

KNIGHT CAPITAL GROUP, INC.

Form 10-Q

November 09, 2012

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2012**

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

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(Address of principal executive offices and zip code)

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

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

As of November 5, 2012 the number of shares outstanding of the Registrant's Class A Common Stock was 181,892,665 and there were no shares outstanding of the Registrant's Class B Common Stock.

As of November 5, 2012, the number of shares outstanding of the Registrant's Series A-1 Cumulative Perpetual Convertible Preferred Stock was 266,350 and Series A-2 Non-Voting Cumulative Perpetual Convertible Preferred Stock was 7,865.

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KNIGHT CAPITAL GROUP, INC.
FORM 10-Q QUARTERLY REPORT
For the Quarter Ended September 30, 2012

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements.****KNIGHT CAPITAL GROUP, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)**

	For the three months ended September 30, 2012		For the nine months ended September 30, 2011	
	2012	2011	2012	2011
	(In thousands, except per share amounts)			
Revenues				
Commissions and fees	\$ 144,217	\$ 207,252	\$ 501,920	\$ 585,324
Net trading revenue	(343,618)	185,981	(90,396)	463,578
Interest, net	4,812	(1,201)	17,874	4,205
Investment income and other, net	4,751	5,410	19,043	10,093
Total revenues	(189,838)	397,442	448,441	1,063,200
Expenses				
Employee compensation and benefits	124,638	157,201	402,770	446,290
Execution and clearance fees	46,731	63,589	153,179	175,775
Communications and data processing	25,788	23,137	72,545	65,552
Payments for order flow	20,099	22,985	61,942	66,031
Interest	12,330	10,822	39,769	30,242
Depreciation and amortization	11,924	13,747	38,713	40,480
Professional fees	8,066	5,530	18,933	15,398
Occupancy and equipment rentals	7,127	7,026	20,007	21,526
Business development	4,983	5,909	16,040	16,870
Writedown of assets and lease loss accrual	143,034	1,333	143,034	2,278
Restructuring	-	28,624	-	28,624
Other	8,302	13,095	25,014	30,152
Total expenses	413,022	352,998	991,946	939,218
(Loss) income from continuing operations before income taxes	(602,860)	44,444	(543,505)	123,982
Income tax (benefit) expense	(212,939)	17,449	(189,980)	48,605
(Loss) income from continuing operations, net of tax	(389,921)	26,995	(353,525)	75,377
Loss from discontinued operations, net of tax	-	(59)	-	(378)
Net (loss) income	\$ (389,921)	\$ 26,936	\$ (353,525)	\$ 74,999
Dividend on convertible preferred shares	(1,051)	-	(1,051)	-
Deemed dividend related to beneficial conversion feature of convertible preferred shares	(373,364)	-	(373,364)	-
Net (loss) income attributable to common stockholders	\$ (764,336)	\$ 26,936	(727,940)	\$ 74,999

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Basic (loss) earnings per share from continuing operations	\$ (6.30)	\$ 0.29	\$ (7.20)	\$ 0.82
Diluted (loss) earnings per share from continuing operations	\$ (6.30)	\$ 0.29	\$ (7.20)	\$ 0.80
Basic (loss) earnings per share	\$ (6.30)	\$ 0.29	\$ (7.20)	\$ 0.82
Diluted (loss) earnings per share	\$ (6.30)	\$ 0.29	\$ (7.20)	\$ 0.79
Shares used in computation of basic earnings per share	121,246	91,564	101,044	91,877
Shares used in computation of diluted earnings per share	121,246	93,840	101,044	94,803

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents**KNIGHT CAPITAL GROUP, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Unaudited)**

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
Net (loss) income	\$ (389,921)	\$ 26,936	\$ (353,525)	\$ 74,999
Other comprehensive income:				
Cumulative translation adjustment	1,056	448	1,145	234
Comprehensive (loss) income	\$ (388,865)	\$ 27,384	\$ (352,380)	\$ 75,233

The accompanying notes are an integral part of these condensed consolidated financial statement.

Table of Contents**KNIGHT CAPITAL GROUP, INC.****CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION****(Unaudited)**

	September 30, 2012	December 31, 2011
	(In thousands)	
ASSETS		
Cash and cash equivalents	\$ 420,808	\$ 467,633
Cash and securities segregated under federal and other regulations	137,794	11,010
Financial instruments owned, at fair value, including securities pledged of \$4,338,136 at September 30, 2012 and \$2,672,709 at December 31, 2011:		
Equities	1,170,813	1,416,090
Debt securities	248,916	134,631
Loan inventory	151,772	206,572
Listed equity options	132,379	280,384
Other financial instruments	109	21,483
Securitized HECM loan inventory	3,410,607	1,722,631
Total financial instruments owned, at fair value	5,114,596	3,781,791
Collateralized agreements:		
Securities borrowed	1,060,049	1,494,647
Receivable from brokers, dealers and clearing organizations	944,239	623,897
Fixed assets and leasehold improvements, at cost, less accumulated depreciation and amortization	107,947	111,464
Investments	97,620	83,231
Goodwill	218,600	337,843
Intangible assets, less accumulated amortization	68,170	92,889
Income taxes receivable	173,638	9,788
Other assets	242,393	138,758
Total assets	\$ 8,585,854	\$ 7,152,951
LIABILITIES, CONVERTIBLE PREFERRED STOCK & EQUITY		
Liabilities		
Financial instruments sold, not yet purchased, at fair value:		
Equities	\$ 1,080,339	\$ 1,369,750
Listed equity options	111,691	254,506
Debt securities	99,679	63,073
Other financial instruments	4,431	34,563
Total financial instruments sold, not yet purchased, at fair value	1,296,140	1,721,892
Collateralized financings:		
Financial instruments sold under agreements to repurchase	471,349	420,320
Securities loaned	353,953	697,998
Other secured financings	115,311	59,405
Liability to GNMA trusts, at fair value	3,383,240	1,710,627
Total collateralized financings	4,323,853	2,888,350
Payable to brokers, dealers and clearing organizations	303,277	322,660
Payable to customers	460,826	23,664
Accrued compensation expense	131,970	188,939
Accrued expenses and other liabilities	183,611	121,083
Long-term debt	410,089	424,338
Total liabilities	7,109,766	5,690,926

Convertible Preferred Stock

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Series A convertible preferred stock		
Shares issued: 400 at September 30, 2012,		
Shares outstanding: 274 at September 30, 2012	259,278	-
Equity		
Class A common stock		
Shares authorized: 500,000 at September 30, 2012 and at December 31, 2011; Shares issued: 254,171 at September 30, 2012 and 166,361 at December 31, 2011; Shares outstanding: 181,505 at September 30, 2012 and 96,645 at December 31, 2011		
	2,542	1,664
Additional paid-in capital	1,367,625	850,837
Retained earnings	705,380	1,433,320
Treasury stock, at cost; 72,666 at September 30, 2012 and 69,717 shares at December 31, 2011	(859,109)	(823,023)
Accumulated other comprehensive income (loss)	372	(773)
Total equity	1,216,810	1,462,025
Total liabilities, convertible preferred stock and equity	\$ 8,585,854	\$ 7,152,951

The accompanying notes are an integral part of these condensed consolidated financial statements.

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KNIGHT CAPITAL GROUP, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN CONVERTIBLE PREFERRED STOCK AND EQUITY

For the Year Ended December 31, 2011 and Nine Months Ended September 30, 2012

(Unaudited)

Knight Capital Group, Inc. Stockholders Equity													
(in thousands)													
	Series A Convertible Preferred Stock			Class A Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock		Accumulated other comprehensive income (loss)	Total	Non-controlling Interests	Total Equity
	Series A-1 Shares	Series A-2 Shares	Amount	Shares	Amount			Shares	Amount				
Balance, December 31, 2010	-	-	\$ -	162,818	\$ 1,628	\$ 807,287	\$ 1,317,462	(65,082)	\$ (765,875)	\$ (265)	\$ 1,360,237	\$ 621	\$ 1,360,858
Net income	-	-	-	-	-	-	115,237	-	-	-	115,237	-	115,237
Net loss attributable to noncontrolling interests related to discontinued operations	-	-	-	-	-	-	621	-	-	-	621	(621)	-
Common stock repurchased	-	-	-	-	-	-	-	(4,754)	(58,553)	-	(58,553)	-	(58,553)
Reissuance of treasury shares	-	-	-	-	-	(27)	-	119	1,405	-	1,378	-	1,378
Stock options exercised	-	-	-	91	1	999	-	-	-	-	1,000	-	1,000
Income tax provision stock based compensation	-	-	-	-	-	(6,449)	-	-	-	-	(6,449)	-	(6,449)
Cumulative translation adjustment	-	-	-	-	-	-	-	-	-	(508)	(508)	-	(508)
Stock-based compensation	-	-	-	3,452	35	49,027	-	-	-	-	49,062	-	49,062
Balance, December 31, 2011	-	-	\$ -	166,361	\$ 1,664	\$ 850,837	\$ 1,433,320	(69,717)	\$ (823,023)	\$ (773)	\$ 1,462,025	\$ -	\$ 1,462,025
Net loss	-	-	-	-	-	-	(353,525)	-	-	-	(353,525)	-	(353,525)
Issuance of Series A convertible preferred stock, net of issuance costs of \$40,519	80	320	359,481	-	-	-	-	-	-	-	-	-	-
Beneficial Conversion	-	-	-	-	-	373,364	(373,364)	-	-	-	-	-	-

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Feature													
Series A-2 converted to Series A-1 convertible preferred stock	312	(312)	-	-	-	-	-	-	-	-	-	-	-
Series A-1 convertible preferred stock converted into Class A common stock	(126)	-	(100,203)	83,857	839	99,364	-	-	-	-	100,203	-	100,203
Dividend on convertible preferred shares	-	-	-	-	-	-	(1,051)	-	-	-	(1,051)	-	(1,051)
Common stock repurchased	-	-	-	-	-	-	-	(2,949)	(36,086)	-	(36,086)	-	(36,086)
Stock options exercised	-	-	-	130	1	1,139	-	-	-	-	1,140	-	1,140
Income tax provision stock based compensation	-	-	-	-	-	195	-	-	-	-	195	-	195
Reclassification of Urban earnout to liabilities	-	-	-	-	-	(2,000)	-	-	-	-	(2,000)	-	(2,000)
Cumulative translation adjustment	-	-	-	-	-	-	-	-	-	1,145	1,145	-	1,145
Stock-based compensation	-	-	-	3,823	38	44,726	-	-	-	-	44,764	-	44,764
Balance, September 30, 2012	266	8	\$ 259,278	254,171	\$ 2,542	\$ 1,367,625	\$ 705,380	(72,666)	\$ (859,109)	\$ 372	\$ 1,216,810	\$ -	\$ 1,216,810

The accompanying notes are an integral part of these consolidated financial statements.

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KNIGHT CAPITAL GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the nine months ended September 30,	
	2012	2011
	(In thousands)	
Cash flows from operating activities		
Net (loss) income	\$ (353,525)	\$ 74,999
Loss from discontinued operations, net of tax	-	(378)
	(353,525)	75,377
(Loss) income from continuing operations, net of tax	(353,525)	75,377
Adjustments to reconcile (loss) income from continuing operations, net of tax to net cash (used in) provided by operating activities		
Writedown of assets and lease loss accrual	143,034	2,278
Stock-based compensation	42,393	38,887
Depreciation and amortization	38,713	40,480
Debt discount accretion and other debt related expenses	13,053	11,534
Restructuring charges	-	11,454
Deferred rent	(925)	245
Unrealized (gain) loss on investments	(11,014)	888
Operating activities from discontinued operations	-	(1,195)
(Increase) decrease in operating assets		
Cash and securities segregated under federal and other regulations	(26,239)	47,503
Financial instruments owned, at fair value	(1,350,227)	(1,961,226)
Securities borrowed	434,598	(113,474)
Receivable from brokers, dealers and clearing organizations	40,152	(180,600)
Income taxes receivable	(163,850)	(15,501)
Other assets	(246,935)	(107,170)
(Decrease) increase in operating liabilities		
Financial instruments sold, not yet purchased, at fair value	(408,330)	569,534
Financial instruments sold under agreements to repurchase	51,029	111,567
Securities loaned	(344,045)	157,027
Other secured financings	55,906	36,780
Liability to GNMA trusts, at fair value	1,672,613	1,210,680
Payable to brokers and dealers and clearing organizations	(19,382)	72,890
Payable to customers	(35,035)	44,995
Accrued compensation expense	(54,680)	(17,976)
Accrued expenses and other liabilities	178,289	26,175
Net cash (used in) provided by operating activities	(344,407)	61,152
Cash flows from investing activities		
Distributions from investments	4,220	4,078
Purchases of investments	(5,842)	(24,952)
Purchases of fixed assets and leasehold improvements	(23,600)	(32,009)
Purchase of intangible asset	(50)	-
Purchases of business, net of cash acquired	(3,072)	(625)
Net cash used in investing activities	(28,344)	(53,508)
Cash flows from financing activities		
Proceeds of convertible preferred stock offering, net of issuance costs of \$40,519	359,480	-
Proceeds from credit facility	-	97,838
Proceeds from revolving credit agreement	200,000	-
Repayment of revolving credit agreement	(200,000)	-

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Stock options exercised	1,140	758
Income tax benefit related to stock-based compensation	195	67
Cost of common stock repurchased	(36,034)	(32,337)
Net cash provided by financing activities	324,781	66,326
Effect of exchange rate changes on cash and cash equivalents	1,145	234
(Decrease) increase in cash and cash equivalents	(46,825)	74,204
Cash and cash equivalents at beginning of period	467,633	375,569
Cash and cash equivalents at end of period	\$ 420,808	\$ 449,773
 Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 45,533	\$ 20,522
Cash paid for income taxes	\$ 44,910	\$ 39,859

The accompanying notes are an integral part of these condensed consolidated financial statements.

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KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Organization and Description of the Business

Knight Capital Group, Inc. (collectively with its subsidiaries, Knight or the Company) is a global financial services firm that provides access to the capital markets across multiple asset classes to a broad network of clients, including broker-dealers, institutions and corporations. The Company seeks to continually apply its expertise and innovation to the market making and trading process to build lasting client relationships through consistent performance and superior client service. The Company has four operating segments: (i) Market Making; (ii) Institutional Sales and Trading; (iii) Electronic Execution Services; and (iv) Corporate and Other.

Market Making

The Market Making segment principally consists of market making in global equities and listed domestic options. As a market maker, the Company commits capital for trade executions by offering to buy securities from, or sell securities to, institutions and broker-dealers. The Market Making segment primarily includes client, and to a lesser extent, non-client market making activities in which the Company operates as a market maker in equity securities quoted and traded on the Nasdaq Stock Market; the over-the-counter (OTC) market for New York Stock Exchange (NYSE), NYSE Amex Equities (NYSE Amex), NYSE Arca listed securities; and several European exchanges. As a complement to electronic market making, the Company's cash trading business handles specialized orders and also transacts on the OTC Bulletin Board, the OTC Pink Markets and the Alternative Investment Market (AIM) of the London Stock Exchange. The segment provides trade executions as an equities Designated Market Maker (DMM) on the NYSE and NYSE Amex. The Market Making segment also includes the Company's option market making business which trades on substantially all domestic electronic exchanges.

Institutional Sales and Trading

The Institutional Sales and Trading segment includes global equity, exchange traded fund (ETF), and fixed income sales; reverse mortgage origination and securitization; capital markets; and asset management activities. The primary business of the Institutional Sales and Trading segment is to execute and facilitate equities, ETFs and fixed income transactions as an agent on behalf of institutional clients, and commit capital on behalf of clients when needed. This is predominantly a full-service execution business, in which much of the interaction is based on the Company's client relationships. This segment also facilitates client orders through program and block trades and riskless principal trades and provides capital markets services, including equity and debt offerings as well as private placements.

Electronic Execution Services

The Electronic Execution Services segment offers access via its electronic agency-based platforms to markets and self-directed trading in equities, options, fixed income, foreign exchange and futures. In contrast to Market Making, the businesses within this segment generally do not act as a principal to transactions that are executed and generally earn commissions for acting as an agent between the principals to the trade.

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KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

Corporate and Other

The Corporate and Other segment invests in strategic financial services-oriented opportunities, allocates, deploys and monitors all capital, and maintains corporate overhead expenses and all other income and expenses that are not attributable to the other segments. The Corporate and Other segment houses functions that support the Company's other segments such as self-clearing services, including securities lending activities. Beginning in the second quarter of 2012, the Corporate and Other segment includes the Company's Futures Commission Merchant (FCM) which comprises certain assets and liabilities that were acquired or assumed from the futures division of Penson Financial Services, Inc. (Penson) on June 1, 2012. This business primarily provides futures execution, clearing and custody services to facilitate transactions among brokers, institutions and non-clearing FCMs on major U.S. and European futures and options exchanges.

Discontinued Operations

Discontinued operations comprise costs associated with shutting down the Company's former Deephaven Capital Management business which was discontinued in 2009.

2. Significant Accounting Policies

Basis of consolidation and form of presentation

The accompanying unaudited Consolidated Financial Statements, prepared in conformity with accounting principles generally accepted in the United States of America (GAAP), should be read in conjunction with the audited Consolidated Financial Statements for the year ended December 31, 2011 included in the Company's Current Report on Form 8-K dated August 6, 2012 which was filed in relation to the Company's raising of \$400.0 million in equity financing. These unaudited Consolidated Financial Statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. All such adjustments are of a normal recurring nature. Certain footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to U.S. Securities and Exchange Commission (SEC) rules and regulations, although the Company believes that the disclosures herein are adequate to make the information presented not misleading. All significant intercompany transactions and balances have been eliminated. Interim period operating results may not be indicative of the operating results for a full year.

Certain reclassifications have been made to the prior periods' Consolidated Financial Statements in order to conform to the current year presentation. Such reclassifications had no effect on previously reported net income.

The Company consolidates all of its wholly-owned subsidiaries as well as any investment in which it is considered to be the primary beneficiary of a variable interest entity (VIE). The Company performs a qualitative assessment to determine if a VIE should be consolidated. As described in more detail in this footnote, the primary attributes the Company assesses include the entity's capital structure and power. The Company will consolidate a VIE if it has both (i) the power to direct the activities of a VIE that most significantly impact the entity's economic performance and (ii) the

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obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. As of September 30, 2012 and December 31, 2011, the Company was not considered to be a primary beneficiary of any VIE.

Cash and cash equivalents

Cash and cash equivalents include money market accounts, which are payable on demand, and short-term investments with an original maturity of less than 90 days. The carrying amount of such cash equivalents approximates their fair value due to the short-term nature of these instruments.

Cash and securities segregated under federal and other regulations

The Company maintains custody of customer funds and, as a result, it is subject to various regulatory rules and regulations. As a result of these customer holdings, the Company is obligated by the SEC and the Commodities Futures Trading Commission (CFTC) to segregate or set aside cash and/or qualified securities to satisfy these regulations, which have been promulgated to protect customer assets. The amounts recognized as Cash and securities segregated under federal and other regulations approximate fair value.

Market making, sales, trading and execution activities

Financial instruments owned and Financial instruments sold, not yet purchased, which relate to market making and trading activities, include listed and OTC equity securities, listed equity options and fixed income securities which are recorded on a trade date basis and carried at fair value. Net trading revenue (trading gains, net of trading losses) are also recorded on a trade date basis.

Commissions (which includes commission equivalents earned on institutional client orders, commissions on futures transactions and home equity conversion mortgage (HECM) loan origination and securitization activities) and related expenses are also recorded on a trade date basis. Commissions earned by the Company's FCM are recorded net of any commissions paid to independent brokers and are recognized on a half-turn basis.

The Company's third party clearing agreements call for payment or receipt of interest income, net of transaction-related interest charged by clearing brokers, for facilitating the settlement and financing of securities transactions. The Company also nets interest income on its securitized HECM loan inventory against interest expense on its liability to Government National Mortgage Association (GNMA) trusts. Interest income and interest expense which have been netted on the Consolidated Statements of Operations are as follows (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Interest Income	\$ 36,409	\$ 12,330	\$ 100,410	\$ 28,872
Interest Expense	(31,597)	(13,531)	(82,536)	(24,667)
Interest, net	\$ 4,812	\$ (1,201)	\$ 17,874	\$ 4,205

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued****(Unaudited)**

Dividend income relating to securities owned and dividend expense relating to securities sold, not yet purchased, derived primarily from the Company's market making activities are included as a component of Net trading revenue on the Consolidated Statements of Operations. Net trading revenue includes dividend income and expense as follows (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Dividend Income	\$ 7,730	\$ 4,547	\$ 22,001	\$ 15,136
Dividend Expense	\$ (6,778)	\$ (5,167)	\$ (18,947)	\$ (15,426)

Payments for order flow represent payments to broker-dealer clients, in the normal course of business, for directing their order flow in U.S. equities and options to the Company. Payments for order flow also include fees paid to third party brokers with respect to wholesale loan production at the Company's reverse mortgage business.

Fair value of financial instruments

The Company values its financial instruments using a hierarchy of fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.

The fair value hierarchy can be summarized as follows:

Level 1 Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

Level 2 Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3 Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Changes in fair value are recognized in earnings each period for financial instruments that are carried at fair value. See Footnote 6 Fair Value of Financial Instruments for a description of valuation methodologies applied to the classes of financial instruments at fair value.

Securitization activities

The Company securitizes HECMs under its GNMA issuance authority. Securitization and transfer of financial assets to a third party are generally accounted for as sales when an issuer has relinquished control over the transferred assets. Based upon the current structure of the GNMA securitization program, the Company believes that it has not met the GAAP criteria for relinquishing control over the transferred assets and therefore its securitizations fail to meet the GAAP criteria for sale accounting. As such, the Company continues to recognize the HECMs in Financial instruments owned, at fair value, and the Company recognizes a corresponding liability in Liability to GNMA trusts, at fair value on

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KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

the Consolidated Statements of Financial Condition. The associated change in fair value of the securitized HECM loan inventory is recorded in Commissions and fees on the Consolidated Statements of Operations.

Collateralized agreements and financings

Collateralized agreements consist of securities borrowed and collateralized financings include securities loaned, financial instruments sold under agreements to repurchase, other secured financings and liability to GNMA trusts, at fair value.

Securities borrowed and securities loaned transactions are recorded at the amount of cash collateral advanced or received. Securities borrowed transactions facilitate the securities settlement process and require the Company to deposit cash or other collateral with the lender. Securities loaned transactions help finance the Company's securities inventory whereby the Company lends stock to counterparties in exchange for the receipt of cash or other collateral from the borrower. In these transactions, the Company receives or lends cash or other collateral in an amount generally in excess of the market value of the applicable securities borrowed or loaned. The Company monitors the market value of securities borrowed or loaned on a daily basis, with additional collateral obtained or refunded as necessary.

