions contained in this letter remain in effect during the pilot period.

The pilot program will provide Nasdaq with useful information to help determine whether the quote update restrictions on Computer Generated Quoting systems can be modified or eliminated. Any decision in this regard must be consistent with Nasdaq's obligation to ensure the integrity of its systems and to protect investors and the public interest.

This interpretive relief and your inclusion in the pilot program are based solely on your representations and the facts that you presented to the staff, as well as Nasdaq's belief that providing KSLP with this interpretation will enhance market liquidity and serve the public interest. This interpretation is strictly limited to the application of NASD IM-4613 to KSLP's system described in this letter. In the event that any material change occurs with respect to any of those facts or representations as they relate to NASD IM-4613, you should immediately inform Nasdaq staff.

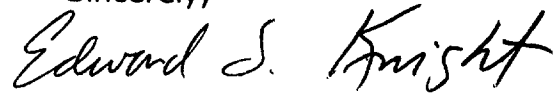
The interpretive relief and the pilot program are subject to modification or revocation if at any time Nasdaq determines that such action is necessary or appropriate in furtherance of applicable laws or NASD rules. Moreover, the interpretation and the pilot program may be revoked or modified, if Nasdaq determines that KSLP's practices are having a material adverse impact on Nasdaq's systems capacity, such action is necessary for maintenance of fair and honest markets and the protection of investors, or that KSLP has not complied with any of the conditions described above. Nasdaq also may limit or terminate KSLP's ability to enter quotes in the manner described in this letter. As you know, Nasdaq and NASD monitor for compliance with the conditions contained in this interpretive relief.

Leonard Amoruso, Esq.
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The opinions expressed herein are staff opinions only and have not been reviewed or endorsed by the board of Directors of Nasdaq or NASD Regulation, or the Board of Governors of the NASD. This letter responds only to the issues that you have raised, based on the facts as described, and does not address any other rule or interpretation of the NASD, or other regulatory or legal issues.

If you have any questions, please feel free to call me at 202-728-8212, or Peter R. Geraghty, Associate Vice President and Associate General Counsel, at 202-728-8227.

Sincerely,

A handwritten signature in black ink that reads "Edward S. Knight". The signature is written in a cursive, flowing style.

Edward S. Knight