Financial instruments sold under agreements to repurchase are used to finance inventories of securities and other financial instruments and are recorded at their contractual amount. The Company has entered into bilateral and tri-party term and overnight repurchase agreements which bear interest at negotiated rates. The Company receives cash and makes delivery of financial instruments to a custodian who monitors the market value of these instruments on a daily basis. The market value of the instruments delivered must be equal to or in excess of the principal amount loaned under the repurchase agreements plus the agreed upon margin requirement. The custodian may request additional collateral, if appropriate.

Other secured financings represent contractual agreements used to finance financial instruments and are recorded at their contractual amount. These agreements are short-term in nature with durations of typically less than one month and bear interest at negotiated rates. The Company receives cash and pledges financial instruments to banks and other financial institutions as collateral for these secured financing arrangements. The market value of the collateral delivered must be in excess of the principal amount loaned plus the agreed upon margin requirement under the secured financings. The banks and other financial institutions may request additional collateral, if appropriate.

Liability to GNMA trusts, at fair value, represents the liability associated with the Company's securitization of HECMs where the securitization does not meet the GAAP criteria for sale treatment.

The Company's securities borrowed, securities loaned, financial instruments sold under agreements to repurchase and other secured financings are recorded at amounts that approximate fair value. These items are recorded based upon their contractual terms and are not materially sensitive to shifts in interest rates because they are short-term in nature and are fully collateralized. These items would be categorized as Level 2 in the fair value hierarchy if they were required to be recorded at fair value.

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KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *Continued*

(Unaudited)

Investments

Investments primarily comprise strategic investments and deferred compensation investments. Strategic investments include noncontrolling equity ownership interests and debt instruments held by the Company within its non-broker-dealer subsidiaries, primarily in financial services-related businesses. Strategic investments are accounted for under the equity method, at cost or at fair value. The equity method of accounting is used where the Company is considered to exert significant influence on the investee. Strategic investments are held at cost, less impairment if any, when the Company is not considered to exert significant influence on operating and financial policies of the investee. Deferred compensation investments primarily consist of mutual funds, which are accounted for at fair value.

Strategic investments are reviewed on an ongoing basis to ensure that the carrying values of the investments have not been impaired. If the Company determines that an impairment loss on a strategic investment has occurred due to a decline in fair value or other market conditions, the investment is written down to its estimated fair value.

The Company maintains a non-qualified deferred compensation plan related to certain employees and directors. This plan provides a return to the participants based upon the performance of various investments. In order to hedge its liability under this plan, the Company generally acquires the underlying investments and holds such investments until the deferred compensation liabilities are satisfied. Changes in value of such investments are recorded in Investment income and other, net, with a corresponding charge or credit to Employee compensation and benefits on the Consolidated Statements of Operations.

Goodwill and intangible assets

The Company tests goodwill and intangible assets with an indefinite useful life for impairment annually or when an event occurs or circumstances change that signifies the existence of an impairment. The Company amortizes other intangible assets on a straight line basis over their estimated useful lives and tests for recoverability whenever events indicate that the carrying amounts may not be recoverable.

Payable to customers

Payable to customers arise primarily from futures transactions and include amounts due on cash and margin transactions. Due to their short-term nature, such amounts approximate fair value.

Treasury stock

The Company records its purchases of treasury stock at cost as a separate component of stockholders' equity. The Company obtains treasury stock through purchases in the open market or through privately negotiated transactions. The Company may re-issue treasury stock, at average cost, for the acquisition of new businesses or, in certain instances, as inducement grants to new hires or grants to consultants.

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KNIGHT CAPITAL GROUP, INC.

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(Unaudited)

Foreign currency translation and foreign currency forward contracts

The Company's European subsidiary utilizes the Pound Sterling as its functional currency while the Company's Hong Kong subsidiary utilizes the Hong Kong dollar as its functional currency. For all other entities, the Company's functional currency is the U.S. dollar.

Assets and liabilities of foreign subsidiaries having non-U.S. dollar functional currencies are translated at exchange rates at the end of a period. Revenues and expenses are translated at average exchange rates during the period. Gains and losses resulting from translating foreign currency financial statements into U.S. dollars are included in Accumulated other comprehensive income (loss) on the Consolidated Statements of Financial Condition and Cumulative translation adjustment on the Consolidated Statements of Comprehensive Income. Gains or losses resulting from foreign currency transactions are included in Investment income and other, net on the Company's Consolidated Statements of Operations. For the three months ended September 30, 2012 and 2011, losses of \$2.0 million and \$0.1 million, respectively, were recorded in Investment income and other, net and losses of \$0.9 million and a \$1.0 million, respectively, were recorded for the nine months ended September 30, 2012 and 2011, respectively.

The Company seeks to reduce the impact of fluctuations in foreign exchange rates on its net investment in certain non-U.S. operations through the use of foreign currency forward contracts. For foreign currency forward contracts designated as hedges, the Company assesses its risk management objectives and strategy, including identification of the hedging instrument, the hedged item and the risk exposure and how effectiveness is to be assessed prospectively and retrospectively. The ineffectiveness of the hedge is assessed based on the overall changes in the fair value of the forward contracts. For qualifying net investment hedges, any gains or losses, to the extent effective, are included in Accumulated other comprehensive income (loss) on the Consolidated Statements of Financial Condition and the Consolidated Statements of Comprehensive Income. The ineffective portion, if any, is recorded in Investment income and other, net on the Consolidated Statements of Operations.

Soft dollar expense

Under a commission management program, the Company allows institutional clients to allocate a portion of their gross commissions to pay for research and other services provided by third parties. As the Company acts as an agent in these transactions, it records such expenses on a net basis within Commissions and fees on the Consolidated Statements of Operations.

Depreciation, amortization and occupancy

Fixed assets are depreciated on a straight-line basis over their estimated useful lives of three to seven years. Leasehold improvements are being amortized on a straight-line basis over the shorter of the term of the related office lease or the expected useful life of the assets. The Company capitalizes certain costs associated with the acquisition or development of internal-use software and amortizes the software over its estimated useful life of three years, commencing at the time the software is placed in service. The Company reviews fixed assets and leasehold improvements for impairment whenever events or changes in circumstances indicate that the related carrying amounts may not be recoverable.

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(Unaudited)

The Company recognizes rent expense under operating leases with fixed rent escalations, lease incentives and free rent periods on a straight-line basis over the lease term beginning on the date the Company takes possession of or controls the use of the space, including during free rent periods.

Lease loss accrual

The Company's policy is to identify excess real estate capacity and where applicable, accrue for related future costs, net of estimated sub-lease income. In the event the Company is able to sub-lease the excess real estate after recording a lease loss, such accrual is adjusted to the extent the actual terms of sub-leased property differ from the assumptions used in the calculation of the accrual. In the event that the Company concludes that previously determined excess real estate is needed for the Company's use, such lease loss accrual is adjusted accordingly.

Income taxes

The Company records deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities and measures them using the enacted tax rates and laws that will be in effect when such differences are expected to reverse. The Company evaluates the recoverability of future tax deductions by assessing the adequacy of future expected taxable income from all sources, including reversal of temporary differences and forecasted operating earnings. Net deferred tax assets and liabilities are included in Other assets and Accrued expenses and other liabilities, respectively, on the Consolidated Statements of Financial Condition.

Stock-based compensation

Stock-based compensation is measured based on the grant date fair value of the awards. These costs are amortized over the requisite service period, which is typically the vesting period.

Expected forfeitures are considered in determining stock-based employee compensation expense. For all periods presented, the Company recorded a benefit for expected forfeitures on all outstanding stock-based awards. The benefit recorded did not have a material impact on the results of operations in any of the periods presented.

The Company applies a non-substantive vesting period approach for stock-based awards whereby the expense is accelerated for those employees and directors that receive options and restricted stock units (RSUs) and are eligible to retire prior to the options or RSUs vesting.

Variable interest entities

A VIE is an entity that lacks one or more of the following characteristics (i) the total equity investment at risk is sufficient to enable the entity to finance its activities independently and (ii) the equity holders have the power to direct the activities of the entity that most significantly impact its economic performance, the obligation to absorb the losses of the entity and the right to receive the residual returns of the entity. The Company has a controlling financial interest and will consolidate a VIE if it has both (i) the power to direct the activities of the VIE that most significantly impact the VIE's economic performance and (ii) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE.

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(Unaudited)

VIEs generally finance the purchase of assets by issuing debt and equity securities that are either collateralized by or indexed to the assets held by the VIE. The debt and equity securities issued by a VIE may include tranches of varying levels of subordination. The Company's involvement with VIEs includes purchased interests and commitments to VIEs.

The Company is principally involved with VIEs through the following business activities:

Mortgage-backed securities (MBS) The Company purchases and sells beneficial interests issued by mortgage-backed VIEs in connection with its trading activities

Securitized HECM loan inventory The Company sells HECM loans to GNMA trusts which have the characteristics of a VIE and retains certain commitments and obligations to these trusts

Nonconsolidated VIEs

The Company's exposure to the obligations of VIEs is generally limited to its interests in these entities. Nonconsolidated VIEs are aggregated based on principal business activity.

For MBS, the maximum exposure to loss is the carrying value of these interests

For Securitized HECM loan inventory, the maximum exposure to loss is the value of the obligations as issuer and servicer to the GNMA trust

The carrying values of the Company's variable interests in nonconsolidated VIEs are included in the Consolidated Statements of Financial Condition as follows:

MBS are included as Debt securities within Financial instruments owned, at fair value

Securitized HECM loan inventory VIEs are captured in the valuation of the Securitized HECM loan inventory and the Liability to GNMA trusts, at fair value

The following table presents the Company's nonconsolidated VIEs at September 30, 2012 and December 31, 2011 (in thousands):

	September 30, 2012
	Securitized HECM loan inventory
	MBS
Carrying value of the VIEs	

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Assets	\$ -	\$ 114,636
Liabilities	794	-
Maximum exposure to loss in nonconsolidated VIEs		
Commitments	24,217	-
Purchased interests	-	114,636

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(Unaudited)

	December 31, 2011	
	Securitized HECM loan inventory	MBS
Carrying value of the VIEs		
Assets	\$ -	\$ 16,399
Liabilities	2,299	-
Maximum exposure to loss in nonconsolidated VIEs		
Commitments	12,874	-
Purchased interests	-	16,399
<i>Use of estimates</i>		

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Accounting Standards Updates

In December 2011, the Financial Accounting Standards Board (FASB) issued an Accounting Standard Update (ASU) that requires additional disclosures about financial assets and liabilities that are subject to netting arrangements. Under the ASU, financial assets and liabilities must be disclosed at their respective gross asset and liability amounts, the amounts offset on the balance sheet and a description of the respective netting arrangements. The new disclosures are required for annual reporting periods beginning on or after January 1, 2013, and are to be applied retrospectively. Other than the change in disclosures, the Company has determined that the adoption of this ASU will not have an impact on its Consolidated Financial Statements.

In July 2012, the FASB issued an ASU which allows a company to first assess qualitative factors to determine whether it is necessary to perform a quantitative impairment test of an indefinite-lived intangible asset. This ASU simplifies the guidance for impairment testing of indefinite-lived intangible assets other than goodwill and gives companies the option to assess qualitative factors to determine whether it is necessary to perform a quantitative impairment test. Companies electing to perform a qualitative assessment are no longer required to calculate the fair value of an indefinite-lived intangible asset unless the company determines, based on a qualitative assessment, that it is more likely than not that the asset is impaired. This update is effective for annual impairment tests, or more frequently if deemed appropriate, performed in fiscal years beginning after September 15, 2012; however, early adoption is permitted. The Company is currently evaluating the impact, if any that this ASU will have on its Consolidated Financial Statements.

3. August 1, 2012 Technology Issue

The Company experienced a technology issue at the open of trading at the NYSE on August 1, 2012. This issue was related to the installation of trading software and resulted in the Company's broker-dealer subsidiary, Knight Capital Americas LLC, sending numerous erroneous orders in NYSE-listed and NYSE Arca securities into the market. Although this software was subsequently removed from the Company's systems, the Company's results for the three and nine months ended

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KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

September 30, 2012 includes a \$457.6 million trading loss which is included in Net trading revenues, and \$3.5 million in incremental professional fees which are included in Professional fees as a result of the technology issue.

4. Series A Convertible Preferred Stock

As a result of the financial losses incurred due to the August 1, 2012 technology issue, the Company, on August 6, 2012, raised \$400.0 million in equity financing through a convertible preferred share offering with several investors. Under the terms, the Company sold 400,000 shares of Series A Convertible Preferred Stock, par value \$0.01 per share. The Series A Convertible Preferred Stock consisted of 79,600 shares of Series A-1 Cumulative Perpetual Convertible Preferred Stock (the Series A-1 Shares) and 320,400 shares of Series A-2 Non-Voting Cumulative Perpetual Convertible Preferred Stock (the Series A-2 Shares) (collectively the Series A Shares). The Series A-1 and Series A-2 preferred shares are convertible into approximately 266.7 million shares of Class A common stock, or approximately 73% of the total number of shares of Class A common stock outstanding at August 6, 2012 assuming the conversion in full of the Series A Shares into Class A common stock.

The Series A-1 Shares and Series A-2 Shares rank on parity with each other, and rank senior to the Class A common stock as to dividend and liquidation rights. Dividends on the Series A Shares accrue daily and are payable on a cumulative basis, as and if declared by the Board of Directors, in cash at a rate per annum equal to 2% of (i) the liquidation preference of \$1,000 per share and (ii) the amount of any accrued but unpaid dividends in respect of such shares. Declared dividends on the Series A Shares are payable quarterly, in arrears, on each January 15, April 15, July 15 and October 15, with the first dividend paid on October 15, 2012. The Company is prohibited from paying any dividend with respect to shares of Class A common stock or repurchasing or redeeming any shares of Class A common stock in any quarter unless full dividends are paid on the Series A Shares in such quarter. The Series A Shares participate in any dividends paid on the Class A common stock.

Holder of Series A-1 Shares are entitled to vote with holders of Class A common stock, on an as-converted into Class A common stock basis on all matters submitted to a vote. The Series A-2 Shares do not have voting rights. Each Series A-2 Share is convertible, at the option of the holder, into one Series A-1 Share with all associated rights. Each Series A-1 Share is convertible, at the option of the holder, into 666.667 shares of Class A common stock (the Conversion Rate), subject to customary anti-dilution adjustments. The Conversion Rate also will be adjusted upon the occurrence of certain merger or acquisition transactions and fundamental changes. The Conversion Price is equal to \$1,000 divided by the Conversion Rate in effect at such time, for an initial Conversion Price of \$1.50 per share of Class A common stock.

The outstanding Series A Shares will mandatorily convert into Class A common stock on the third trading day following the date on which the closing price of the Class A common stock exceeds 200% of the then-applicable Conversion Price (as defined below) for 60 consecutive trading days.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS **Continued**

(Unaudited)

Neither the Series A-1 Shares nor the Series A-2 Shares are redeemable by the Company or by the holders other than in connection with certain fundamental corporate changes, which include but are not limited to a change in control, a merger or consolidation, or a delisting of the Company's Class A common stock. Upon a fundamental change, a holder of Series A Shares may elect to require the Company to redeem such holder's shares of Series A for consideration payable (at the option of the Company) in cash or securities listed on a national securities exchange with a fair market value equal to the greater of (1) the fair market value of such Series A Shares or (2) \$1,000 per share plus the accrued but unpaid dividends thereon.

The Company incurred approximately \$40.5 million of fees and costs related to the issuance of the Series A Shares which have been recorded as a reduction of the initial \$400.0 million in proceeds, resulting in an initial balance of \$359.5 million which is classified as temporary equity as described below.

The \$359.5 million initial temporary equity balance has been reduced on a pro-rata basis as the 400,000 Series A Shares are converted into Class A common stock. During the third quarter of 2012, 125,785 or approximately 30% of the original Series A Shares were converted to Class A common stock (resulting in 274,215 Series A Shares outstanding at September 30, 2012 comprising 266,350 Series A-1 Shares and 7,865 Series A-2 Shares). These conversions resulted in a \$100.2 million reduction in the temporary equity balance to \$259.3 million at September 30, 2012, which was offset by a \$0.8 million increase in Class A common stock and a \$99.4 million increase in Additional paid-in capital.

Temporary equity classification

Pursuant to GAAP, an equity instrument with redemption features that are not solely within the control of the issuer is required to be classified outside of permanent equity as temporary equity, which is presented on the Consolidated Statement of Financial Condition above permanent equity.

Since the Series A Shares become redeemable at the option of the holder upon a fundamental change, and such a fundamental change could come about under circumstances that are not solely within the control of the Company, Series A Shares are classified as temporary equity on the Company's Consolidated Statements of Financial Condition.

Beneficial conversion feature

Pursuant to GAAP, a beneficial conversion feature (BCF) exists to the extent that a convertible security is issued at a price that is less than the fair value of the security into which it is convertible. This guidance applies to the Series A Shares as these shares were issued at \$1,000 per share which, based on the Conversion Rate computes to a common share equivalent price of \$1.50 per share, which was less than the share price of the Company's Class A common stock at the time of issuance of \$2.81 per share. The difference between these two prices, as well as costs paid to investors with respect to the issuance, created a BCF. The BCF is treated as a deemed dividend to the Series A Shares shareholders since the conversion feature is immediately exercisable for the Series A Shares. The BCF is recorded as a decrease to Retained earnings and an increase to Additional paid-in capital. The deemed dividend also affects the Company's earnings per share calculations by increasing the

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loss attributable to Class A common stockholders to the extent that it is not anti-dilutive. As a result of the BCF, the Company recorded a \$373.4 million non-cash deemed dividend for the period ended September 30, 2012.

Dividend

On September 24, 2012, the Company's Board of Directors declared the first quarterly dividend with respect to the Series A Shares, and that dividend was paid on October 15, 2012. Such dividend totaled \$1.1 million based upon 274,215 Series A Shares outstanding as of the record date covering the period from August 6, 2012 through October 14, 2012. As this dividend was declared prior to September 30, 2012, it was reflected in the Consolidated Financial Statements for the period ended September 30, 2012 as a reduction in Retained earnings and in the earnings per share calculation as an increase in the loss attributable to the common stockholders.

5. Segregated Cash and Securities

Cash and securities segregated under federal and other regulations primarily relates to the Company's recently acquired FCM business (see Footnote 20 Acquisition for further discussion) and consists of the following (in thousands):

	September 30, 2012	December 31, 2011
Segregated cash	\$ 137,519	\$ 11,010
Segregated securities	275	-
Total Segregated cash and securities	\$ 137,794	\$ 11,010

Segregated securities consist of U.S. government obligations.

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(Unaudited)

6. Fair Value of Financial Instruments

The Company's financial instruments recorded at fair value have been categorized based upon a fair value hierarchy, as described more fully in Footnote 2 Significant Accounting Policies. The following fair value hierarchy table presents information about the Company's financial assets and liabilities measured at fair value on a recurring basis (in thousands):

September 30, 2012	Assets and Liabilities Measured at Fair Value on a Recurring Basis			Total
	Level 1	Level 2	Level 3	
Assets				
Financial instruments owned, at fair value:				
Equities ⁽¹⁾	\$ 1,170,813	\$ -	\$ -	\$ 1,170,813
U.S. government and Non-U.S. government obligations	57,762	-	-	57,762
Corporate debt ⁽²⁾	76,518	-	-	76,518
Mortgage-backed securities	-	114,636	-	114,636
Loan inventory	-	151,772	-	151,772
Listed equity options	132,379	-	-	132,379
Purchased call options	-	109	-	109
Securitized HECM loan inventory ⁽³⁾	-	3,410,607	-	3,410,607
Total Financial instruments owned, at fair value	1,437,472	3,677,124	-	5,114,596
Securities segregated under federal and other regulations ⁽⁴⁾	275	-	-	275
Securities on deposit with clearing organizations ⁽⁴⁾	201,619	-	-	201,619
Deferred compensation investments ⁽⁵⁾	-	21,711	-	21,711
Investment in Deephaven Funds ⁽⁵⁾	-	1,406	-	1,406
Total fair value of financial instrument assets	\$ 1,639,366	\$ 3,700,242	\$ -	\$ 5,339,608
Liabilities				
Financial instruments sold, not yet purchased, at fair value:				
Equities ⁽¹⁾	\$ 1,080,339	\$ -	\$ -	\$ 1,080,339
Listed equity options	111,691	-	-	111,691
U.S. government obligations	18,626	-	-	18,626
Corporate debt ⁽²⁾	81,053	-	-	81,053
Embedded conversion derivative	-	109	-	109
Foreign currency forward contracts	-	4,322	-	4,322
Total Financial instruments sold, not yet purchased, at fair value	1,291,709	4,431	-	1,296,140
Liability to GNMA trusts, at fair value ⁽³⁾	-	3,383,240	-	3,383,240
Total fair value of financial instrument liabilities	\$ 1,291,709	\$ 3,387,671	\$ -	\$ 4,679,380

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(Unaudited)

- (1) Equities of \$560.2 million have been netted by their respective long and short positions by CUSIP number.
- (2) Corporate debt of \$8.1 million has been netted by respective long and short positions by CUSIP number.
- (3) Represents HECMs that have been securitized into HECM Mortgage Backed Securities (HMBS) where the securitization is not accounted for as a sale of the underlying HECMs. See *Securitized HECM loan inventory* below for full description.
- (4) Securities segregated under federal and other regulations and Securities on deposit with clearing organizations consist of U.S. government obligations.
- (5) Deferred compensation investments and investment in the Deephaven Funds are included within Investments on the Consolidated Statements of Financial Condition.

December 31, 2011	Assets and Liabilities Measured at Fair Value on a Recurring Basis			Total
	Level 1	Level 2	Level 3	
Assets				
Financial instruments owned, at fair value:				
Equities ⁽¹⁾	\$ 1,416,090	\$ -	\$ -	\$ 1,416,090
U.S. government obligations	44,316	-	-	44,316
Corporate debt ⁽²⁾	73,916	-	-	73,916
Mortgage-backed securities	16,399	-	-	16,399
Loan inventory	-	206,572	-	206,572
Listed equity options	280,384	-	-	280,384
Purchased call options	-	17,532	-	17,532
Foreign currency forward contracts	-	3,951	-	3,951
Securitized HECM loan inventory ⁽³⁾	-	1,722,631	-	1,722,631
Total Financial instruments owned, at fair value	1,831,105	1,950,686	-	3,781,791
Deferred compensation investments ⁽⁴⁾	-	20,414	-	20,414
Investment in Deephaven Funds ⁽⁴⁾	-	1,319	-	1,319
Total fair value of financial instrument assets	\$ 1,831,105	\$ 1,972,419	\$ -	\$ 3,803,524
Liabilities				
Financial instruments sold, not yet purchased, at fair value:				
Equities ⁽¹⁾	\$ 1,369,750	\$ -	\$ -	\$ 1,369,750
U.S. government obligations	10,644	-	-	10,644
Corporate debt ⁽²⁾	52,429	-	-	52,429
Listed equity options	254,506	-	-	254,506
Embedded conversion derivative	-	17,532	-	17,532
Total return swap	-	17,031	-	17,031
Total Financial instruments sold, not yet purchased, at fair value	1,687,329	34,563	-	1,721,892
Liability to GNMA trusts, at fair value ⁽³⁾	-	1,710,627	-	1,710,627
Total fair value of financial instrument liabilities	\$ 1,687,329	\$ 1,745,190	\$ -	\$ 3,432,519

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KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

- (1) Equities of \$400.6 million have been netted by their respective long and short positions by CUSIP number.
- (2) Corporate debt of \$0.4 million has been netted by respective long and short positions by CUSIP number.
- (3) Represents HECMs that have been securitized into HMBS where the securitization is not accounted for as a sale of the underlying HECMs. See *Securitized HECM loan inventory* below for full description.
- (4) Deferred compensation investments and investment in the Deephaven Funds are included within Investments on the Consolidated Statements of Financial Condition. Excluded from deferred compensation investments is \$1.1 million of Level 2 assets which relate to discontinued operations and are included within Other assets on the Consolidated Statements of Financial Condition.

The Company's equities, listed equity options, U.S. government and Non-U.S. government obligations, rated corporate debt, and actively traded mortgage-backed securities will generally be classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices or broker or dealer quotations with reasonable levels of price transparency.

The types of instruments that trade in markets that are not considered to be active, but are valued based on observable inputs such as quoted market prices or alternative pricing sources with reasonable levels of price transparency are generally classified within Level 2 of the fair value hierarchy.

Certain instruments are classified within Level 3 of the fair value hierarchy because they trade infrequently and therefore have little or no price transparency. For those instruments that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used. As of September 30, 2012 and December 31, 2011, the Company did not hold any financial instruments that met the definition of Level 3.

The Company's assets measured at fair value on a nonrecurring basis solely relates to goodwill and intangible assets arising from various acquisitions which would be classified as Level 3 within the fair value hierarchy. See Footnote 10 Goodwill and Intangible Assets for additional information.

There were no transfers of financial instruments between levels of the fair value hierarchy for any periods presented.

As of September 30, 2012 and December 31, 2011, the Company's loan inventory, foreign currency forward contracts, certain mortgage-backed securities, purchased call options and embedded conversion derivative related to its long-term debt (see Footnote 11 Long-Term Debt), deferred compensation investments and its remaining investment in the Deephaven Funds are classified within Level 2 of the fair value hierarchy.

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KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

The following is a description of the valuation basis, techniques and significant inputs used by the Company in valuing its Level 2 assets:

Loan inventory

The Company's loan inventory primarily comprises newly issued HECMs that it has originated or purchased and for which the Company has elected to account for at fair value. Significant inputs that are used in determining fair value include LIBOR and U.S. treasury interest rates, weighted average coupon and pricing of actively-traded HMBS and dealer quotations for HECMs.

Securitized HECM loan inventory

Securitized HECM loan inventory comprises HECMs that the Company has securitized into HMBS. The Company has recorded the securitized loans in Financial instruments owned, at fair value and a corresponding liability recorded as Liability to GNMA trusts, at fair value, on its Consolidated Statements of Financial Condition. As of September 30, 2012 and December 31, 2011 all of the HMBS created by the Company has been sold to third parties. Significant inputs that are used in determining fair value include LIBOR and U.S. treasury interest rates, weighted average coupon and pricing of actively-traded HMBS and dealer quotations for HECMs.

Foreign currency forward contracts

At September 30, 2012 and December 31, 2011, the Company had a foreign currency forward contract with a notional value of 75.0 million British pounds which is used to hedge the Company's investment in its European subsidiary. As of September 30, 2012 and December 31, 2011, the Company had a foreign currency forward contract with a notional value of 10.3 million Euros and 6.0 million Euros, respectively, which is used as an economic hedge against a strategic investment that is denominated in Euros. The fair value of these contracts was determined based upon spot foreign exchange rates, LIBOR interest rates and dealer quotations.

Mortgage-backed securities

The Company's mortgage-backed securities that are not actively traded are priced based upon dealer quotations, prices observed from recently executed transactions and cash flow models that incorporate LIBOR forward interest rates, weighted average coupon, weighted average loan age, loan to value and other observable inputs.

Purchased call options and embedded conversion derivative

The fair value of the purchased call options and embedded conversion derivative are determined using an option pricing model based on observable inputs such as implied volatility of the Company's Class A common stock, risk-free interest rate, and other factors.

Deferred compensation investments

Deferred compensation investments comprise investments in liquid mutual funds that the Company acquires to hedge its obligations to employees and directors under certain non-qualified deferred compensation arrangements. These mutual fund investments can generally be redeemed at any time and are valued based upon quoted market prices.

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued****(Unaudited)***Investment in the Deephaven Funds*

Investment in the Deephaven Funds represents our residual investment in certain funds that were formerly managed by Deephaven Capital Management. These investments are in the process of liquidation and are valued based upon the fair value of the underlying investments within such funds.

Fair value of derivative instruments

The Company enters into derivative transactions, primarily with respect to making markets in listed domestic options. In addition, the Company enters into derivatives to manage foreign currency exposure and related to its long-term debt (see Footnote 11 Long-Term Debt). Cash flows associated with such derivative activities are included in cash flows from operating activities on the Consolidated Statements of Cash Flows, when applicable.

The following tables summarize the fair value of derivative instruments in the Consolidated Statements of Financial Condition and the gains and losses included in the Consolidated Statements of Operations (in thousands):

	Statements of Financial Condition Location	Fair Value as of	
		September 30, 2012	December 31, 2011
Asset Derivatives			
Derivative instruments not designated as hedging instruments:	Financial instruments owned, at fair value		
Purchased call options		\$ 109	\$ 17,532
Listed equity options ⁽¹⁾		132,379	280,384
Foreign currency forward contracts		-	477
		\$ 132,488	\$ 298,393
Derivative instruments designated as hedging instruments:			
	Financial instruments owned, at fair value		
Foreign currency forward contracts		\$ -	\$ 3,474
Liability Derivatives			
Derivative instruments not designated as hedging instruments:	Financial instruments sold, not yet purchased, at fair value		
Embedded conversion derivative		\$ 109	\$ 17,532
Listed equity options ⁽¹⁾		111,691	254,506
Total return swap ⁽²⁾		-	17,031
Foreign currency forward contracts		472	-
		\$ 112,272	\$ 289,069

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

(Unaudited)

Asset Derivatives Liability Derivatives	Statements of Financial Condition Location	Fair Value as of	
		September 30, 2012	December 31, 2011
Derivative instruments designated as hedging instruments:	Financial instruments sold, not yet purchased, at fair value		
Foreign currency forward contracts		\$ 3,850	\$ -

- (1) At September 30, 2012, the Company held 0.6 million long and 0.6 million short listed equity option contracts. At December 31, 2011, the Company held 1.3 million long and 1.5 million short listed equity option contracts. These contracts are not subject to collateral requirements and are not netted.
- (2) At December 31, 2011, the total return swap liability was offset by an asset of equal value that was included in Financial instruments owned, at fair value on the Company's Consolidated Statements of Financial Condition. This total return swap was liquidated during the first quarter of 2012.

Derivative instruments not designated as hedging instruments:	Financial Statements Location	Gain (Loss) Recognized For the three months ended September 30,	
		2012	2011
Purchased call options	Investment income and other, net	\$ (7,891)	\$ 7,577
Listed equity options ⁽¹⁾	Net trading revenue	(3,382)	(10,703)
Embedded conversion derivative	Investment income and other, net	7,891	(7,577)
Total return swap ⁽²⁾	Investment income and other, net	-	1,035
Foreign currency forward contracts	Investment income and other, net	(1,696)	600
		\$ (5,078)	\$ (9,068)

Derivative instruments designated as hedging instruments:

Foreign currency forward contracts	Accumulated other comprehensive income (loss)	\$ (2,164)	\$ 3,500
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Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

(Unaudited)

	Financial Statements Location	Gain (Loss) Recognized For the nine months ended September 30,	
		2012	2011
Derivative instruments not designated as hedging instruments:			
Purchased call options	Investment income and other, net	\$ (17,422)	\$ (14,649)
Listed equity options ⁽¹⁾	Net trading revenue	(9,185)	(2,072)
Embedded conversion derivative	Investment income and other, net	17,422	14,649
Total return swap ⁽²⁾	Investment income and other, net	-	(5,735)
Foreign currency forward contracts	Investment income and other, net	(1,498)	600
		\$ (10,683)	\$ (7,207)
Derivative instruments designated as hedging instruments:			
Foreign currency forward contracts	Accumulated other comprehensive income (loss)	\$ (3,284)	\$ (118)

- (1) Realized gains and losses on listed equity options relate to the Company's market making activities in such options. Such market making activities also comprise trading in the underlying equity securities, with gains and losses on such securities generally offsetting the gains and losses reported in this table. Gains and losses on such equity securities are also included in Net trading revenue on the Company's Consolidated Statements of Operations.
- (2) Loss on the total return swap is offset by an equal gain on the underlying position which is recorded in Investment income and other, net on the Company's Consolidated Statements of Operations.

7. Collateralized Transactions

The Company receives financial instruments as collateral in connection with securities borrowed. Such financial instruments generally consist of equity and convertible securities but may include obligations of the U.S. government, federal agencies, Non-U.S. government and corporations. In most cases, the Company is permitted to deliver or repledge these financial instruments in connection with securities lending and other secured financings and meeting settlement requirements.

The table below presents financial instruments at fair value received as collateral that were permitted to be delivered or repledged and that were delivered or repledged by the Company and in some instances could be further repledged by the receiving counterparty (in thousands):

	September 30, 2012	December 31, 2011
Collateral permitted to be delivered or repledged	\$ 1,018,017	\$ 1,450,281
Collateral that was delivered or repledged	951,027	1,383,298
Collateral permitted to be further repledged by the receiving counterparty	47,600	275,912

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued****(Unaudited)**

In order to finance securities positions and loan inventory, the Company also pledges financial instruments that it owns to counterparties who, in turn, are permitted to deliver or repledge them. Under these transactions, the Company pledges certain financial instruments owned to collateralize repurchase agreements and other secured financings. Repurchase agreements and other secured financings are short-term and mature within one year. Financial instruments owned and pledged to counterparties that do not have the right to sell or repledge such financial instruments consist of equity securities and loans.

The table below presents information about assets pledged by the Company (in thousands):

	September 30, 2012	December 31, 2011
Financial instruments owned, at fair value, pledged to counterparties that had the right to deliver or repledge	\$ 3,699,610	\$ 2,121,783
Financial instruments owned, at fair value, pledged to counterparties that do not have the right to deliver or repledge	\$ 638,526	\$ 550,926

8. Receivable from and Payable to brokers, dealers, and clearing organizations

Amounts receivable from and payable to brokers, dealers, and clearing organizations consist of the following (in thousands):

	September 30, 2012	December 31, 2011
Receivable:		
Clearing organizations and other	\$ 772,888	\$ 553,960
Securities failed to deliver	171,351	69,937
	\$ 944,239	\$ 623,897
Payable:		
Clearing organizations and other	\$ 226,201	\$ 306,728
Securities failed to receive	77,077	15,932
	\$ 303,277	\$ 322,660

9. Investments

Investments include strategic investments, deferred compensation investments related to employee and director deferred compensation plans and investment in Deephaven Funds. Investments consist of the following (in thousands):

	September 30, 2012	December 31, 2011
Strategic investments:		
Investments accounted for under the equity method	\$ 72,714	\$ 59,711

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Common stock of companies representing less than 20% equity ownership held at adjusted cost	1,789	1,787
Total Strategic investments	74,502	61,498
Deferred compensation investments	21,711	20,414
Investment in Deephaven Funds	1,406	1,319
Total Investments	\$ 97,620	\$ 83,231

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KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

During the second quarter of 2012, the Company became aware that a strategic investee that is accounted for under the equity method of accounting had identified errors in its accounting for income taxes. Specifically, the investee had not correctly accounted for an income tax benefit that resulted from a change in its tax status during 2010. The correction of this error by the investee resulted in an increase in the Company's equity method investment of \$10.0 million. The Company evaluated the impact of recording this investment gain in the relevant prior periods and concluded that such amounts would not have been material, qualitatively or quantitatively, to its previously issued consolidated financial statements for any prior period. The Company also concluded that recording the investment gain in 2012 would not be material to its forecasted results for the year. Accordingly the Company recorded a \$10.0 million gain in the second quarter of 2012.

10. Goodwill and Intangible Assets

Goodwill is assessed for impairment annually or when events indicate that the amounts may not be recoverable. The Company assesses goodwill for impairment at the reporting unit level. The Company's reporting units are the components of its business segments for which discrete financial information is available and is regularly reviewed by the Company's management. As part of the assessment for impairment, the Company considers the cash flows of the respective reporting unit and assesses the fair value of the respective reporting unit as well as the overall market value of the Company compared to its net book value. The assessment of fair value of the reporting units is principally performed using a discounted cash flow methodology with a risk-adjusted weighted average cost of capital which the Company believes to be the most reliable indicator of the fair values of its respective reporting units. The Company also assesses the fair value of each reporting unit based upon its estimated market value and assesses the Company's overall market value based upon the market price of its Class A common shares. In June 2012 and 2011, the Company assessed the impairment of goodwill as part of its annual assessment and concluded that there was no impairment at that time.

Intangible assets are assessed for recoverability when events or changes in circumstances indicate that the carrying amount of the asset or asset group may not be recoverable. The Company assesses intangible assets for impairment at the asset group level which is the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. As part of the assessment for impairment, the Company considers the cash flows of the respective asset group and assesses the fair value of the respective asset group. Step 1 of the impairment assessment for intangibles is performed using undiscounted cash flow models, which indicates whether the future cash flows of the asset group are sufficient to recover the book value of such asset group. When an asset is not considered to be recoverable, step 2 of the impairment assessment is performed using a discounted cash flow methodology with a risk-adjusted weighted average cost of capital to determine the fair value of the intangible asset group. In cases where amortizable intangible assets and goodwill are assessed for impairment at the same time, the amortizable intangibles are assessed for impairment prior to goodwill being assessed.

The events surrounding the August 1, 2012 technology issue resulted in a substantial decrease in the Company's market capitalization and decreases in trading volumes and commission revenues as many customers reduced their trading activity. This was determined by management to be a triggering event for certain of the Company's businesses and resulted in the Company being required to assess the carrying amount and recoverability of the goodwill related to those businesses. Certain reporting

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued****(Unaudited)**

units did not have a triggering event as they were relatively unaffected by the August 1, 2012 events. These events also indicated that certain of the Company's amortizable intangible assets may not be recoverable.

The intangible asset impairment assessment performed in the third quarter of 2012 indicated that the intangible assets in the Company's DMM, asset management and reverse mortgage businesses were impaired, and that the fair value of such intangible assets was less than the book value. As a result, the Company recorded an impairment charge of \$15.3 million during the third quarter of 2012 comprising \$11.9 million of trading rights related to the Company's DMM business and \$3.4 million of customer relationships related to the Company's asset management business. During the third quarter of 2012 the Company also recorded a charge of \$1.4 million related to the abandonment of intangible assets related to the Company's reverse mortgage business.

The goodwill impairment assessment performed as a result of the August 1, 2012 triggering event, indicated that the fair value of goodwill within the institutional fixed income and asset management reporting units was less than their book values and as a result the Company recorded an impairment charge of \$126.4 million during the third quarter of 2012 comprising goodwill of \$114.3 million and \$12.1 million related to the institutional fixed income and asset management reporting units, respectively.

As a result of a corporate restructuring the Company wrote off goodwill of \$1.0 million in the Corporate and Other segment during the third quarter of 2011.

No other events occurred in 2012 or 2011 that would indicate that the carrying amounts of the Company's goodwill or intangible assets may not be recoverable.

The following table summarizes the Company's Goodwill as of September 30, 2012 and December 31, 2011 by segment (in thousands):

	September 30, 2012	December 31, 2011
Market Making	\$ 24,727	\$ 24,727
Institutional Sales and Trading	21,376	147,736
Electronic Execution Services	165,380	165,380
Corporate and Other	7,117	-
Total	\$ 218,600	\$ 337,843

In 2012, the Company recorded goodwill of \$7.1 million as a result of the acquisition of certain assets and assumption of certain liabilities of the former futures division of Penson.

Intangible assets primarily represent client relationships and are amortized over their estimated remaining useful lives, the majority of which have been determined to range from one to 18 years. The weighted average remaining life of the Company's intangible assets at September 30, 2012 and December 31, 2011 is approximately 10 and 11 years, respectively.

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(Unaudited)

The following tables summarize the Company's Intangible assets, net of accumulated amortization as of September 30, 2012 and December 31, 2011 by segment and type (in thousands):

	September 30, 2012	December 31, 2011
Market Making		
Trading rights	\$ 11,769	\$ 25,283
Other	43	-
Total	11,812	25,283
Institutional Sales and Trading		
Customer and broker relationships	17,591	24,165
Trade names	1,275	1,350
Other	325	3,905
Total	19,191	29,420
Electronic Execution Services		
Customer and broker relationships	23,886	26,730
Trade names	5,867	6,207
Other	3,979	5,249
Total	33,732	38,186
Corporate and Other		
Customer and broker relationships	3,435	-
Total	3,435	-
Consolidated Total	\$ 68,170	\$ 92,889

In 2012, the Company recorded intangible assets of \$3.5 million as a result of the acquisition of certain assets and assumption of certain liabilities of the former futures division of Penson.

		September 30, 2012	December 31, 2011
Customer and broker relationships ⁽¹⁾	Gross carrying amount	\$ 94,200	\$ 93,600
	Accumulated amortization	(49,288)	(42,705)

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	Net carrying amount	44,912	50,895
Trading rights ⁽²⁾	Gross carrying amount	15,520	28,520
	Accumulated amortization	(3,751)	(3,237)
	Net carrying amount	11,769	25,283
Trade names ⁽³⁾	Gross carrying amount	9,800	9,800
	Accumulated amortization	(2,658)	(2,243)
	Net carrying amount	7,142	7,557
Other ⁽⁴⁾	Gross carrying amount	13,960	18,761
	Accumulated amortization	(9,613)	(9,607)
	Net carrying amount	4,347	9,154
Total	Gross carrying amount	133,480	150,681
	Accumulated amortization	(65,310)	(57,792)
	Net carrying amount	\$ 68,170	\$ 92,889

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(Unaudited)

- (1) Customer and broker relationships primarily relate to the Donaldson, Direct Trading, Hotspot, EdgeTrade, Libertas, Urban, Astor and Penson Futures acquisitions. The weighted average remaining life is approximately 11 years as of September 30, 2012 and 10 years as of December 31, 2011. Lives may be reduced depending upon actual retention rates.
- (2) Trading rights provide the Company with the rights to trade on certain exchanges. The gross and net carrying amounts were reduced in the third quarter of 2012 by \$13.0 million and \$11.9 million, respectively as a result of the impairment assessment described above. The weighted average remaining life is approximately 8 years as of September 30, 2012 and 14 years as of December 31, 2011.
- (3) Trade names relate to the acquisitions of Hotspot, EdgeTrade and Urban. The weighted average remaining life is approximately 14 years as of both September 30, 2012 and December 31, 2011.
- (4) Other primarily includes technology and non-compete agreements acquired by the Company. The gross and net carrying amounts were reduced in the third quarter of 2012 by \$7.8 million and \$4.8 million, respectively as a result of the impairment assessment described above. The weighted average remaining life is approximately three years as of September 30, 2012 and two years as of December 31, 2011.

The following table summarizes the Company's amortization expense relating to Intangible assets (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Amortization expense	\$ 3,695	\$ 3,965	\$ 11,595	\$ 11,866

As of September 30, 2012, the following table summarizes the Company's estimated amortization expense for the following future periods (in thousands):

	Amortization expense
Three months ended December 31, 2012	\$ 3,338
For the year ended December 31, 2013	11,539
For the year ended December 31, 2014	9,720
For the year ended December 31, 2015	7,565
For the year ended December 31, 2016	4,718

11. Long-Term Debt

The Company's Long-term debt is recorded at amortized cost. The carrying value and fair value of such Long-term debt as of September 30, 2012 and December 31, 2011 is as follows (in thousands):

	September 30, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Term Credit Agreement	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000
Convertible Notes	335,089	309,589	324,338	287,505

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Total	435,089	409,589	424,338	387,505
Less: Current portion recorded in Accrued expenses and other liabilities	25,000	25,000	-	-
Total Long-term debt	\$ 410,089	\$ 384,589	\$ 424,338	\$ 387,505

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KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

The carrying value of the Term Credit Agreement approximates fair value as it is not materially sensitive to shifts in interest rates due to its floating interest rate, which also considers changes in the Company's credit risks and financial condition. The fair value of the Convertible Notes is based upon the value of such debt in the secondary market. The Term Credit Agreement and the Convertible Notes would both be categorized as Level 2 in the fair value hierarchy if they were required to be recorded at fair value.

Credit Agreements

On June 29, 2011, the Company, as borrower, entered into a \$100.0 million three-year Term Loan Credit Agreement (the Term Credit Agreement) with a consortium of banks. The Company, as guarantor, also entered into a \$200.0 million one-year Revolving Credit Agreement (the Revolving Credit Agreement) and together with the Term Credit Agreement, the Credit Agreements) with the same consortium of banks with Knight Execution & Clearing Services LLC (KECS) and Knight Capital Americas, L.P., wholly-owned subsidiaries of the Company, as borrowers. The Revolving Credit Agreement was renewed with substantially the same consortium of banks on substantially the same terms and conditions on June 27, 2012 and will expire on June 26, 2013. As a result of the consolidation of Knight Capital Americas, L.P. into KECS as of June 30, 2012, and the subsequent renaming of KECS to Knight Capital Americas LLC (KCA), KCA is now the sole borrower under the Revolving Credit Agreement.

Term Credit Agreement

The proceeds of the Term Credit Agreement are being used for general corporate purposes. As of September 30, 2012, the Company has borrowed all the funds under the Term Credit Agreement. Borrowings under the Term Credit Agreement bear interest at variable rates as determined at the Company's election, at LIBOR or a base rate, in each case, plus an applicable margin of (a) for each LIBOR loan, 2.50% or 3.00% per annum or (b) for each base rate loan, 1.50% or 2.00% per annum (in each case, depending on the Company's leverage ratio). As of September 30, 2012, the interest rate was 2.72% per annum, which is based on the one month LIBOR rate plus 2.50%. Interest is paid monthly. The Term Credit Agreement is repayable in three installments as follows: \$25.0 million on June 28, 2013, \$25.0 million on December 27, 2013 and \$50.0 million on June 27, 2014.

Under the Term Credit Agreement, substantially all of the Company's material subsidiaries (the Guarantors), other than its foreign subsidiaries, excluded regulated subsidiaries (which include registered broker-dealer subsidiaries) and subsidiaries thereof, guarantee the repayment of loans made pursuant to the Term Credit Agreement. The Term Credit Agreement is secured by substantially all of the assets of the Company and the Guarantors unless and until the Company obtains an investment grade rating.

Revolving Credit Agreement

The Revolving Credit Agreement comprises two classes of loans: Borrowing Base A and Borrowing Base B. The proceeds of the Borrowing Base A Loans are available to KCA and may be used to meet the short-term liquidity needs of KCA arising in the ordinary course of clearing and settlement activity. The proceeds of the Borrowing Base B Loans can only be used to fund National Securities Clearing Corporation (NSCC) margin deposits.

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KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

Borrowings under the Revolving Credit Agreement bear interest at a rate equal to the greater of the federal funds rate or the one month LIBOR rate plus (a) for each Borrowing Base A Loan, a margin of 1.50% per annum and (b) for each Borrowing Base B Loan a margin of 2.00% per annum. Interest is payable quarterly. On August 6, 2012, the Company drew down \$200.0 million under the Revolving Credit Agreement for both a Borrowing Base A and Borrowing Base B Loan and repaid the full amount of each loan on August 7, 2012. As of September 30, 2012 and December 31, 2011, there were no outstanding borrowings under the Revolving Credit Agreement.

The Company is charged an annual commitment fee of 0.25% on the average daily amount of the unused portion of the Revolving Credit Agreement. Depending on each borrowing base, availability under the Revolving Credit Agreement is limited to either (i) a percentage of the market value of temporary positions pledged as collateral in the case of Borrowing Base A Loans, or (ii) a percentage of the margin deposit required by the NSCC in the case of Borrowing Base B Loans.

Among other restrictions, the Credit Agreements include customary representations, warranties, affirmative and negative covenants related to (a) liens, (b) financial covenant requirements for maintaining a consolidated leverage ratio and a liquidity ratio, as well as requirements for maintaining minimum levels of tangible net worth and regulatory capital, and (c) restrictions on investments, dispositions and other restrictions and events of default customary for financings of these types. As of September 30, 2012, the Company was in compliance with all covenants under the Credit Agreements.

In connection with the Credit Agreements, the Company incurred issuance costs of \$2.2 million. The issuance costs are recorded within Other assets on the Consolidated Statements of Financial Condition and are being amortized over the term of the Credit Agreements.

Cash Convertible Senior Subordinated Notes

In March 2010, the Company issued \$375.0 million of Cash Convertible Senior Subordinated Notes (the Notes) due on March 15, 2015 in a private offering exempt from registration under the Securities Act of 1933, as amended. At the same time, the Company entered into hedge transactions effected through the purchase of options and sale of warrants designed to limit shareholder dilution up to a price of \$31.50 per share.

The Notes bear interest at a rate of 3.50% per year, payable semi-annually in arrears, on March 15 and September 15 of each year, commencing on September 15, 2010 and will mature on March 15, 2015, subject to earlier repurchase or conversion. In connection with the issuance of the Notes, the Company recognized an original issue discount of \$73.8 million which is being accreted to interest expense over the term of the Notes, resulting in an effective annual interest rate of the Notes of approximately 7.90%. The Notes, net of unamortized original issue discount are reported as Long-term debt in the Company's Consolidated Statements of Financial Condition.

Prior to December 15, 2014, the Notes will be convertible into cash only upon specified events which are based upon the price of the Company's common shares and of the Notes or upon the occurrence of specified corporate events. On or after December 15, 2014, the Notes will be convertible at any time, based on an initial conversion rate of 47.9185 shares of the Company's Class A common stock per \$1,000 principal amount of Notes, which is equivalent to an initial conversion price of approximately \$20.87 or a conversion premium of approximately 32.5% over the closing sale price of \$15.75 per share of the Company's Class A common stock on the Nasdaq Global Select Market on March 15, 2010. The conversion rate and conversion price will be subject to adjustment in certain

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KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

events, such as distributions of dividends or stock splits. Upon cash conversion, the Company will deliver an amount of cash calculated over the applicable observation period. The Company will not deliver its common stock (or any other securities) upon conversion under any circumstances. In addition, following certain corporate events that occur prior to the maturity date, the Company will pay a cash make-whole premium by increasing the conversion rate for a holder who elects to convert its Notes in connection with such a corporate event in certain circumstances. Subject to certain exceptions, holders may require the Company to repurchase, for cash, all or part of the Notes upon a fundamental change at a price equal to 100% of the principal amount of the Notes being repurchased plus any accrued and unpaid interest.

Concurrent with the sale of the Notes, the Company paid \$73.7 million to enter into privately negotiated cash convertible note hedge transactions (the purchased call options) with affiliates of the initial purchasers of the Notes and another financial institution (the option counterparties) that are expected generally to reduce the Company's exposure to potential cash payments in excess of the principal amount of the Notes that may be required to be made by the Company upon the cash conversion of the Notes under certain conditions. The purchased call options cover, subject to adjustments, approximately 18 million shares of the Company's Class A common stock at a strike price of \$20.87 and are expected to reduce the Company's economic exposure to potential cash payments in the event that the market price per share of the Company's Class A common stock is greater than the conversion price of the Notes. The purchased call options were recorded as an asset within Financial instruments owned, at fair value on the Consolidated Statements of Financial Condition and is accounted for as derivative instruments under GAAP. As of September 30, 2012, the fair value of the purchased call options was \$0.1 million.

In connection with the sale of the Notes, the Company also entered into separate warrant transactions with the option counterparties whereby the Company sold to the option counterparties, for \$15.0 million, warrants (the warrants) to purchase shares of the Company's Class A common stock, subject to adjustments, at a strike price of \$24.10 per share, which represents a premium of approximately 100% over the closing price of the Company's Class A common stock on March 15, 2010. The warrants are net share settled, meaning that the Company will issue a number of shares per warrant having a value equal to the difference between the share price at each warrant expiration date and the strike price; however, at the discretion of the Company, the Company may elect to settle the warrants in cash. If the market price per share of the Company's Class A common stock exceeds the strike price of the warrants over the warrants' exercise period and the Company elects net share settlement, the warrants would have a dilutive effect on the Company's Class A common stock. The warrants may not be exercised prior to the maturity of the Notes. The warrants have been recorded as Additional paid-in capital in the Consolidated Statements of Financial Condition. The warrants also meet the criteria of derivative instruments under GAAP; however, because the warrants are indexed to the Company's Class A common stock and are recorded within Equity in the Consolidated Statements of Financial Condition, the warrants are exempt from the scope and fair value provisions of GAAP related to accounting for derivative instruments.

The requirement that the Company settle conversions of the Notes entirely in cash gives rise to a bifurcated derivative instrument under GAAP (the embedded conversion derivative). The initial valuation of the embedded conversion derivative was \$73.8 million, and was recorded as a liability within Financial instruments sold, not yet purchased, at fair value on the Consolidated Statements of Financial Condition. As of September 30, 2012, the fair value of the embedded conversion derivative was \$0.1 million.

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Both the purchased call options and the embedded conversion derivative are derivative instruments and as such are marked to fair value each reporting period with any change recognized on the Consolidated Statements of Operations as Investment income and other, net. The Company expects the gain or loss associated with changes to the valuation of the purchased call options to substantially offset the gain or loss associated with changes to the valuation of the embedded conversion derivative.

In connection with the issuance of the Notes, the Company incurred issuance costs of \$8.5 million. The issuance costs are being recorded within Other assets on the Consolidated Statements of Financial Condition and are amortized over the term of the Notes.

The Company recorded expenses with respect to the Long-term debt as follows (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Interest expense	\$ 7,640	\$ 7,380	\$ 22,685	\$ 20,450
Amortization of debt issuance cost ⁽¹⁾	743	780	2,301	1,630
Commitment fee ⁽¹⁾	125	128	401	128
Total	\$ 8,508	\$ 8,288	\$ 25,387	\$ 22,208

(1) Included in Other expense on the Consolidated Statements of Operations.

12. Related Parties

As a result of the August 6, 2012 recapitalization, as of September 30, 2012, three investors held more than 10% of the Class A common stock plus Series A Shares on a fully converted basis and therefore are considered related parties.

The Company interacts with these three investors as part of its normal day-to-day operations. It earns revenues, incurs expenses and maintains balances with these related parties or their affiliates on a regular basis. As of the date and period indicated below, the Company had the following balances and transactions with the related parties or their affiliates as follows (in thousands):

	For the period August 6, 2012 to September 30, 2012
Statement of Operations	
<i>Revenues</i>	
Commissions and fees	\$ 77
Net trading revenue	406
Interest, net	16
Total revenues with related parties	\$ 499
<i>Expenses</i>	

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Execution and clearance fees	\$	12
Interest expense		133
Total expenses with related parties	\$	145

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Statement of Financial Condition	As of September 30, 2012
<i>Assets</i>	
Securities borrowed	\$ 47,269
Other assets	\$ 4,425
<i>Liabilities</i>	
Securities loaned	\$ 37,023
Payable to brokers, dealers and clearing organizations	\$ 56
Accrued expenses and other liabilities	\$ 5,936

The Company paid a total of \$22.6 million in fees to related parties in connection with the August 6, 2012 recapitalization which was recorded as a reduction of the proceeds from the \$400.0 million convertible preferred share offering. In the ordinary course of business, the Company enters into foreign exchange contracts with related parties.

13. Stock-Based Compensation

The Knight Capital Group, Inc. 2010 Equity Incentive Plan (2010 Plan) was established to provide long-term incentive compensation to employees and directors of the Company. The 2010 Plan is administered by the Compensation Committee of the Company's Board of Directors, and allows for the grant of options, stock appreciation rights, restricted stock and restricted stock units (collectively, the awards), as defined by the 2010 Plan. In addition to overall limitations on the aggregate number of awards that may be granted, the 2010 Plan also limits the number of awards that may be granted to a single individual. The 2010 Plan replaced prior stockholder-approved equity plans for future equity grants and no additional grants will be made under those historical stock plans. However, the terms and conditions of any outstanding equity grants under the historical stock plans were not affected. As of September 30, 2012, the Company has not issued any stock appreciation rights. In addition, the Company established the Knight Capital Group, Inc. 2009 Inducement Award Plan (the Inducement Plan) (along with the 2010 Plan, the Stock Plans) which is used under limited circumstances for equity grants to new hires. The Company did not issue any awards pursuant to the Inducement Plan in 2012 or 2011.

Unvested awards granted before September 1, 2010 are generally canceled if employment is terminated for any reason before the end of the relevant vesting period. For annual incentive awards granted after September 1, 2010 and up to September 30, 2011, full vesting is given where an employee has been terminated without cause by the Company. For all other awards granted after September 1, 2010 and up to September 30, 2011 unvested awards are generally canceled if employment is terminated for any reason before the end of the relevant vesting period. Effective October 1, 2011, for all awards granted after such date, unless otherwise provided for in the applicable award agreement, full vesting will be given where an employee has been terminated without cause by the Company.

Under the terms of our prior stockholder-approved equity plans (excluding the 2010 Plan), accelerated vesting of unvested equity awards is triggered upon a change-in-control which is generally defined, amongst other things, as the acquisition by any one person of 20% or more of the Company's voting stock. Subsequent to the Company's issuance of Series A Shares on August 6, 2012, one of the investors exceeded the 20% ownership threshold on an as-converted basis, which resulted in the accelerated vesting

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of unvested grants held by employees under these historical plans. The affected equity awards were generally granted from December 2009 through March 2010, and generally would have vested between December 2012 and March 2013. The accelerated vesting resulted in additional stock-based compensation of \$1.6 million in the third quarter of 2012. Each of our Named Executive Officers and Section 16 reporting persons previously executed letters waiving the acceleration of vesting triggered by this change-in-control for any unvested awards held by them under the prior historical plans as of such date.

Restricted Shares and Restricted Stock Units

Eligible employees and directors may receive restricted shares and/or restricted stock units (collectively restricted awards) as a portion of their total compensation. The majority of restricted awards vest ratably over three years. The Company has also issued restricted awards that vest based upon the market price of Knight's Class A common stock reaching a certain price for a specified period of time, however no such awards were granted in 2012 or 2011. The Company has the right to fully vest employees and directors in their restricted stock units upon retirement and in certain other circumstances.

The Company measures compensation cost related to restricted awards based on the fair value of the Company's Class A common stock at the date of grant. Compensation expense relating to restricted awards, primarily recorded in Employee compensation and benefits, and the corresponding income tax benefit, which was recorded in Income tax (benefit) expense on the Consolidated Statements of Operations are presented in the following table (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Stock award compensation expense	\$ 13,615	\$ 13,480	\$ 41,327	\$ 40,939
Income tax benefit	\$ 4,765	\$ 5,284	\$ 14,464	\$ 16,048

The following table summarizes restricted awards activity during the nine months ended September 30, 2012 (shares and units in thousands):

	Restricted Shares		Restricted Stock Units	
	Number of Shares	Weighted- Average Grant date Fair Value	Number of Units	Weighted- Average Grant date Fair Value
Outstanding at January 1, 2012	307	\$ 16.20	7,716	\$ 14.33
Granted	21	13.09	4,268	12.45
Vested	(234)	16.32	(3,072)	15.00
Forfeited	(11)	15.74	(460)	13.17
Outstanding at September 30, 2012	83	\$ 15.12	8,452	13.34

There is \$60.8 million of unamortized compensation related to unvested restricted awards outstanding at September 30, 2012. The cost of these unvested restricted awards is expected to be recognized over a weighted average life of 1.8 years.

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The Company's policy is to grant options for the purchase of shares of Class A common stock at not less than market value. Options generally vest ratably over a three or four-year period and expire on the fifth or tenth anniversary of the grant date, pursuant to the terms of the applicable option award agreement. The Company has the right to fully vest employees in their options upon retirement and in certain other circumstances. Options are otherwise canceled if employment is terminated before the end of the relevant vesting period. The Company's policy is to issue new shares upon share option exercises by its employees and directors.

The fair value of each option granted is estimated as of its respective grant date using the Black-Scholes option-pricing model. Stock options granted have exercise prices equal to the market value of the Company's Class A common stock at the date of grant as defined by the Stock Plans. The principal assumptions utilized in valuing options and the methodology for estimating such model inputs include: (1) risk-free interest rate estimate is based on the yield of U.S. zero coupon securities with a maturity equal to the expected life of the option; (2) expected volatility estimate is based on several factors including implied volatility of market-traded options on the Company's Class A common stock on the grant date and the volatility of the Company's Class A common stock; and (3) expected option life estimate is based on internal studies of historical experience and projected exercise behavior based on different employee groups and specific option characteristics, including the effect of employee terminations. The Company did not grant any options in 2012 or 2011.

Compensation expense relating to stock options, which was recorded in Employee compensation and benefits, and the corresponding income tax benefit, which was recorded in Income tax (benefit) expense on the Consolidated Statements of Operations are as follows (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Stock option compensation expense	\$ 572	\$ 294	\$ 1,066	\$ 1,038
Income tax benefit	\$ 200	\$ 115	\$ 373	\$ 407

The following table summarizes stock option activity during the nine months ended September 30, 2012 (shares and units in thousands):

	Number of Stock Options	Weighted- Average Exercise Price
Outstanding at January 1, 2012	2,829	\$ 13.48
Granted at market value	-	-
Exercised	(130)	8.77
Forfeited or expired	(94)	16.11
Outstanding at September 30, 2012	2,605	13.62
Exercisable at September 30, 2012	2,569	13.59
Available for future grants at September 30, 2012*	7,173	

* Represents both options and awards available for grant

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There is \$0.1 million of unrecognized compensation related to unvested stock options outstanding at September 30, 2012. The cost of these unvested awards is expected to be recognized over a weighted average life of 0.3 years.

14. Income taxes

The Company and its subsidiaries file a consolidated federal income tax return as well as combined state income tax returns in certain jurisdictions. In other jurisdictions, the Company and its subsidiaries file separate company state and local income tax returns.

The following table reconciles the U.S. federal statutory income tax rate to the Company's actual income tax rate:

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
U.S. federal statutory income tax rate	35.0%	35.0%	35.0%	35.0%
U.S. state and local income taxes, net of U.S. federal income tax effect	0.8%	4.0%	0.5%	4.0%
Nondeductible charges and other, net	-0.5%	0.3%	-0.5%	0.2%
Actual income tax rate	35.3%	39.3%	35.0%	39.2%

At September 30, 2012, the Company had \$1.0 million of unrecognized tax benefits, all of which would affect the Company's effective tax rate if recognized.

As of September 30, 2012, the Company is subject to U.S. Federal income tax examinations for the tax years 2008 through 2011, and to non-U.S. income tax examinations for the tax years 2007 through 2011. In addition, the Company is subject to state and local income tax examinations in various jurisdictions for the tax years 2003 through 2011. The final outcome of these examinations is not yet determinable. However, the Company anticipates that adjustments to the unrecognized tax benefits, if any, will not result in a material change to the results of operations or financial condition.

The Company's policy for recording interest and penalties associated with audits is to record such items as a component of income or loss from continuing operations before income taxes. Penalties, if any, are recorded in Other expenses and interest paid or received is recorded in Interest expense and Interest, net, on the Consolidated Statements of Operations.

Deferred income taxes reflect the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when such differences are expected to reverse. Valuation allowances recorded on the balance sheet dates are necessary in cases where management believes that it is more likely than not that some portion or all of the deferred tax assets will not be realized.

At September 30, 2012 and December 31, 2011, the Company had federal and state deferred tax assets related to temporary differences and tax loss carryforwards of \$86.8 million and \$26.2 million, respectively. Due to the losses generated in the third quarter of 2012, the Company currently is in a

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

three year cumulative loss position. The Company has a long standing history of sustainable profitability, and based on its forecasts it is expecting to return to profitability. A significant portion of the customer base has remained unchanged and the business has generally demonstrated a return to normality following the technology related losses of August 1, 2012, and the Company does not expect the loss to recur in the future. The goodwill and intangible asset impairment that the Company recorded in the third quarter of 2012 are related to businesses that have not performed well and are not reflective of any weakness in the Company's electronic market making business, which has historically been its most profitable business. Based on the weight of the positive and negative evidences considered, management believes that it is more likely than not that it will be able to realize its deferred tax assets in the future and therefore has not established a valuation allowance against its net deferred tax assets for the period ended September 30, 2012.

As a result of the losses generated in the third quarter of 2012, it is likely that the Company will generate federal, state and local net operating losses for the year ending December 31, 2012.

A significant portion of our anticipated 2012 U.S. federal net operating loss will be eligible to be carried back against taxable income earned by the Company in 2010 and 2011, which will result in a refund of U. S. federal taxes that the Company previously paid in such years. Since the Company uses a calendar year for tax reporting purposes, it cannot calculate its taxable loss for the year ending December 31, 2012 until after the close of that period. For the nine months ended September 30, 2012, however, the Company estimates its taxable loss to be approximately \$400.0 million.

The Company generated taxable income for 2010 and 2011 of approximately \$338.0 million and paid U.S. federal income tax of approximately \$118.0 million for these years. Based upon the estimated \$400.0 million U.S. federal taxable loss for the nine months ended September 30, 2012, the Company would be able to carry \$338.0 million of such loss back to 2010 and 2011 and the Company would be able to obtain a \$118.0 million refund of U.S. federal income taxes. This \$118.0 million benefit has been recorded within Income taxes receivable on the Company's Consolidated Statements of Financial Condition as of September 30, 2012. The balance of the \$173.6 million Income taxes receivable on the Company's Consolidated Statements of Financial Condition as of September 30, 2012 also includes \$55.6 million of refunds due the Company with respect to estimated taxes paid for the year ending December 31, 2012 and refunds due the Company with respect to earlier periods.

The portion of the \$400.0 million loss that could not be carried back, approximately \$70.0 million, would generate a U.S. federal net operating loss carryforward related to the nine months ended September 30, 2012. Including this estimated \$70.0 million tax loss carryforward the Company had U.S. federal net operating loss carryforwards of approximately \$100.0 million and \$31.3 million at September 30, 2012 and December 31, 2011, respectively, of which \$31.3 million resulted from acquisitions. The Company recorded related deferred income tax assets related to these net operating loss carryforwards of \$35.1 million and \$11.0 million as of September 30, 2012 and December 31, 2011, respectively. As of both periods, the Company recorded an offsetting valuation allowance of \$7.0 million which represents the portion of these net operating loss carryforwards that are considered more likely than not to expire unutilized.

In accordance with Section 382 of the Internal Revenue Code of 1986, as amended, a change in equity ownership of greater than 50% of the Company within a three-year period results in an annual limitation on the Company's ability to utilize its net operating losses (NOL) carryforwards that were

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(Unaudited)

created during tax periods prior to the change in ownership. As a result of the Series A convertible preferred stock equity issuance, on August 6, 2012, the Company experienced an ownership change under Section 382 and therefore the rate of utilization of a portion of the Company's NOL carryforwards will be limited. The Company does not believe this limitation will have a significant effect on the Company's ability to utilize its anticipated federal NOL carryforward. The Company's U.S. federal NOL carryforwards will begin to expire in 2019.

Net operating losses generally cannot be carried back for state income tax purposes, and as a result the Company had significant state and local net operating loss carryforwards as of September 30, 2012. The Company recorded a valuation allowance for substantially all of its anticipated state and local tax loss carryforwards as it is more likely than not that due to limitations on utilization in the particular jurisdictions in which the Company operates that the benefit of such items will not be realized.

At September 30, 2012, the Company had non-U.S. net operating loss carryforwards of \$66.9 million as compared to \$63.7 at December 31, 2011. The Company recorded foreign deferred tax assets of \$17.4 million and \$17.8 million related to these loss carryforwards as of September 30, 2012 and December 31, 2011, respectively, along with offsetting U.S. federal deferred tax liabilities of \$17.4 million and \$17.8 million for the expected future reduction in U.S. foreign tax credits associated with the use of the non-U.S. loss carryforwards. These non-U.S. net operating losses may be carried forward indefinitely.

15. Restructuring, Writedown of Assets and Lease Loss Accrual

As discussed in footnote 10 "Goodwill and Intangible Assets", in the third quarter of 2012 the Company recorded a non-cash impairment charge of \$143.0 million, representing \$126.4 of goodwill related to the institutional fixed income and asset management businesses and \$16.7 million of intangible assets related to the Company's DMM, asset management and reverse mortgage businesses.

In the third quarter of 2011, the Company undertook a corporate restructuring designed to lower operating expenses and improve financial performance. This restructuring comprised a reduction in workforce, a significant downsizing of its Hong Kong presence and discontinuing certain other initiatives. For the three and nine months ended September 30, 2011, the Company recorded a Restructuring charge of \$28.6 million which affected all segments and comprised the following:

Employee severance and other employee benefit costs of \$17.7 million;

Hong Kong asset writedown, lease and contract termination costs of \$2.7 million; and

Capitalized software, intangible asset and goodwill writedown of \$8.3 million.

Writedown of assets and lease loss accrual was \$1.3 million and \$2.3 million for the three and nine months ended September 30, 2011, respectively, related to excess real estate capacity.

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16. Earnings Per Share

Basic loss or earnings per common share (EPS) have been calculated by dividing net loss income by the weighted average shares of Class A common stock outstanding during each respective period. Diluted EPS reflects the potential reduction in EPS using the treasury stock method to reflect the impact of common stock equivalents if stock options were exercised, restricted awards were to vest and preferred stock were to convert to Class A common stock.

The Series A Shares are participating securities and as a result the Company is required to calculate EPS under two class method whereby earnings are allocated to Class A common stock and Series A Shares as if all of the earnings for the period had been distributed. Since the Company recorded a net loss for the period ended September 30, 2012 the impact of the two class method would be antidilutive. The calculation of diluted EPS excludes the conversion of Series A Shares into Class A common stock and excludes options, restricted awards and Series A Shares that could potentially dilute EPS in the future but were antidilutive for the periods presented. The number of such options excluded was approximately 2.6 million and 1.8 million for the three months ended September 30, 2012 and 2011, respectively, and 1.8 million and 2.0 million for the nine months ended September 30, 2012 and 2011, respectively. The number of such restricted awards excluded was approximately 1.1 million for the three months ended September 30, 2012 and 2.8 million for the nine months ended September 30, 2012. The number of such Series A Shares excluded was approximately 129.1 million for the three months ended September 30, 2012 and 43.3 million for the nine months ended September 30, 2012. The computation of diluted shares can vary among periods due in part to the change in the average price of the Company's Class A common stock.

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The following is a reconciliation of the numerators and denominators of the basic and diluted (loss) earnings per share computations for the three and nine months ended September 30, 2012 and 2011 (in thousands):

	For the three months ended September 30,			
	2012			2011
	Numerator / (net loss)	Denominator / shares	Numerator / net income	Denominator / shares
Net (loss) income	\$ (389,921)		\$ 26,936	
Dividend on convertible preferred shares	(1,051)		-	
Deemed dividend related to beneficial conversion feature of convertible preferred shares	(373,364)		-	
Net (loss) income attributable to common stockholders and shares used in basic calculations	\$ (764,336)	121,246	\$ 26,936	91,564
Effect of dilutive stock based awards		-		2,276
(Loss) Income and shares used in diluted calculations	\$ (764,336)	121,246	\$ 26,936	93,840
Basic (loss) earnings per share		\$ (6.30)		\$ 0.29
Diluted (loss) earnings per share		\$ (6.30)		\$ 0.29

	For the nine months ended September 30,			
	2012			2011
	Numerator / (net loss)	Denominator / shares	Numerator / net income	Denominator / shares
Net (loss) income	\$ (353,525)		\$ 74,999	
Dividend on convertible preferred shares	(1,051)		-	
Deemed dividend related to beneficial conversion feature of convertible preferred shares	(373,364)		-	
(Loss) Income attributable to common stockholders and shares used in basic calculations	\$ (727,940)	101,044	\$ 74,999	91,877
Effect of dilutive stock based awards		-		2,926
(Loss) Income and shares used in diluted calculations	\$ (727,940)	101,044	\$ 74,999	94,803
Basic (loss) earnings per share		\$ (7.20)		\$ 0.82
Diluted (loss) earnings per share		\$ (7.20)		\$ 0.79

17. Significant Clients

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The Company considers significant clients to be those clients who account for 10% or more of the total U.S. equity dollar value traded or fixed income notional value traded by the Company. No clients accounted for more than 10% of the Company's U.S. equity dollar value traded or fixed income notional value traded during the three and nine months ended September 30, 2012 or 2011.

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18. Commitments and Contingencies

In the ordinary course of business, the nature of the Company's business subjects it to claims, lawsuits, regulatory examinations and other proceedings. The Company is subject to several of these matters at the present time. Given the inherent difficulty of predicting the outcome of the litigation and regulatory matters, particularly in cases or proceedings in which substantial or indeterminate damages or fines are sought, or where cases or proceedings are in the early stages, the Company cannot estimate losses or ranges of losses for cases or proceedings where there is only a reasonable possibility that a loss may be incurred. There can be no assurance that these matters will not have a material adverse effect on the Company's results of operations in any future period and a material judgment could have a material adverse impact on the Company's financial condition and results of operations. However, it is the opinion of management, after consultation with legal counsel that, based on information currently available, the ultimate outcome of these matters will not have a material adverse impact on the business, financial condition or operating results of the Company although they might be material to the operating results for any particular period, depending, in part, upon operating results for that period.

As previously mentioned, the Company experienced a technology issue at the open of trading at the NYSE on August 1, 2012. This issue was related to the installation of trading software and resulted in the Company's broker-dealer subsidiary, KCA, sending numerous erroneous orders in NYSE-listed and NYSE Arca securities into the market. The Company has since been named in two putative class actions and has received several derivative demand letters and/or requests for the inspection or production of certain books and records pursuant to Delaware law related to the technology issue and the August 6, 2012 recapitalization. In addition, the Company and/or KCA are the subject of regulatory investigations. While the Company is unable to predict the outcome of any possible litigation or investigation related to the technology issue or the August 6, 2012 recapitalization, an unfavorable outcome in one or more of these matters could have a material adverse effect on the Company's financial condition or ongoing operations. In addition, the Company expects to incur additional expenses in defending against litigation and in connection with investigations.

In the second quarter of 2012, the Company recorded pre-tax trading losses of \$35.4 million related to the Facebook IPO. On August 1, 2012 Nasdaq's proposed voluntary accommodation program (the Accommodation Program) was published in the Federal Register by the SEC. The Accommodation Program creates a fund for voluntary accommodations for qualifying Nasdaq members disadvantaged by problems that arose during the Facebook IPO. Under the Accommodation Program as proposed by Nasdaq, the Company would recover a portion of its pre-tax trading losses. The Accommodation Program, however, remains subject to SEC approval and there can be no assurance will be approved by the SEC or that the terms will not change from those proposed. As previously disclosed, there are no assurances that the Company will be able to recover its pre-tax trading losses relating to the Facebook IPO.

The Company leases office space under noncancelable operating leases. Certain office leases contain fixed dollar-based escalation clauses. Rental expense under the office leases was \$4.9 million and \$5.3 million for the three months ended September 30, 2012 and 2011, respectively, and is included in Occupancy and equipment rentals on the Consolidated Statements of Operations. For the nine months ended September 30, 2012 and 2011, rental expense under the office leases was \$12.9 million and \$15.1 million, respectively.

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(Unaudited)

The Company leases certain computer and other equipment under noncancelable operating leases and has entered into guaranteed employment contracts with certain employees. As of September 30, 2012, future minimum rental commitments under all noncancelable office, computer and equipment leases (Gross Lease Obligations), Sublease Income and guaranteed employment contracts longer than one year (Other Obligations) were as follows (in thousands):

Lease & Contract Obligations

	Gross Lease Obligations	Sublease Income	Net Lease Obligations	Other Obligations
three months ending December 31, 2012	\$ 6,043	\$ 527	\$ 5,516	\$ -
Year ending December 31, 2013	23,444	2,170	21,274	8,941
Year ending December 31, 2014	22,480	1,987	20,493	-
Year ending December 31, 2015	21,696	1,813	19,883	-
Year ending December 31, 2016	21,309	1,856	19,453	-
Thereafter through August 31, 2023	100,061	2,816	97,245	-
	\$ 195,033	\$ 11,169	\$ 183,864	\$ 8,941

During the normal course of business, the Company collateralizes certain leases or other contractual obligations through letters of credit or segregated funds held in escrow accounts. In the ordinary course of business, Knight Capital Group, Inc. has provided, and may provide in the future, unsecured guarantees with respect to the payment obligations of certain of its subsidiaries under trading, repurchase, financing and stock loan arrangements, as well as under certain leases.

The Company has issued floating rate HECMs for which the borrowers have additional borrowing capacity of approximately \$382.9 million as of September 30, 2012. This additional borrowing capacity is primarily in the form of undrawn lines of credit, with the balance available on a scheduled payments basis. As the issuer of these HECMs, the Company is under the obligation to fund this capacity upon the borrowers requesting such funds or such scheduled payments coming due, as applicable.

During the normal course of business, our Market Making and Institutional Sales and Trading segments may enter into futures contracts. These financial instruments are subject to varying degrees of risks whereby the fair value of the securities underlying the financial instruments, may be in excess of, or less than, the contract amount. The Company is obligated to post collateral against certain futures contracts.

The following tables summarize the Company's futures contract activity (in thousands):

Futures Contracts	Consolidated Statements of Financial Condition Location	Fair Value of asset or (liability) as of	
		September 30, 2012	December 31, 2011
Notional Value	Not Applicable	\$ (175,284)	\$ (20,769)
Fair Value	(Payable to) Receivable from brokers, dealers and clearing organizations	\$ (399)	\$ 895

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(Unaudited)

Futures Contracts	Consolidated Statements of Operations Location	Gain (Loss) Recognized For the three months ended September 30,	
		2012	2011
Unrealized Gain (Loss)	Net trading revenue	\$ 4,609	\$ (23,587)

Futures Contracts	Consolidated Statements of Operations Location	Gain (Loss) Recognized For the nine months ended September 30,	
		2012	2011
Unrealized Gain (Loss)	Net trading revenue	\$ 10,706	\$ (62,543)

19. Financial Instruments with Off-Balance Sheet Risk and Concentrations of Credit Risk

As a market maker of equities and options, the majority of the Company's securities transactions are conducted as principal or riskless principal with broker-dealers and institutional counterparties primarily located in the United States. The Company self-clears substantially all of its U.S. equity and option securities transactions. The Company clears a portion of its securities transactions through third party clearing brokers. Foreign transactions are settled pursuant to global custody and clearing agreements with major U.S. banks. Substantially all of the Company's credit exposures are concentrated with its clearing brokers, broker-dealer and institutional counterparties. The Company's policy is to monitor the credit standing of counterparties with which it conducts business.

Upon the acquisition of the futures business of Penson in June 2012 (see Footnote 20 Acquisition), the Company began providing execution, clearing and custody services in futures contracts and options on futures contracts to facilitate customer transactions on major U.S. and European futures and options exchanges. Customer activities may expose the Company to off-balance sheet risk in the event the customer is unable to fulfill its contracted obligation as the Company guarantees the performance of its customers to the respective clearing houses or other brokers. In accordance with regulatory requirements and market practice, the Company requires its customers to meet, at a minimum, the margin requirements established by each of the exchanges at which contracts are traded. Margin is a good faith deposit from the customer that reduces risk to the Company of failure by the customer to fulfill obligations under these contracts. The Company establishes customer credit limits and monitors required margin levels on a daily basis and, pursuant to such guidelines, require customers to deposit additional collateral, or to reduce positions, when necessary. Further, the Company seeks to reduce credit risk by entering into netting agreements with customers, which permit receivables and payables with such customers to be offset in the event of a customer default. Management believes that the margin deposits and collateral held at September 30, 2012 were adequate to minimize the risk of material loss that could be created by positions held at that time.

In the normal course of its operations, the Company enters into contracts that contain a variety of representations and warranties which provide general indemnifications. The Company's maximum exposure under these arrangements is unknown, as this would involve future claims that may be made against the Company that have not yet occurred. However, based on experience, the Company believes the risk of significant loss is minimal.

Financial instruments sold, not yet purchased, at fair value represent obligations to purchase such securities (or underlying securities) at a future date. The Company may incur a loss if the market value of the securities subsequently increases.

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The Company currently has no loans outstanding to any former or current executive officer or director.

20. Acquisition*Penson Futures*

On June 1, 2012, the Company completed the acquisition of certain assets and assumption of certain liabilities of Penson Futures, the futures division of Penson for \$5.0 million in cash and a potential earn-out based on future performance valued at \$8.4 million. Goodwill and intangible assets recognized upon the closing of the transaction amounted to \$10.6 million. All of the goodwill from this transaction is expected to be deductible for income tax purposes. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed (in thousands):

Cash	\$	5,000
Fair value of earn-out		8,400
Recorded purchase price	\$	13,400

Cash	\$	1,928
Segregated cash and securities		100,545
Receivable from brokers, dealers and clearing organizations		360,494
Goodwill		7,117
Intangible assets		3,500
Other assets		24,604
Payable to customers		(472,197)
Accrued expenses and other liabilities		(12,591)
Purchase of business	\$	13,400

Assuming this transaction had been made at the beginning of any period presented, the consolidated pro forma results would not be materially different from reported results.

21. Business Segments

The Company has four operating segments: (i) Market Making; (ii) Institutional Sales and Trading; (iii) Electronic Execution Services; and (iv) Corporate and Other.

The Market Making segment principally consists of market making in global equities and listed domestic options. Market Making primarily includes client, and to a lesser extent, non-client electronic market making and cash trading activities in which the Company operates as a market maker in equity securities. Market Making also includes the Company's option market making business which trades on substantially all domestic electronic exchanges.

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The Institutional Sales and Trading segment includes global equity, ETFs, and fixed income sales; reverse mortgage origination and securitization; capital markets; and asset management activities. The primary business of the Institutional Sales and Trading segment is to execute and facilitate transactions predominantly as agent on behalf of institutional clients for equities and fixed income

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

(Unaudited)

offerings, and the Company commits its capital on behalf of its clients when needed. This is predominantly a full-service business, in which much of the interaction is based on the Company's client relationships. This segment also facilitates client orders through program and block trades and riskless principal trades, and provides capital markets services, including equity and debt offerings as well as private placements.

The Electronic Execution Services segment offers access via its electronic agency-based platforms to markets and self-directed trading in equities, options, fixed income, foreign exchange and futures.

The Corporate and Other segment invests in strategic financial services-oriented opportunities, allocates, deploys and monitors all capital, and maintains corporate overhead expenses and other expenses that are not attributable to the other segments. The Corporate and Other segment houses functions that support Knight's other segments such as self-clearing services, including securities lending, and other support and overhead. This segment also provides futures execution, clearing and custody services to facilitate transactions among brokers, institutions and non-clearing FCMs.

The Company's revenues, income (loss) from continuing operations before income taxes (Pre-tax earnings) and total assets by segment are summarized in the following table (in thousands):

	Market Making	Institutional Sales and Trading	Electronic Execution Services	Corporate and Other	Consolidated Total
<i>For the three months ended September 30, 2012:</i>					
Revenues	\$ (341,154)	\$ 101,719	\$ 34,778	\$ 14,819	\$ (189,838)
Pre-tax earnings	(451,964)	(140,807)	6,267	(16,356)	(602,860)
Total assets	1,363,992	4,467,878	379,350	2,374,634	8,585,854
<i>For the three months ended September 30, 2011:</i>					
Revenues	\$ 204,879	\$ 145,440	\$ 45,088	\$ 2,034	\$ 397,442
Pre-tax earnings	69,188	(15,552)	13,838	(23,030)	44,444
Total assets	2,130,021	2,655,021	271,948	2,003,485	7,060,475
<i>For the nine months ended September 30, 2012:</i>					
Revenues	\$ (75,499)	\$ 353,654	\$ 122,287	\$ 47,999	\$ 448,441
Pre-tax earnings	(400,901)	(133,639)	29,882	(38,847)	(543,505)
Total assets	1,363,992	4,467,878	379,350	2,374,634	8,585,854
<i>For the nine months ended September 30, 2011:</i>					
Revenues	\$ 517,105	\$ 407,697	\$ 127,347	\$ 11,051	\$ 1,063,200
Pre-tax earnings	171,729	(27,211)	37,007	(57,544)	123,982
Total assets	2,130,021	2,655,021	271,948	2,003,485	7,060,475

Included in Market Making revenues for the three and nine months ended September 30, 2012 is a trading loss of \$457.6 million related to the August 1st technology issue.

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KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

Included in Pre-tax earnings for the three and nine months ended September 30, 2012 is a writedown of assets of \$143.0 million which includes \$11.9 million for Market Making and \$131.1 million for Institutional Sales and Trading. Additionally, the Corporate and Other segment includes \$3.5 million in professional fees related to the August 1st technology issue.

Included in revenues for the nine months ended September 30, 2012 is a Facebook IPO trading loss of \$35.4 million which includes \$26.0 million for Market Making and \$9.4 million for Institutional Sales and Trading.

Included in revenues for the nine months ended September 30, 2012 in the Corporate and Other segment is a gain on a strategic investment of \$10.0 million.

Included in expenses for the three and nine months ended September 30, 2011 is a Restructuring charge of \$28.6 million which includes \$0.5 million for Market Making, \$23.9 million for Institutional Sales and Trading, \$0.4 million for Electronic Execution Services, and \$3.8 million for Corporate and Other.

Total assets do not include assets within discontinued operations of \$2.4 million at September 30, 2011.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion of our results of operations should be read in conjunction with our audited Consolidated Financial Statements and notes for the year ended December 31, 2011 included in our Current Report on Form 8-K dated August 6, 2012 as filed with the U.S. Securities and Exchange Commission (SEC). On August 6, 2012, we entered into a securities purchase agreement where we raised \$400.0 million in equity financing through a convertible preferred share offering with several investors. The Form 8-K filed on this date updated the historical consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2011 by revising the order of presentation of the Company's Consolidated Statement of Comprehensive Income and Consolidated Statements of Changes in Equity. This discussion contains forward-looking statements that involve risks and uncertainties, including those discussed in our Form 10-K for the year ended December 31, 2011, our Quarterly Report on Form 10-Q for the period ended June 30, 2012 and herein. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth elsewhere in this document, in our Form 10-K for the year ended December 31, 2011 and in our Quarterly Report on Form 10-Q for the period ended June 30, 2012.

Certain statements contained in this Quarterly Report on Form 10-Q, including, without limitation, those under Management's Discussion and Analysis of Financial Condition and Results of Operations herein (MD&A), Quantitative and Qualitative Disclosures About Market Risk in Part I, Item 3, Legal Proceedings and Risk Factors in Part II and the documents incorporated by reference, may constitute forward-looking statements. 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 the August 1, 2012 technology issue that resulted in the Company's broker-dealer subsidiary, Knight Capital Americas LLC (KCA), sending numerous erroneous orders in NYSE-listed and NYSE Arca securities into the market and the impact to the Company's capital structure and business as well as actions taken in response thereto and consequences thereof, risks associated with the Company's ability to recover all or a portion of the damages that are attributable to the manner in which NASDAQ OMX handled the Facebook IPO, risks associated with changes in market structure, legislative, regulatory or financial reporting rules, risks associated with the Company's changes to its organizational structure and management and the costs, integration, performance and operation of businesses previously acquired or developed organically, or that may be acquired or developed organically in the future. Readers should carefully review the risks and uncertainties disclosed in the Company's reports with the SEC including, without limitation, those detailed under Certain Factors Affecting Results of Operations within MD&A herein and under Risk Factors herein and in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 and in other reports or documents the Company files with, or furnishes to, the SEC from time to time. This information should also be read in conjunction with the Company's Consolidated Financial Statements and the Notes thereto contained in this Form 10-Q, and in other reports or documents the Company files with, or furnishes to, the SEC from time to time.

Table of Contents***Executive Overview***

We are a global financial services firm that provides access to the capital markets across multiple asset classes to a broad network of clients, including broker-dealers, institutions and corporations. We seek to continually apply our expertise and innovation to the market making and trading process to build lasting client relationships through consistent performance and superior client service. We also provide capital markets services to corporate issuers and private companies. We have four operating segments: (i) Market Making; (ii) Institutional Sales and Trading; (iii) Electronic Execution Services; and (iv) Corporate and Other.

Market Making Our Market Making segment principally consists of market making in global equities and listed domestic options. As a market maker, we commit capital for trade executions by offering to buy securities from, or sell securities to, institutions and broker-dealers. Our Market Making segment primarily includes client, and to a lesser extent, non-client electronic market making activities in which we operate as a market maker in equity securities quoted and traded on the Nasdaq Stock Market, the over-the-counter (OTC) market for New York Stock Exchange (NYSE), NYSE Amex Equities (NYSE Amex), NYSE Arca listed securities and several European exchanges. As a complement to electronic market making, our cash trading business handles specialized orders and also transacts on the OTC Bulletin Board, the OTC Pink Markets, and the Alternative Investment Market (AIM) of the London Stock Exchange. We provide trade executions as an equities Designated Market Maker (DMM) on the NYSE and NYSE Amex. Market Making also includes our option market making business which trades on substantially all domestic electronic exchanges.

Institutional Sales and Trading Our Institutional Sales and Trading segment includes global equity, exchange traded fund (ETF) and fixed income sales; reverse mortgage origination and securitization; capital markets; and asset management activities. The primary business of the Institutional Sales and Trading segment is to execute and facilitate equities, ETFs, and fixed income transactions as agent on behalf of institutional clients, and we commit capital on behalf of our clients when needed. This is predominantly a full-service execution business, in which much of the interaction is based on the Company's client relationships. This segment also facilitates client orders through program and block trades and riskless principal trades and provides capital markets services, including equity and debt private placement.

Electronic Execution Services Our Electronic Execution Services segment offers access via our electronic agency-based platforms to markets and self-directed trading in equities, options, fixed income, foreign exchange and futures. In contrast to Market Making, we generally do not act as a principal to transactions that are executed within this segment and generally earn commissions for acting as agent between the principals to the trade.

Corporate and Other Our Corporate and Other segment invests in strategic financial services-oriented opportunities, allocates, deploys and monitors all capital, and maintains corporate overhead expenses and all other income and expenses that are not attributable to the other segments. The Corporate and Other segment houses functions that support our other segments such as self-clearing services, including securities lending activities. Beginning in the second quarter of 2012, our Corporate and Other segment includes our futures commission merchant (FCM) which comprises certain assets and liabilities which we acquired or assumed from the futures division of Penson Financial Services, Inc. on June 1, 2012. This business primarily provides futures execution, clearing and custody services to facilitate transactions among brokers, institutions and non-clearing FCMs on major U.S. and European futures and options exchanges.

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The following table sets forth: (i) Revenues; (ii) Expenses; and (iii) Pre-tax earnings or loss from our segments and on a consolidated basis (in millions):

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
Market Making				
Revenues ⁽¹⁾⁽³⁾	\$ (341.2)	\$ 204.9	\$ (75.5)	\$ 517.1
Expenses ⁽²⁾⁽⁵⁾	110.8	135.7	325.4	345.4
Pre-tax (loss) earnings	(452.0)	69.2	(400.9)	171.7
Institutional Sales and Trading				
Revenues ⁽³⁾	101.7	145.4	353.7	407.7
Expenses ⁽²⁾⁽⁵⁾	242.5	161.0	487.3	434.9
Pre-tax loss	(140.8)	(15.6)	(133.6)	(27.2)
Electronic Execution Services				
Revenues	34.8	45.1	122.3	127.3
Expenses ⁽⁵⁾	28.5	31.3	92.4	90.3
Pre-tax earnings	6.3	13.8	29.9	37.0
Corporate and Other				
Revenues ⁽⁴⁾	14.8	2.0	48.0	11.0
Expenses ⁽²⁾⁽⁵⁾	31.2	25.1	86.8	68.6
Pre-tax loss	(16.4)	(23.0)	(38.8)	(57.5)
Consolidated				
Revenues	(189.8)	397.4	448.4	1,063.2
Expenses	413.0	353.0	991.9	939.2
Pre-tax (loss) earnings	\$ (602.9)	\$ 44.4	\$ (543.5)	\$ 124.0

* Totals may not add due to rounding.

- (1) Included in revenues for the three and nine months ended September 30, 2012 is a trading loss of \$457.6 million related to the August 1st technology issue.
- (2) Included in expenses for the three and nine months ended September 30, 2012 is a writedown of assets of \$143.0 million which includes \$11.9 million for Market Making and \$131.1 million for Institutional Sales and Trading. Additionally, the Corporate and Other segment includes \$3.5 million in professional fees related to the August 1st technology issue.
- (3) Included in revenues for the nine months ended September 30, 2012 is a Facebook IPO trading loss of \$35.4 million which includes \$26.0 million for Market Making and \$9.4 million for Institutional Sales and Trading.
- (4) Included in revenues for the nine months ended September 30, 2012 is a gain on a strategic investment of \$10.0 million.
- (5) Included in expenses for the three and nine months ended September 30, 2011 is a Restructuring charge of \$28.6 million which includes \$0.5 million for Market Making, \$23.9 million for Institutional Sales and Trading, \$0.4 million for Electronic Execution Services, and \$3.8 million for Corporate and Other.

Consolidated revenues for the three months ended September 30, 2012 decreased \$587.3 million from the same period a year ago, while consolidated expenses increased \$60.0 million. Consolidated pre-tax loss for the three months ended September 30, 2012 was \$602.9 million as compared to consolidated pre-tax earnings of \$44.4 million for the same period a year ago.

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Consolidated revenues for the nine months ended September 30, 2012 decreased \$614.8 million from the same period a year ago, while consolidated expenses increased \$52.7 million. Consolidated pre-tax loss for the nine months ended September 30, 2012 was \$543.5 million as compared to consolidated pre-tax earnings of \$124.0 million for the same period a year ago.

On August 1, 2012, we experienced a technology issue at the open of trading at the NYSE. This issue was related to the installation of trading software and resulted in KCA sending numerous erroneous orders in NYSE-listed and NYSE Arca securities into the market. Although this software was subsequently removed from our systems, it resulted in trading losses and subsequent related costs of \$461.1 million (August 1, 2012 Loss). This event was deemed a triggering event requiring us to assess the carrying amount and recoverability of our goodwill and intangible assets. As a result of this assessment, we recorded a non-cash impairment charge of \$143.0 million, representing \$126.4 million of goodwill related to our acquisitions of Libertas and Astor, and \$16.7 million of intangible assets primarily related to our acquisitions of Astor, Kellogg and Urban.

On August 6, 2012 we raised \$400.0 million in equity financing through a convertible preferred share offering with several investors. We incurred approximately \$40.5 million in fees and costs related to the offering, resulting in net proceeds of \$359.5 million. As a result of our ability to obtain these capital resources we no longer believe there is a substantial doubt in our ability to continue as a going concern.

In the second quarter of 2012, we recorded pre-tax trading losses of \$35.4 million related to the Facebook IPO. On August 1, 2012 Nasdaq's proposed voluntary accommodation program (the Accommodation Program) was published in the Federal Register by the SEC. The Accommodation Program creates a fund for voluntary accommodations for qualifying Nasdaq members disadvantaged by problems that arose during the Facebook IPO. Under the Accommodation Program as proposed by Nasdaq, we would recover a portion of our pre-tax trading losses. The Accommodation Program, however, remains subject to SEC approval and there can be no assurance will be approved by the SEC or that the terms will not change from those proposed. As previously disclosed, there are no assurances that we will be able to recover our pre-tax trading losses relating to the Facebook IPO.

The changes in our pre-tax earnings (loss) by segment from the three and nine months ended September 30, 2011 are summarized as follows:

Market Making Our pre-tax losses from Market Making for the three and nine months ended September 30, 2012 were \$452.0 million and \$400.9 million, respectively, compared to pre-tax earnings of \$69.2 million and \$171.7 million, respectively, during the comparable periods in 2011. Excluding the \$457.6 million effects of the August 1, 2012 Loss, which resulted in trading losses of \$457.6 million, and subsequent review of our intangible assets that resulted in an \$11.9 million writedown to intangible assets, and the second quarter 2012 \$26.0 million trading loss related to the Facebook IPO, our pre-tax results from Market Making for the three and nine months ended September 30, 2012 decreased \$51.7 million and \$77.2 million, respectively, to pre-tax earnings of \$17.5 million and \$94.6 million, respectively. The reason for the decrease in results, excluding the noted items, was primarily a decrease in volumes, which were impacted by the August 1, 2012 technology issue as well as lower overall market volumes. The lower volumes had a negative impact on both our client and non-client quantitative trading models.

Institutional Sales and Trading Our pre-tax losses from Institutional Sales and Trading for the three and nine months ended September 30, 2012 increased by \$125.3 million and \$106.4 million, respectively, from the comparable periods in 2011. Excluding the effects of the third quarter 2012 asset impairment assessment that resulted in a writedown of \$131.1 million

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related to goodwill and intangible assets primarily within our institutional fixed income and asset management businesses and as well as the second quarter 2012 \$9.4 million trading loss related to the Facebook IPO, our pre-tax results from Institutional Sales and Trading for the three and nine months ended September 30, 2012 improved by \$5.9 million and \$34.1 million, respectively, to a pre-tax loss of \$9.7 million and pre-tax earnings of \$6.9 million, respectively. The improvement in segment results, excluding the noted items, was primarily attributable to improved results from our reverse mortgage business, a decrease in guaranteed compensation in our fixed income business and the absence of restructuring costs offset, in part, by a decrease in client volumes as a result of the events surrounding the August 1 technology issue.

Electronic Execution Services Our pre-tax earnings from Electronic Execution Services for the three and nine months ended September 30, 2012 decreased by \$7.6 million and \$7.1 million, respectively, from the comparable periods in 2011. The quarter over quarter and year over year decrease is primarily due to temporary lower volumes as a result of the August 1, 2012 Loss. By the end of the third quarter of 2012, volumes were substantially back to pre-August 1 levels.

Corporate and Other Our pre-tax results from our Corporate and Other segment for the three months ended September 30, 2012 improved by \$6.7 million from the comparable period in 2011. The improved results quarter over quarter is primarily due to a \$5.3 million grant received in August 2012 from the State of New Jersey related to the Business Employment Incentive Program (BEIP) offset, in part, by higher professional fees related to the August 1, 2012 technology issue. Our pre-tax results from our Corporate and Other segment for the nine months ended September 30, 2012 improved by \$18.7 million from the comparable period in 2011. The improved results year over year is primarily due to a \$10.0 million gain related to a change in the tax status of a strategic investment accounted for under the equity method of accounting and a \$5.3 million BEIP grant received in August 2012 offset, in part, by higher interest expense related to our long-term debt and securities lending activity and higher professional fees related to the August 1, 2012 technology issue.

Certain Factors Affecting Results of Operations

We may experience significant variation in our future results of operations. These fluctuations may result from numerous factors, including, among other things, market conditions and the resulting volatility, 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 financial 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 and profile of our order flow; our market share with institutional and broker-dealer clients; the performance and size of, and volatility in, our client market making and program trading portfolios; the performance of our non-client principal trading activities; movements of credit spreads; home equity conversion mortgages (HECMs) origination and HECM Mortgage Backed Securities (HMBS) securitization volumes; the overall size of our balance sheet and capital usage; further impairment of goodwill and/or intangible assets; the performance of our global operations, trading technology and trading infrastructure; costs associated with overall business growth; the effectiveness of our self-clearing and futures platforms and our ability to manage risk related thereto; the availability of credit and liquidity in the marketplace; erroneous trade orders submitted by us on account of technology or other issues (such as occurred on August 1, 2012) and consequences thereof; the performance, operation and connectivity to various market centers; our ability to manage personnel, compensation, overhead and other expenses; the strength of our client relationships; changes in payments for order flow; changes to execution quality and changes in clearing, execution and regulatory transaction costs; interest rate movements; the

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addition or loss of executive management, sales, trading and technology professionals; legislative, legal, regulatory and financial reporting changes; legal, regulatory matters or proceedings; geopolitical risk; the amount, timing and cost 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 other economic conditions.

Such factors may also have an impact on our ability to achieve our strategic objectives, including, without limitation, increases in market share, growth and profitability in our four operating segments. If demand for our services declines or our performance deteriorates significantly 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 and debt markets and the level of trading volumes and volatility in such markets.

During the quarter ended September 30, 2012, volatility levels across equity markets decreased as compared to the previous quarter, while in the debt markets, credit spreads narrowed. Secondary trading volumes in the equity and fixed income markets were down significantly from prior periods. Overall, there are still concerns about global stability and growth, inflation and declining asset values.

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:

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 sophistication and automation within their operations and the extent of price improvement. 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 and margin metrics of the Company and other market making firms.

Market Making, Institutional Sales and Trading and Electronic Execution Services transaction volumes executed by clients have fluctuated over the past few years due to retail and institutional investor sentiment, market conditions and a variety of other factors. Market Making, Institutional Sales and Trading and Electronic Execution Services transaction volumes may not be sustainable and are not predictable.

Over the past several years exchanges have become far more competitive, and market participants have created alternative trading systems (ATS), ECN and other execution

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venues which compete within the OTC and listed trading venues. For example, on July 3, 2012, the SEC approved proposed rules submitted by the NYSE and NYSE Amex to establish a Retail Liquidity Program (RLP) on a pilot basis for one year. The RLP seeks to attract retail flow to the NYSE and NYSE Amex. This new program (as well as any similar program established by other national stock exchanges) could draw market share away from Knight, and thus negatively impact our business. In addition, there are many new entrants into the market, including ATS, Multilateral Trading Facilities, systematic internalizers, dark liquidity pools, high frequency trading firms, and market making firms competing for retail and institutional order flow. Further, many broker-dealers are offering their own internal crossing networks. These factors continue to create further fragmentation and competition in the marketplace.

Market structure changes, competition, market conditions and a steady increase in electronic trading have resulted in a reduction in institutional commission rates and volumes which may continue in the future. Additionally, many institutional clients allocate commissions to broker-dealers based not only on the quality of executions, but also in exchange for research, or participation in soft dollar and commission recapture programs.

There continues to be growth in electronic trading, as evidenced by increased volumes in direct market access platforms, algorithmic and program trading, high frequency 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 and may further reduce demand for traditional institutional voice services.

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.

There has been continued scrutiny of the capital markets industry by the regulatory and legislative authorities, both in the U.S. and abroad. New legislation or new or modified regulations and rules could occur in the future. Members of the U.S. Congress have asked the SEC and other regulators to take a close look at the regulatory structure and make the changes necessary to insure the rule framework governing the U.S. financial markets is comprehensive and complete. The SEC and other regulators have stated that they will propose and adopt rules where necessary, on a variety of marketplace issues including, but not limited to: high frequency trading, indications of interest, off-exchange trading, dark liquidity pools, internalization, post-trade attribution, co-location, market access, short sales, consolidated audit trails and market volatility rules (including, circuit breakers and limit-up, limit-down rules).

We expect increases, possibly substantial, in Section 31 fees and fees imposed by other regulators. In addition, DTCC and NSCC are considering proposals which could require substantial increases in clearing margin and collateral requirements.

The Dodd-Frank Act affects nearly all financial institutions that operate in the U.S. While the weight of the Dodd-Frank Act falls more heavily on large, complex financial institutions, smaller institutions will continue to face a more complicated and expensive regulatory framework.

Reverse mortgages can be a cost-effective way to help seniors (age 62 and older) meet their financial needs in retirement, by enabling them to tap the equity in their home. Reverse mortgages have been popular with seniors who have equity in their homes and want to

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supplement their income and enhance their liquidity. This popularity may continue as the Baby Boomer generation enters retirement age. However, there is no guarantee that current volumes or the referenced popularity will continue.

In 2011, two of the largest reverse mortgage originators exited the reverse mortgage business. Declining home values and the inability to assess borrowers' financial health were cited as factors contributing to their respective decisions. In 2012, the largest reverse mortgage lender also exited the reverse mortgage business citing its focus on other business lines.

In January 2011, the U.S. Department of Housing and Urban Development (HUD) provided loss mitigation guidance for the resolution of HECMs that are delinquent due to, among other things, unpaid property charges (including taxes and homeowners insurance). HUD also discussed what steps lenders could take to get mortgagors back on track (e.g., establishing a repayment plan). HUD noted that foreclosure is and must remain a method of last resort for the resolution of unpaid property charges. It has also been reported that HUD is developing procedures that would allow lenders to assess a prospective borrower's income and expenses, and possibly require homeowners to set aside money to pay for taxes and homeowners insurance. However, no formal guidelines have yet been published.

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 all of our business segments.

Revenues on transactions for which we charge explicit commissions or commission equivalents, which include the majority of our institutional client orders, commissions on futures transactions, as well as the mark-to-market of securitized HECM loan inventory, are included within Commissions and fees. Commissions and fees are primarily affected by changes in our equity, fixed income, futures and foreign exchange transaction volumes with institutional clients, changes in commission rates, level of volume based fees from providing liquidity to other trading venues, loan origination and securitization volume and spreads, assets under management and the level of our soft dollar and commission recapture activity.

Trading profits and losses on principal transactions primarily relate to our global market making activities and are included within Net trading revenue. These revenues are primarily affected by changes in the amount and mix of 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 market making models, performance of our non-client trading models, volatility in the marketplace, our mix of broker-dealer and institutional clients, regulatory changes and evolving industry customs and practices.

Interest income, net is earned from our cash held at banks, cash held in trading accounts at third party clearing brokers and from collateralized financing arrangements, such as securities borrowing, carry interest on loans and bonds held, and interest income net of interest expense on securitized HECM loan inventory. The Company's third party clearing agreements call for payment or receipt of interest income, net of transaction-related interest charged by clearing brokers for facilitating the

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settlement and financing of securities transactions. Net interest is primarily affected by interest rates, the level of cash balances held at banks and third party clearing brokers including those held for customers, the level of our securities borrowing activity, our level of securities positions in which we are long compared to our securities positions in which we are short, the extent of our collateralized financing arrangements and the level of securitized HECM loan inventory.

Investment income and other, net primarily represents returns on our strategic and deferred compensation investments. Such income or loss is primarily affected by the performance and activity of our strategic investments and changes in value of certain deferred compensation investments.

Expenses

Employee compensation and benefits expense, our largest expense, primarily consists of salaries and wages paid to all employees, profitability-based compensation, which includes compensation paid to sales personnel and incentive compensation paid to all other employees based on our profitability, employee benefits, and changes in value of certain deferred compensation liabilities. Employee compensation and benefits expense fluctuates, for the most part, based on changes in our revenues and business mix, profitability and the number of employees. Compensation for employees engaged in sales activities is determined primarily based on a percentage of their gross revenues net of certain transaction-based expenses.

Execution and clearance fees primarily represent fees paid to third party clearing brokers for clearing equities, options and fixed income transactions; transaction fees paid to Nasdaq and other exchanges, clearing organizations and regulatory bodies; execution fees paid to third parties, primarily for executing trades on the NYSE, other exchanges and ECNs; and loan processing fees. Execution and clearance fees primarily fluctuate based on changes in trade and share volume, execution strategies, rate of clearance fees charged by clearing brokers and rate of fees paid to ECNs, exchanges and certain regulatory bodies and loan origination volume.

Communications and data processing expense primarily consists of costs for obtaining market data, connectivity, telecommunications services and systems maintenance.

Payments for order flow primarily represent payments to broker-dealer clients, in the normal course of business, for directing to us their order flow in U.S. equities and options. Payments for order flow also include fees paid to third party brokers with respect to reverse mortgage wholesale loan production and fluctuate as we modify our rates and as our percentage of clients whose policy is not to accept payments for order flow varies. Payments for order flow also fluctuate based on U.S. equity share and option volumes, reverse mortgage loan production and channel mix, our profitability and the mix of market orders, limit orders, and customer mix.

Interest expense consists primarily of costs associated with our long-term debt and for collateralized financing arrangements such as securities lending and sale of financial instruments under our agreements to repurchase.

Depreciation and amortization expense results from the depreciation of fixed assets, which consist of computer hardware, furniture and fixtures, and the amortization of purchased software, capitalized software development costs, acquired intangible assets and leasehold improvements. We depreciate our fixed assets and amortize our purchased software, capitalized software development costs and acquired intangible assets on a straight-line basis over their expected useful lives. We amortize leasehold improvements on a straight-line basis over the lesser of the life of the improvement or the remaining term of the lease.

Professional fees consist primarily of legal, accounting and consulting fees.

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Occupancy and equipment rentals consist primarily of rent and utilities related to leased premises and office equipment.

Business development consists primarily of costs related to sales and marketing, advertising, conferences and relationship management.

Restructuring charges consist of employee severance and other benefit costs, writedown of assets, inclusive of capitalized software, intangible assets and goodwill, and lease and contract terminations in connection with restructuring plans set in place in order to lower operating expenses.

Writedown of assets and lease loss accrual consist primarily of costs associated with the writedown of assets, primarily goodwill and intangible assets, and lease losses related to excess office space.

Other expenses include regulatory fees, corporate insurance, employment fees, partial month interest reserves associated with our Government National Mortgage Association (GNMA) issuances, and general office expense.

Three Months Ended September 30, 2012 and 2011*Revenues**Market Making*

	For the three months ended September 30,		Change	% of Change
	2012	2011		
Commissions and fees (millions)	\$ 15.5	\$ 41.2	\$ (25.8)	-62.4%
Net trading revenue (millions)	(353.5)	161.9	(515.4)	-318.3%
Interest, net (millions)	(3.2)	1.7	(4.9)	N/M
Total Revenues from Market Making (millions)	\$ (341.2)	\$ 204.9	\$ (546.0)	-266.5%
U.S. equity Market Making statistics:				
Average daily dollar value traded (\$ billions)*	16.7	29.3	(12.6)	-42.8%
Average daily trades (thousands)*	2,507.5	4,189.6	(1,682.1)	-40.1%
Nasdaq and Listed shares traded (billions)*	37.9	60.6	(22.8)	-37.5%
FINRA OTC Bulletin Board and Other shares traded (billions)*	151.2	174.6	(23.4)	-13.4%
Average revenue capture per U.S. equity dollar value traded (bps)*	(3.29)	1.04	(4.34)	-415.5%
Average revenue capture per U.S. equity dollar value traded, excluding impact of August 1st technology issue (bps)**	1.04	1.04	(0.00)	0.0%

* Represents new presentation for U.S. equity Market Making for all periods presented as described more fully in text below.

** Statistic excludes \$456.6 million in trading losses related to the August 1, 2012 technology issue.

Totals may not add due to rounding.

N/M Not meaningful

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Total revenues from the Market Making segment, which primarily comprises Net trading revenue from our domestic businesses, decreased to net negative revenues of \$341.2 million for the three months ended September 30, 2012, from positive revenues of \$204.9 million for the comparable period in 2011. Revenues for the three months ended September 30, 2012 were negatively impacted by the August 1, 2012 Loss which resulted in a \$457.6 million trading loss and the effects that the August 1, 2012 Loss had on client volumes immediately after the event as well as a decrease in overall market volumes which drove down our average daily dollar volumes.

In the first quarter of 2012, we modified our quarterly revenue capture and monthly equity volume statistics in order to provide data specific to the U.S. equity market making activity within the Market Making segment. Our revenue capture and volume statistics previously also included U.S. institutional sales activity. Average revenue capture per U.S. equity dollar value traded was a loss of 3.29 basis points (bps) for the third quarter of 2012, down significantly from the third quarter of 2011. Excluding the impact of the August 1, 2012 Loss, average revenue capture per U.S. equity dollar value traded for the third quarter of 2012 remained unchanged at 1.04 bps from the comparable period in 2011. The primary driver for the stability in revenue capture was due in part to growth and enhancements to our trading models and infrastructure. Average revenue capture per U.S. equity market making dollar value traded is calculated as the total of net domestic market making trading revenues plus volume based fees from providing liquidity to other trading venues (included in Commissions and fees), less certain transaction-related regulatory fees (included in Execution and clearance fees) (collectively Domestic U.S. Equity Market Making Revenues), divided by the total dollar value of the related equity transactions. Domestic U.S. Equity Market Making Revenues for the three months ended September 30, 2012 were net negative \$347.5 million, or positive \$109.0 million excluding the impact of August 1, 2012 for the three months ended September 30, 2012, as compared to revenues of \$195.8 million for the three months ended September 30, 2011.

Institutional Sales and Trading

	For the three months ended September 30,		Change	% of Change
	2012	2011		
Commissions and fees (millions)	\$ 89.2	\$ 119.8	\$ (30.6)	-25.5%
Net trading revenue (millions)	10.1	24.7	(14.6)	-58.9%
Interest, net (millions)	2.0	(6.5)	8.5	130.3%
Investment income and other, net (millions)	0.4	7.5	(7.1)	-94.7%
Total Revenues from Institutional Sales and Trading (millions)	\$ 101.7	\$ 145.4	\$ (43.7)	-30.1%

Totals may not add due to rounding.

Total revenues from the Institutional Sales and Trading segment, which primarily comprises Commissions and fees from institutional equities, ETFs, fixed income sales and reverse mortgage originations, decreased 30.1% to \$101.7 million for the three months ended September 30, 2012, from \$145.4 million for the comparable period in 2011. Revenues were negatively impacted by the significant slowdown in client activity as a result of the August 1, 2012 Loss offset, in part by increased revenues from our reverse mortgage business.

Table of Contents*Electronic Execution Services*

	For the three months ended September 30,		Change	% of Change
	2012	2011		
Commissions and fees (millions)	\$ 34.9	\$ 45.6	\$ (10.7)	-23.5%
Investment income and other, net (millions)	(0.1)	(0.5)	0.4	N/M
Total Revenues from Electronic Execution Services (millions)	\$ 34.8	\$ 45.1	\$ (10.3)	-22.9%
Average daily Knight Direct equity shares (millions)	174.8	196.7	(21.8)	-11.1%
Average daily Knight Hotspot FX notional dollar value traded (\$ billions)*	24.1	32.2	(8.1)	-25.1%

Totals may not add due to rounding.

* In the second quarter of 2012, Knight modified the reporting of Knight Hotspot FX notional dollar value traded volume to count one side of the transaction. The Company previously counted total client volume to include both sides of the transaction. The Company posts Knight Hotspot FX volume statistics each month to its web site, which has been updated to show one-sided volume statistics dating back to the beginning of 2010.

N/M Not meaningful

Total revenues from the Electronic Execution Services segment, which primarily comprises Commissions and fees from agency execution activity, decreased 22.9% to \$34.8 million for the three months ended September 30, 2012, from \$45.1 million for the comparable period in 2011. Revenues were negatively impacted by lower overall market volumes made more apparent post August 1, 2012; however, by the end of the quarter volumes were substantially back to pre-August 1, 2012 levels.

Corporate and Other

	For the three months ended September 30,		Change	% of Change
	2012	2011		
Total Revenues from Corporate and Other (millions)	\$ 14.8	\$ 2.0	\$ 12.8	628.5%

Total revenues from the Corporate and Other segment, which primarily represent interest income from our securities borrowing activity, gains or losses on strategic investments, and deferred compensation investments related to certain employees and directors, increased to \$14.8 million for the three months ended September 30, 2012, from \$2.0 million for the comparable period in 2011, primarily due to the \$5.3 million BEIP grant received in August 2012, and from the first full quarter of revenues from our newly acquired futures business which we acquired in June 2012.

Expenses

Employee compensation and benefits expense decreased to \$124.6 million for the three months ended September 30, 2012 from \$157.2 million for the comparable period in 2011. The decrease on a dollar basis was primarily due to reduced bonus accruals and sales commissions expense related to the overall decrease and change in the mix of our revenues across businesses and a decrease in guaranteed compensation from our Institutional Sales and Trading segment. As a percentage of total revenue, excluding the effects of the August 1, 2012 Loss, Employee compensation and benefits increased to 46.6% for the three months ended September 30, 2012, from 39.6% for the comparable period in 2011. The increase as a percentage of revenues was primarily due to a decrease in revenues as well as additional compensation related to retention and acceleration of certain stock-based awards as a result of the recapitalization which resulted in additional stock-based compensation of \$1.6 million in the third quarter of 2012.

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The number of full time employees increased to 1,545 at September 30, 2012, from 1,391 at September 30, 2011, primarily due to the acquisition of our futures business and the expansion of our market making and reverse mortgage businesses. Employee compensation and benefits expense fluctuates, for the most part, based on changes in our business mix, revenues, profitability, and the number of employees.

Execution and clearance fees decreased to \$46.7 million for the three months ended September 30, 2012, from \$63.6 million for the comparable period in 2011. As a percentage of total revenue, excluding the effects of the August 1, 2012 Loss, execution and clearance fees increased slightly to 17.5% for the three months ended September 30, 2012, from 16.0% for the comparable period in 2011. This increase as a percentage of revenues was due to lower revenue base and the effect of lower volumes on tier-based pricing. Execution and clearance fees fluctuate based on changes in transaction volumes, shift in business mix, regulatory fees and operational efficiencies and scale.

Payments for order flow decreased 12.6% to \$20.1 million for the three months ended September 30, 2012, from \$23.0 million for the comparable period in 2011. As a percentage of total revenue, excluding the effects of the August 1, 2012 Loss, payments for order flow increased to 7.5% for the three months ended September 30, 2012, from 5.8% for the comparable period in 2011. The increase as a percentage of revenues is due to lower revenue base and additional cost as we begin to regain market share. Payments for order flow fluctuate as a percentage of revenue due to changes in volume, reverse mortgage loan production, client and product mix, profitability, and competition.

There was no restructuring charge for the three months ended September 30, 2012. The restructuring charge of \$28.6 million for the three months ended September 30, 2011 is related to employee severance and other employee benefits, writedown of assets and lease and contract termination costs in connection with our plan to discontinue certain initiatives and decrease operating expenses.

Writedown of assets and lease loss accrual of \$143.0 million for the three months ended September 30, 2012 relate to the impairment of goodwill and intangibles triggered by the August 1, 2012 Loss. Writedown of assets and lease loss accrual of \$1.3 million for the three months ended September 30, 2011, related to excess real estate space.

All other expenses decreased by 0.9%, or \$0.8 million, to \$78.5 million for the three months ended September 30, 2012 from \$79.3 million for the comparable period in 2011. Excluding the August 1, 2012 related professional fees of \$3.5 million, all other expenses decreased by 5.4%, or \$4.2 million, to \$75.0 million for the three months ended September 30, 2012. Business development expense decreased due to fewer client related events. Other expenses decreased due to lower reserves associated with our GNMA issuances, offset in part by higher administrative expenses. Communications and data processing expense increased primarily due to higher market data and connectivity expenses as a result of our overall growth. Interest expense increased primarily due to our increased securities lending activity and long-term debt. Professional fees increased due to higher consulting expenses and costs related to the August 1, 2012 Loss.

Our effective tax rate from continuing operations of 35.3% for the three months ended September 30, 2012, differed from the federal statutory rate of 35% primarily due to non-deductible charges. Our effective rate of 39.3% for the three months ended September 30, 2011 differed from the federal statutory rate of 35% primarily due to state and local income taxes and non-deductible charges.

Table of Contents*Nine Months Ended September 30, 2012 and 2011**Revenues**Market Making*

	For the nine months ended September 30,		Change	% of Change
	2012	2011		
Commissions and fees (millions)	\$ 60.9	\$ 97.5	\$ (36.7)	-37.6%
Net trading revenue (millions)	(134.5)	413.3	(547.7)	-132.5%
Interest, net (millions)	(1.9)	6.3	(8.2)	N/M
Total Revenues from Market Making (millions)	\$ (75.5)	\$ 517.1	\$ (592.6)	-114.6%
U.S. equity Market Making statistics:				
Average daily dollar value traded (\$ billions)*	19.9	26.0	(6.1)	-23.6%
Average daily trades (thousands)*	3,050.6	3,632.7	(582.1)	-16.0%
Nasdaq and Listed shares traded (billions)*	130.9	165.5	(34.6)	-20.9%
FINRA OTC Bulletin Board and Other shares traded (billions)*	489.3	757.2	(267.9)	-35.4%
Average revenue capture per U.S. equity dollar value traded (bps)*	(0.27)	1.00	(1.27)	-127.2%
Average revenue capture per U.S. equity dollar value traded, excluding impact of Facebook IPO and August 1st technology issue (bps)**	1.02	1.00	0.02	2.5%

* Represents new presentation for U.S. equity Market Making for all periods presented as described more fully in text below.

** Statistic for 2012 excludes \$26.0 million in trading losses related to the Facebook IPO and \$456.6 million in trading losses related to the August 1, 2012 technology issue.

Totals may not add due to rounding.

N/M Not meaningful

Total revenues from the Market Making segment, which primarily comprises Net trading revenue from our domestic businesses, decreased to net negative revenues of \$75.5 million for the nine months ended September 30, 2012, from positive revenues of \$517.1 million for the comparable period in 2011. Revenues for the nine months ended September 30, 2012 were negatively impacted by \$26.0 million of trading losses related to the Facebook IPO the \$457.6 million August 1, 2012 Loss and the effects that the August 1, 2012 Loss had on client volumes immediately after the event as well as a decrease in overall market volumes, which drove down our average daily dollar volumes.

Average revenue capture per U.S. equity dollar value traded was a loss of 0.27 bps for the nine months ended September 30, 2012, down from the comparable period in 2011. Excluding the impact of August 1, 2012 Loss and Facebook IPO, average revenue capture per U.S. equity dollar value traded was 1.02 bps for the nine months ended September 30, 2012, up 2.5% from the comparable period in 2011. The primary driver for the increase in revenue capture excluding the impact of the August 1, 2012 Loss and the Facebook IPO loss was the growth and enhancements to our trading models and infrastructure. Domestic U.S. Equity Market Making revenues were net negative \$101.3 million, or \$381.2 million when excluding the impact of August 1, 2012 Loss and Facebook IPO for the nine months ended September 30, 2012, and \$491.0 million for the nine months ended September 30, 2011.

Table of Contents*Institutional Sales and Trading*

	For the nine months ended September 30,		Change	% of Change
	2012	2011		
Commissions and fees (millions)	\$ 310.5	\$ 358.6	\$ (48.1)	-13.4%
Net trading revenue (millions)	44.8	51.7	(6.9)	-13.3%
Interest, net (millions)	(2.3)	(12.1)	9.8	81.1%
Investment income and other, net (millions)	0.7	9.5	(8.9)	-92.7%
Total Revenues from Institutional Sales and Trading (millions)	\$ 353.7	\$ 407.7	\$ (54.0)	-13.3%

Totals may not add due to rounding.

Total revenues from the Institutional Sales and Trading segment, which primarily comprises Commissions and fees from institutional equities, ETFs, fixed income sales and reverse mortgage originations, decreased 13.3% to \$353.7 million for the nine months ended September 30, 2012, from \$407.7 million for the comparable period in 2011. Revenues were negatively impacted by \$9.4 million of trading losses related to the Facebook IPO and lower revenues from our capital markets and equity sales businesses, exacerbated by a slowdown in client activity as a result of the August 1, 2012 Loss as well as a decrease in overall market volumes offset, in part, by higher revenues from our reverse mortgage business

Electronic Execution Services

	For the nine months ended September 30,		Change	% of Change
	2012	2011		
Commissions and fees (millions)	\$ 122.6	\$ 128.4	\$ (5.8)	-4.5%
Investment income and other, net (millions)	(0.3)	(1.0)	0.7	N/M
Total Revenues from Electronic Execution Services (millions)	\$ 122.3	\$ 127.3	\$ (5.1)	-4.0%
Average daily Knight Direct equity shares (millions)	203.1	174.9	28.2	16.1%
Average daily Knight Hotspot FX notional dollar value traded (\$ billions)*	26.7	30.4	(3.7)	-12.3%

Totals may not add due to rounding.

* In the second quarter of 2012, Knight modified the reporting of Knight Hotspot FX notional dollar value traded volume to count one side of the transaction. The Company previously counted total client volume to include both sides of the transaction. The Company posts Knight Hotspot FX volume statistics each month to its web site, which has been updated to show one-sided volume statistics dating back to the beginning of 2010.

N/M Not meaningful

Total revenues from the Electronic Execution Services segment, which primarily comprises Commissions and fees from agency execution activity, decreased 4.0% to \$122.3 million for the nine months ended September 30, 2012, from \$127.3 million for the comparable period in 2011. Revenues were negatively impacted by lower overall market volumes made more apparent post-August 1, 2012; however, by the end of the quarter volumes were substantially back to pre-August 1, 2012 levels.

Table of Contents*Corporate and Other*

	For the nine months ended September 30,		Change	% of Change
	2012	2011		
Total Revenues from Corporate and Other (millions)	\$ 48.0	\$ 11.0	\$ 37.0	334.4%

Total revenues from the Corporate and Other segment, which primarily represent interest income from our securities borrowing activity, gains or losses on strategic investments, and deferred compensation investments related to certain employees and directors, increased to \$48.0 million for the nine months ended September 30, 2012, from \$11.0 million for the comparable period in 2011. The primary drivers for the increase in revenues were a \$10.0 million gain from a strategic investment that we account for under the equity method of accounting, the \$5.3 million BEIP grant received in August 2012 and revenues from our newly acquired futures business which we acquired in June 2012. The \$10.0 million investment gain represents our share of the investee's net income which we recorded under the equity method of accounting which was due to an income tax benefit recognized by the investee that arose from a change in its tax status during 2010, but which was reported and disclosed to us in the second quarter of 2012.

Expenses

Employee compensation and benefits expense decreased to \$402.8 million for the nine months ended September 30, 2012 from \$446.3 million for the comparable period in 2011. As a percentage of total revenue, excluding the August 1, 2012 Loss, the Facebook IPO trading loss and the one-time \$10.0 million investment gain from a strategic investment, Employee compensation and benefits increased to 43.2% for the nine months ended September 30, 2012, from 42.0% for the comparable period in 2011. The decrease on a dollar basis was primarily due to an overall decrease in revenues and profitability and change in the mix of our revenues across businesses as well as by a decrease in guaranteed compensation from our Institutional Sales and Trading segment.

Execution and clearance fees decreased to \$153.2 million for the nine months ended September 30, 2012, from \$175.8 million for the comparable period in 2011. Excluding the August 1, 2012 Loss, Facebook IPO trading loss and the one-time \$10.0 million investment gain from a strategic investment, execution and clearance fees as a percentage of revenues decreased to 16.4% for the nine months ended September 30, 2012, from 16.5% for the comparable period in 2011. Execution and clearance fees fluctuate based on changes in transaction volumes, shift in business mix, regulatory fees and operational efficiencies and scale.

Payments for order flow decreased 6.2% to \$61.9 million for the nine months ended September 30, 2012, from \$66.0 million for the comparable period in 2011. Excluding the August 1, 2012 Loss, the Facebook IPO trading loss and the one-time \$10.0 million investment gain from a strategic investment, payments for order flow as a percentage of revenues increased to 6.7% for the nine months ended September 30, 2012, from 6.2% for the comparable period in 2011. The increase is due to lower revenue base and additional cost as we begin to regain market share. Payments for order flow fluctuate as a percentage of revenue due to changes in volume, reverse mortgage loan production, client and product mix, profitability, and competition.

There was no restructuring charge for the nine months ended September 30, 2012. The restructuring charge of \$28.6 million for the nine months ended September 30, 2011 is related to employee severance and other employee benefits, writedown of assets and lease and contract termination costs in connection with our plan to discontinue certain initiatives and decrease operating expenses. Writedown of assets and lease loss accrual of \$143.0 million for the nine months ended

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September 30, 2012 which relate to the impairment of goodwill and intangibles triggered by the August 1, 2012 Loss. Writedown of assets and lease loss accrual of \$2.3 million for the nine months ended September 30, 2011 relate to excess real estate space.

All other expenses increased by 4.9%, or \$10.8 million, to \$231.0 million for the nine months ended September 30, 2012 from \$220.2 million for the comparable period in 2011. Excluding August 1, 2012 related professional fees of \$3.5 million, all other expenses increased by 3.3%, or \$7.3 million to \$227.5 million for the nine months ended September 30, 2012. Communications and data processing expense increased primarily due to higher market data and connectivity expenses as a result of our overall growth. Interest expense increased primarily due to our increased securities lending activity and long-term debt. Professional fees increased due to higher consulting expenses and costs related to the August 1, 2012 Loss. Occupancy and equipment rentals expense decreased primarily due to the reduction in lease costs. Business development expense decreased due to fewer client related events. Other expenses decreased due to lower reserves associated with our GNMA issuances, offset, by higher administrative expenses.

Our effective tax rate from continuing operations of 35.0% for the nine months ended September 30, 2012, differed from the federal statutory rate of 35% primarily due to non-deductible charges. Our effective rate of 39.2% for the nine months ended September 30, 2011 differed from the federal statutory rate of 35% primarily due to state and local taxes and non deductible charges.

Reconciliation of GAAP Pre-Tax to Non-GAAP Pre-Tax Earnings.

We believe that certain non-GAAP financial presentations, when taken into consideration with the corresponding GAAP financial presentations, are important in understanding our operating results. Selected financial information is included in our non-GAAP financial presentations for the three and nine months ended September 30, 2012. This information includes the effects due to the August 1, 2012 Loss, the writedown of goodwill and intangible assets, trading losses related to the Facebook IPO and a gain resulting from a change in the tax status of a strategic investment. We believe these presentations provide meaningful information to shareholders and investors as it provides comparability for our results of operations for the three and nine months ended September 30, 2012 with the results for the periods ended September 30, 2011. See schedules below for a full reconciliation of GAAP to non-GAAP financial presentations (in thousands):

Three months ended September 30, 2012	Market Making	Institutional Sales and Trading	Electronic Execution Services	Corporate and Other	Consolidated
Reconciliation of GAAP Pre-Tax to Non-GAAP Pre-Tax:					
GAAP Pre-Tax (Loss) Income	\$ (451,964)	\$ (140,807)	\$ 6,267	\$ (16,356)	\$ (602,860)
August 1st trading loss and related costs	457,570	-	-	3,520	461,090
Writedown of assets	11,917	131,117	-	-	143,034
Non-GAAP Pre-Tax Income (Loss)	\$ 17,522	\$ (9,690)	\$ 6,267	\$ (12,836)	\$ 1,263

* Totals may not add due to rounding

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Nine months ended September 30, 2012	Market Making	Institutional Sales and Trading	Electronic Execution Services	Corporate and Other	Consolidated
Reconciliation of GAAP Pre-Tax to Non-GAAP Pre-Tax:					
GAAP Pre-Tax (Loss) Income	\$ (400,901)	\$ (133,639)	\$ 29,882	\$ (38,847)	\$ (543,505)
August 1st trading loss and related costs	457,570	-	-	3,520	461,090
Writedown of assets	11,917	131,117	-	-	143,034
Facebook IPO trading losses	25,975	9,385	78	-	35,438
Investment gain	-	-	-	(9,992)	(9,992)
Non-GAAP Pre-Tax Income (Loss)	\$ 94,561	\$ 6,863	\$ 29,960	\$ (45,319)	\$ 86,064

* Totals may not add due to rounding

Financial Condition, Liquidity and Capital Resources*Financial Condition*

We have historically maintained a highly liquid balance sheet, with a substantial portion of our total assets consisting of cash, highly liquid marketable securities and short term receivables. As of September 30, 2012 and December 31, 2011, we had \$8.59 billion and \$7.15 billion, respectively, in assets, a portion of which consisted of cash or assets readily convertible into cash as follows (in millions):

	September 30, 2012	December 31, 2011
Cash and cash equivalents	\$ 420.8	\$ 467.6
Financial instruments owned, at fair value:		
Equities	1,170.8	1,416.1
U.S. government and Non-U.S. government obligations	57.8	44.3
Corporate debt	76.5	73.9
Mortgage-backed securities	112.4	16.4
Listed equity options	132.4	280.4
Collateralized agreements:		
Securities borrowed	1,060.0	1,494.6
Receivables from brokers, dealers and clearing organizations	944.2	623.9
Total cash and assets readily convertible to cash	\$ 3,975.0	\$ 4,417.3

Totals may not add due to rounding.

Substantially all of the amounts disclosed in the table above can be liquidated to cash within five business days under normal market conditions, however, the liquidated values may be subjected to haircuts during distressed market conditions as we saw following the August 1, 2012 Loss.

Financial instruments owned principally consist of equities and listed equity options that trade on the NYSE, NYSE Amex and NYSE Arca markets, Nasdaq and on the OTC Bulletin Board as well as securitized HECM loan inventories.

Securities borrowed represent the value of cash or other collateral deposited with securities lenders to facilitate our trade settlement process.

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Receivables from brokers, dealers and clearing organizations include interest bearing cash balances held with third party clearing brokers, including, or net of, amounts related to securities transactions that have not yet reached their contracted settlement date, which is generally within three business days of the trade date.

As of September 30, 2012 and December 31, 2011, \$812.2 million and \$798.2 million, respectively, of equities have been pledged as collateral to third-parties under financing arrangements.

Other assets primarily represent deposits and other miscellaneous receivables.

Total assets increased \$1.43 billion, or 20.0%, from \$7.15 billion at December 31, 2011 to \$8.59 billion at September 30, 2012. The majority of the increase in assets relates to the growth of our financial instruments owned. Financial instruments owned increased by \$1.33 billion, or 35.2%, from \$3.78 billion at December 31, 2011, to \$5.11 billion at September 30, 2012, primarily due to the \$1.69 billion increase in securitized HECM loan inventory, which represents HECM loans that have been securitized into GNMA securities which have been sold to third parties but where the securitization is not accounted for as a sale under current accounting standards. Offsetting this increase is a decrease of approximately \$280.0 million related to a net reduction in our trading inventory. Our securities inventory fluctuates based on trading volumes, market conditions, trading strategies utilized and our pre-determined risk limits. Receivable from brokers, dealers and clearing organizations increased by \$320.3 million, from \$623.9 million at December 31, 2011 to \$944.2 million at September 30, 2012, due to increased deposits at third party clearing organizations including customer balances related to our futures business as well as timing relating to trade date versus settlement date differences. Securities borrowed decreased by \$434.6 million, from \$1.49 billion at December 31, 2011 to \$1.06 billion at September 30, 2012. This decrease is related to the decrease in our trading inventory as well as the effect of reduced levels of business with some of our counterparties as a result of the August 1, 2012 Loss. Income taxes receivable increased \$163.9 million from \$9.8 million at December 31, 2011 to \$173.6 million at September 30, 2012, primarily due to the August 1, 2012 Loss. Cash and securities segregated under federal and other regulations increased \$126.8 million from \$11.0 million at December 31, 2011 to \$137.8 million at September 30, 2012, primarily due to the acquisition of our futures business.

Total liabilities increased \$1.42 billion, or 24.9%, from \$5.69 billion at December 31, 2011 to \$7.11 billion at September 30, 2012. The majority of the increase in liabilities relates to increases in Collateralized financings and Payable to customers. Collateralized financings increased by \$1.44 billion, or 49.7%, from \$2.89 billion at December 31, 2011, to \$4.32 billion at September 30, 2012 primarily due to the increased Liability to GNMA trusts, at fair value associated with the securitization of HECM loans into GNMA securities, where such securitization is not accounted for as a sale offset by a decrease in lending activity to facilitate transaction settlements relating to self-clearing. Financial instruments sold, not yet purchased decreased by \$425.8 million, or 24.7%, from \$1.72 billion at December 31, 2011, to \$1.30 billion at September 30, 2012, primarily due to a decrease in the size of the securities inventory utilized in our equity market making and ETF activities and for trade execution services. Our securities inventory fluctuates based on trading volumes, market conditions, trading strategies utilized and our pre-determined risk limits and is consistent with the decrease in our long securities position within our market making business. Payable to customers increased by \$437.2 million, from \$23.7 million at December 31, 2011 to \$460.8 million at September 30, 2012, primarily due to the acquisition of our futures business. Accrued compensation expense decreased from \$188.9 million at December 31, 2011 to \$132.0 million at September 30, 2012 primarily as a result of the payment of 2011 incentive compensation offset, in part, by the accrual of current period incentive compensation.

Our Series A convertible preferred stock balance of \$259.3 million is a result of our \$400.0 million issuance of convertible preferred securities, which netted \$359.5 million after \$40.5 million in related

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fees. This initial balance was reduced by \$100.5 million as a result of the conversion of a portion of the, Series A Shares into Class A common stock. Since the Series A Shares can become redeemable at the option of the holder upon the occurrence of certain merger or acquisition transactions or fundamental changes, which may not be solely within the control of the Company, the Series A Shares are classified as temporary equity on the Company's Consolidated Statements of Financial Condition.

Stockholders' equity decreased by \$245.2 million, from \$1.46 billion at December 31, 2011 to \$1.22 billion at September 30, 2012. The decrease in stockholders' equity from December 31, 2011 was primarily a result of the August 1, 2012 loss, offset in part by an increase of \$100.5 million as a result of the aforementioned conversion of a portion of the Series A Shares into Class A common stock.

Liquidity and Capital Resources

Historically we have financed our business primarily through cash generated by operations, our long-term debt and other borrowings. As a result of the August 1, 2012 Loss, on August 6, 2012 we raised \$400.0 million in equity financing through a convertible preferred share offering with several investors. We incurred approximately \$40.5 million of fees and costs related to the offering, resulting in net proceeds of \$359.5 million.

At September 30, 2012, we had net current assets, which consist of net assets readily convertible into cash less current liabilities, of \$1.15 billion.

We have acquired several businesses over the last few years. In July 2010, we completed the acquisition of Urban Financial Group, Inc. (Urban) for \$28.4 million, comprising \$19.4 million in cash, approximately 350,000 shares of unregistered Knight Class A common stock valued at \$5.0 million and a potential earn-out based on future performance valued at \$4.7 million. Urban achieved its first and second year performance targets as of July 31, 2011 and 2012, respectively. Therefore, the seller received \$1.3 million split evenly between cash and unregistered shares of Knight common stock in each of those years. In June 2012, we completed the acquisition of certain assets and assumption of certain liabilities of Penson Futures, the futures division of Penson Financial Services, Inc. for \$5.0 million in cash and a potential earn-out based on future performance with an estimated fair value of \$8.4 million. We expect to fund the purchase price of any future acquisitions with our current cash position or, in some cases, through the issuance of our stock or debt.

We had net loss of \$389.9 million for the three months ended September 30, 2012 and net income of \$26.9 million for the three months ended September 30, 2011. Included in these amounts were certain non-cash expenses such as stock-based compensation, depreciation and amortization, and writedown of assets. Stock-based compensation was \$14.2 million and \$10.7 million for the three months ended September 30, 2012 and 2011, respectively. Depreciation and amortization expense was \$11.9 million and \$13.7 million for the three months ended September 30, 2012 and 2011, respectively. Non-cash writedown of assets were \$143.0 million for the three months ended September 30, 2012 which related to goodwill and intangible assets. There were no non-cash writedowns for the three months ended September 30, 2011.

Capital expenditures were \$8.4 million and \$9.9 million during the three months ended September 30, 2012 and 2011, respectively. Purchases of investments were \$5.5 million and \$3.4 million and distributions from investments were \$10.3 million and \$0.4 million for the three months ended September 30, 2012 and 2011, respectively. There were no payments relating to acquisitions of businesses, trading rights and other items for the three months ended September 30, 2012. Cash payment relating to purchase of business, net of cash acquired for the three months ended September 30, 2011 was \$0.6 million which related to the first year of Urban earn-out.

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In March 2010, we issued Cash Convertible Senior Subordinated Notes (Notes) with a face amount of \$375.0 million in a private offering. Net proceeds from the offering were \$167.5 million, which included \$15.0 million from the sale of warrants, less \$140.5 million for the termination and required repayment of the borrowings under our previous \$140.0 million credit agreement including accrued interest, \$73.7 million for the purchase of call options and \$8.5 million of offering expenses. The Notes bear interest at a rate of 3.50% per year, payable semi-annually in arrears, on March 15 and September 15 of each year, commencing on September 15, 2010 and will mature on March 15, 2015, subject to earlier repurchase or conversion. For the three months ended September 30, 2012 and 2011, we recognized interest expense related to the Notes of \$6.9 million and \$6.7 million, respectively.

In June 2011, we entered into a \$100.0 million three-year Term Loan Credit Agreement (the Term Credit Agreement) with the same consortium of banks. As of September 30, 2012, the Company has borrowed all the funds under the Term Credit Agreement and the interest rate was 2.75% per annum, which is based on the one month LIBOR rate plus 2.50%. Interest is paid monthly. The Term Credit Agreement is repayable in three installments as follows: \$25.0 million on June 28, 2013, \$25.0 million on December 27, 2013 and \$50.0 million on June 27, 2014. For the three months ended September 30, 2012, we recognized interest expense related to the Term Credit Agreement of \$0.7 million.

In June 2011, we also entered into a \$200.0 million one-year Revolving Credit Agreement (the Revolving Credit Agreement) with Knight Execution & Clearing Services LLC and Knight Capital Americas, L.P., as borrowers, with a consortium of banks. Borrowings under the Revolving Credit Agreement bear interest at a rate equal to the greater of the federal funds rate or the one month LIBOR rate plus a margin ranging from 1.50% - 2.00% per annum. Interest is payable quarterly. In June 2012, we renewed our Revolving Credit Agreement with substantially the same consortium of banks on substantially the same terms and conditions as the Revolving Credit Agreement. In August 2012, we drew down the full \$200.0 million available under our Revolving Credit Agreement and repaid in full by the next business day. As of September 30, 2012, and December 31, 2011 there were no outstanding borrowings under the Revolving Credit Agreement. We are charged an annual commitment fee of 0.25% on the average daily amount of the unused portion of the Revolving Credit Agreement. For the three months ended September 30, 2012, we recorded \$0.1 million in commitment fees.

In August 2012, we raised \$400.0 million in equity financing through a convertible preferred share offering with several investors. Under the terms, we sold 400,000 shares of Series A Convertible Preferred Stock, par value \$0.01 per share. We incurred approximately \$40.5 million of fees and costs related to the issuance resulting in net proceeds of \$359.5 million. Dividends on the Series A Shares accrue daily and are payable on a cumulative basis, as and if declared by the Board of Directors, in cash at a rate per annum equal to 2%. Declared dividends on the Series A Shares are payable quarterly, in arrears, on each January 15, April 15, July 15 and October 15, with the first dividend paid on October 15, 2012 of \$1.1 million.

See Footnote 11 Long-Term Debt and Footnote 4 Series A Convertible Preferred Stock included in Part I, Item 1 Financial Statements of this Form 10-Q for further information regarding the Notes, Term Credit Agreement and Revolving Credit Agreement; and Series A Convertible Preferred Stock, respectively.

We declared a cash dividend at the end of September 2012 for holders of our Series A convertible preferred stock totaling \$1.1 million, which was paid in October 2012. See Footnote 4 Series A Convertible Preferred Stock, included in Part I, Item 1 Financial Statements of this Form 10-Q for further information regarding our August 6, 2012 equity financing.

We have an authorized stock repurchase program of \$1.00 billion. We did not repurchase any shares under the stock repurchase program during the third quarter of 2012. Through September 30,

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2012, we had repurchased 76.7 million shares for \$879.1 million under this program. We may repurchase shares from time to time in open market transactions, accelerated stock buyback programs, tender offers, privately negotiated transactions or by other means. Repurchases may also be made under Rule 10b5-1 plans. The timing and amount of repurchase transactions will be determined by our 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. We caution that there are no assurances that any further repurchases will actually occur. The terms of our Series A-1 Cumulative Perpetual Convertible Preferred Stock terms prohibit us from repurchasing any shares if dividends on such shares are in arrears. We had 181.5 million shares of Class A common stock outstanding as of September 30, 2012.

Our U.S. registered broker-dealer is subject to regulatory requirements intended to ensure the general financial soundness and liquidity of broker-dealers and futures commission merchants (FCM) and require the maintenance of minimum levels of net capital, as defined in SEC Rule 15c3-1 as well as other capital requirements from several commodity organizations including the Commodities Futures Trading Commission (CFTC) and the National Futures Association (NFA). These regulations also prohibit a broker-dealer from repaying subordinated borrowings, paying cash dividends, making loans to its parent, affiliates or employees, or otherwise entering into transactions which would result in a reduction of its total net capital to less than 120% of its required minimum capital. Moreover, broker-dealers are required to notify the SEC, CFTC and other regulators prior to repaying subordinated borrowings, paying dividends and making loans to its parent, affiliates or employees, or otherwise entering into transactions, which, if executed, would result in a reduction of 30% or more of its excess net capital (net capital less minimum requirement). The SEC and the CFTC have the ability to prohibit or restrict such transactions if the result is detrimental to the financial integrity of the broker-dealer. As of September 30, 2012, our broker-dealers were in compliance with the applicable regulatory net capital rules.

The following table sets forth the net capital levels and requirements for the following regulated U.S. broker-dealer subsidiary at September 30, 2012, as reported in their respective regulatory filings (in millions):

Entity	Net Capital	Net Capital Requirement	Excess Net Capital
Knights Capital Americas LLC	\$ 289.3	\$ 20.7	\$ 268.6

Effective as of the close of business on June 30, 2012, we merged our broker-dealer subsidiary Knight Capital Americas, L.P. into Knight Execution & Clearing Services LLC (KECS) with KECS as the surviving entity and only U.S. broker-dealer. KECS was then immediately renamed Knight Capital Americas LLC and remains an indirect, wholly-owned subsidiary of Knight Capital Group, Inc.

Our foreign registered broker-dealers are subject to certain financial resource requirements of either the Financial Services Authority (FSA) or the Securities and Futures Commission (SFC). The following table sets forth the financial resource requirement for the following significant foreign regulated broker-dealer at September 30, 2012 (in millions):

Entity	Financial Resources	Resource Requirement	Excess Financial Resources
Knights Capital Europe Limited	\$ 125.7	\$ 34.7	\$ 91.0

Off-Balance Sheet Arrangements

As of September 30, 2012, we did not have any off-balance sheet arrangements, as defined in Item 303(a) (4) (ii) of SEC Regulation S-K.

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Effects of Inflation

Because the majority of our assets are liquid in nature, they are not significantly affected by inflation. However, the rate of inflation may affect our expenses, such as employee compensation, office leasing costs and communications expenses, which may not be readily recoverable in the prices of the services offered by us. To the extent inflation results in rising interest rates and has other adverse effects on the securities markets, it may adversely affect our financial position and results of operations.

Critical Accounting Policies

Our Consolidated Financial Statements are based on the application of GAAP which requires us to make estimates and assumptions about future events that affect the amounts reported in our financial statements and the accompanying notes. Future events and their effects cannot be determined with certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from those estimates and any such differences may be material to our Consolidated Financial Statements. We believe that the estimates set forth below may involve a higher degree of judgment and complexity in their application than our other accounting estimates and represent the critical accounting estimates used in the preparation of our consolidated financial statements. We believe our judgments related to these accounting estimates are appropriate. However, if different assumptions or conditions were to prevail, the results could be materially different from the amounts recorded.

Financial Instruments and Fair Value We value our financial instruments using a hierarchy of fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.

The fair value hierarchy can be summarized as follows:

Level 1 Valuations based on quoted prices in active markets for identical assets or liabilities that we have the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

Level 2 Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3 Valuations based on inputs that are unobservable and significant to the overall fair value measurement. Changes in fair value are recognized in earnings each period for financial instruments that are carried at fair value.

Our financial instruments owned and financial instruments sold, not yet purchased will generally be classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices or broker or dealer quotations with reasonable levels of price transparency.

The types of instruments that trade in markets that are not considered to be active, but are valued based on observable inputs such as quoted market prices or alternative pricing sources with reasonable levels of price transparency are generally classified within Level 2 of the fair value hierarchy.

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As discussed in Footnote 11 Long-Term Debt, included in Part I, Item 1 Financial Statements of this Form 10-Q, we entered into purchased call options and recorded an embedded conversion derivative concurrent with our issuance of the Notes. The fair value of these options and derivative are determined using an option pricing model based on observable inputs such as implied volatility of our common stock, risk-free interest rate, and other factors and, as such, are classified within Level 2 of the fair value hierarchy.

Our loan inventory including securitized HECM loan inventory, foreign currency forward contracts, investment in the Deephaven Funds, deferred compensation investments and certain mortgage-backed securities are also classified within Level 2.

Certain instruments are classified within Level 3 of the fair value hierarchy because they trade infrequently and therefore have little or no price transparency. For those instruments that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used. As of September 30, 2012 and December 31, 2011, we did not hold any financial instruments that met the definition of Level 3.

There were no transfers of financial instruments between levels of the fair value hierarchy for any periods presented.

Securitization activities We securitize HECMs under our GNMA issuance authority. Securitization and transfer of financial assets are generally accounted for as sales when an issuer has relinquished control over the transferred assets. Based upon the current structure of the GNMA securitization program, we believe that we have not met the GAAP criteria for relinquishing control over the transferred assets and therefore our securitizations fail to meet the GAAP criteria for sale accounting. As such, we continue to recognize the HECMs in Financial instruments owned, at fair value, and we recognize a corresponding liability in Liability to GNMA trusts, at fair value on the Consolidated Statements of Financial Condition.

Goodwill and Intangible Assets As a result of our various acquisitions, we have acquired goodwill and identifiable intangible assets. We determine the values and useful lives of intangible assets upon acquisition. Goodwill is the cost of acquired companies in excess of the fair value of net assets, including identifiable intangible assets, at the acquisition date. We test goodwill and intangible assets with an indefinite useful life for impairment at least annually or when an event occurs or circumstances change that signifies the existence of impairment.

Goodwill

Goodwill of \$218.6 million at September 30, 2012 primarily relates to our Institutional Sales and Trading and Electronic Execution Services segments. We test the goodwill in each of our reporting units for impairment at least annually by comparing the estimated fair value of each reporting unit with its estimated net book value. We derive the fair value of each of our reporting units based on valuation techniques we believe market participants would use for each segment (observable market multiples and discounted cash flow analyses) and we derive the net book value of our reporting units by estimating the amount of shareholders' equity required to support the activities of each reporting unit. As part of our test for impairment, we also consider the profitability of the applicable reporting unit as well as our overall market value, compared to our book value. We performed our annual test for impairment of goodwill in the second quarter of 2012 and determined that goodwill was not impaired at that time. Subsequent to that annual impairment test, we experienced a technology issue on August 1, 2012 which resulted in a substantial trading loss and required us to reassess goodwill for impairment and resulted in a writedown of goodwill totaling \$143.0 million.

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Intangible Assets

Intangible assets, less accumulated amortization, of \$68.2 million at September 30, 2012 are primarily attributable to our Institutional Sales and Trading and Electronic Execution Services segments. We amortize these assets, which primarily consist of customer relationships on a straight-line basis over their useful lives, the majority of which have been determined to range from two to 18 years. We test amortizable intangibles for recoverability whenever events indicate that the carrying amounts may not be recoverable. On August 1, 2012 we incurred a technology issue which resulted in a substantial trading loss. Consequently we assessed our amortizable intangibles assets for impairment and recorded a writedown of intangible assets totaling \$16.7 million.

Investments Investments primarily comprise strategic investments and deferred compensation investments. Strategic investments include noncontrolling equity ownership interests and debt instruments held by us within our non-broker-dealer subsidiaries, primarily in financial services-related businesses. Strategic investments are accounted for under the equity method, at cost or at fair value. We use the equity method of accounting where we are considered to exert significant influence on the investee. We hold strategic investments at cost, less impairment if any, when we are not considered to exert significant influence on operating and financial policies of the investee. We account for our deferred compensation investments, which primarily consist of mutual funds, at fair value.

We review investments on an ongoing basis to ensure that the carrying values of the investments have not been impaired. If we assess that an impairment loss on a strategic investment has occurred due to a decline in fair value or other market conditions, we write the investment down to its estimated impaired value.

We maintain a deferred compensation plan related to certain employees and directors. This plan provides a return to the participants based upon the performance of various investments. In order to hedge our liability under this plan, we generally acquire the underlying investments and hold such investments until the deferred compensation liabilities are satisfied. We record changes in the values of such investments in Investment income and other, net, with a corresponding charge or credit to Employee compensation and benefits on the Consolidated Statements of Operations.

Market Making, Sales, Trading and Execution Activities Financial instruments owned and Financial instruments sold, not yet purchased, which relate to market making and trading activities, include listed and OTC equity securities, listed equity options and fixed income securities which are recorded on a trade date basis and carried at fair value. Net trading revenue (trading gains, net of trading losses) and commissions (which includes commission equivalents earned on institutional client orders, futures transactions, and HECM loan originations and securitization activities) and related expenses are also recorded on a trade date basis. Our third party clearing agreements call for payment or receipt of interest income, net of transaction-related interest charged by clearing brokers for facilitating the settlement and financing of securities transactions. The Company also nets interest income on its securitized HECM loan inventory against interest expense on its liability to GNMA trusts.

Dividend income relating to securities owned and dividend expense relating to securities sold, not yet purchased, derived from our market making activities are included as a component of Net trading revenue on our Consolidated Statements of Operations.

Lease Loss Accrual It is our policy to identify excess real estate capacity and where applicable, accrue for related future costs, net of estimated sublease income.

Other Estimates The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions. In addition to the estimates that we make in

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connection with accounting for the items noted above, the use of estimates is also important in determining provisions for potential losses that may arise from litigation, regulatory proceedings and tax audits.

When determining stock-based employee compensation expense, we make certain estimates and assumptions relating to volatility and forfeiture rates. We estimate volatility based on several factors including implied volatility of market-traded options on our common stock on the grant date and the historical volatility of our common stock. We estimate forfeiture rates based on historical rates of forfeiture of employee stock awards.

A portion of our Employee compensation and benefits expense on the Consolidated Statements of Operations represents discretionary bonuses, which are accrued for throughout the year and paid after the end of the year. Among many factors, discretionary bonus accruals are generally influenced by our overall performance and competitive industry compensation levels.

We estimate and accrue for potential losses that may arise out of litigation and regulatory proceedings to the extent that such losses are probable and can be estimated. Significant judgment is required in making these estimates and our final liabilities may ultimately be materially different. Our total liability accrued with respect to litigation and regulatory proceedings is determined on a case-by-case basis and represents an estimate of probable losses based on, among other factors, the progress of each case, our experience and industry experience with similar cases and the opinions and views of internal and external legal counsel. Given the inherent difficulty of predicting the outcome of our litigation and regulatory matters, particularly in cases or proceedings in which substantial or indeterminate damages or fines are sought, or where cases or proceedings are in the early stages, we cannot estimate losses or ranges of losses for cases or proceedings where there is only a reasonable possibility that a loss may be incurred. For more information on our legal and regulatory matters, see *Legal Proceedings* in Part I, Item 3 of our Annual Report on Form 10-K for the year ended December 31, 2011, Part II, Item 1 included in this Form 10-Q and other reports or documents the Company files with, or furnishes, to the SEC from time to time.

Accounting Standards Updates

In December 2011, the Financial Accounting Standards Board (FASB) issued an Accounting Standard Update (ASU) that requires additional disclosures about financial assets and liabilities that are subject to netting arrangements. Under the ASU, financial assets and liabilities must be disclosed at their respective gross asset and liability amounts, the amounts offset on the balance sheet and a description of the respective netting arrangements. The new disclosures are required for annual reporting periods beginning on or after January 1, 2013, and are to be applied retrospectively. Other than the change in disclosures, we have determined that the adoption of this ASU will not have an impact on our Consolidated Financial Statements.

In July 2012 the FASB issued an ASU, which allows a company to first assess qualitative factors to determine whether it is necessary to perform a quantitative impairment test of an indefinite-lived intangible asset. This ASU simplifies the guidance for impairment testing of indefinite-lived intangible assets other than goodwill and gives companies the option to assess qualitative factors to determine whether it is necessary to perform a quantitative impairment test. Companies electing to perform a qualitative assessment are no longer required to calculate the fair value of an indefinite-lived intangible asset unless the company determines, based on a qualitative assessment, that it is more likely than not that the asset is impaired. This update is effective for annual impairment tests, or more frequently if deemed appropriate, performed in fiscal years beginning after September 15, 2012; however, early adoption is permitted. We are currently evaluating the impact, if any that this ASU will have on our Consolidated Financial Statements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to numerous risks in the ordinary course of our business and activities; therefore, effective risk management is critical to our financial soundness and profitability. We have a comprehensive risk management structure and processes to monitor and evaluate the principal risks we assume in conducting our business. Our risk management policies, procedures and methodologies are subject to ongoing review and modification. The principal risks we face are as follows:

Market Risk

Our market making and trading activities expose our capital to significant risks. These risks include, but are not limited to, absolute and relative price movements, price volatility, interest rates, credit spreads, and changes in liquidity, over which we have virtually no control. Securities price risks result from exposure to changes in prices and volatilities of individual securities, baskets and indices. Interest rate risks result primarily from exposure and changes in the yield curve, the volatility of interest rates and credit spreads.

For working capital purposes, we invest in money market funds and government securities or maintain interest-bearing balances at banks and in our trading accounts with clearing brokers, which are classified as Cash and cash equivalents and Receivable from brokers, dealers and clearing organizations, respectively, on the Consolidated Statements of Financial Condition. These financial instruments do not have maturity dates; the balances are short-term in nature and are subject to daily repricing, which helps to mitigate our market risks. Our cash and cash equivalents held in foreign currencies are subject to the exposure of foreign currency fluctuations. These balances are monitored daily and are not material to our overall cash position.

We employ proprietary position management and trading systems that provide real-time, on-line position management and inventory control. We monitor our risks by reviewing trading positions and their appropriate risk measures. We have established a system whereby transactions are monitored by senior management and an independent risk control function on a real-time basis as are individual and aggregate dollar and inventory position totals, capital allocations, and real-time profits and losses. Our management of trading positions is enhanced by our review of mark-to-market valuations and position summaries on a daily basis.

In the normal course of business, we maintain inventories of exchange-listed and OTC equity securities, and to a significantly lesser extent, listed equity options and fixed income products. The fair value of these financial instruments at September 30, 2012 and 2011 was \$1.55 billion and \$ 2.29 billion, respectively, in long positions and \$1.29 billion and \$1.83 billion, respectively, in short positions. Excluding the impact of hedges, the potential change in fair value, using a hypothetical 10% decline in prices, is estimated to be a loss of \$25.7 million and \$46.3 million as of September 30, 2012 and 2011, respectively, due to the offset of gains in short positions against losses in long positions.

Operational Risk

Operational risk can arise from many factors ranging from routine processing errors to potentially costly incidents arising, for example, from major systems failures or human errors. For example, on August 1, 2012, at the open of trading at the NYSE, we experienced a technology issue related to the installation of trading software which resulted in our sending numerous erroneous orders in NYSE-listed and NYSE Arca securities into the market. As a result of this technology issue, we incurred a pre-tax loss of \$461.1 million which principally relates to trading losses. Following August 1, 2012, we commenced an internal review into such event and associated controls and intend to take appropriate remedial measures based on the findings of such review.

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Our businesses are highly dependent on our ability and our market centers to process, on a daily basis, a large number of transactions across numerous and diverse markets in several currencies. We incur operational risk across all of our business activities, including revenue generating activities as well as support functions. Legal and compliance risk is included in the scope of operational risk and is discussed below under Legal Risk.

Primary responsibility for the management of operational risk lies with our operating segments and supporting functions. Our operating segments maintain controls designed to manage and mitigate operational risk for existing activities. As new products and business activities are developed, we endeavor to identify operational risks and design controls to seek to mitigate the identified risks.

Disaster recovery plans are in place for critical facilities related to our primary operations and resources and redundancies are built into the systems as deemed reasonably appropriate. We have also established policies, procedures and technologies designed to seek to protect our systems and other assets from unauthorized access.

Liquidity Risk

Liquidity risk is the risk that we would be unable to meet our financial obligations as they arise in both normal and strained funding environments. To that end, we have established a comprehensive and conservative set of policies and procedures that govern the management of liquidity risk for the Company at the corporate level and at the business unit level.

We maintain a liquidity pool consisting primarily of cash and other highly liquid instruments at the corporate level to satisfy intraday and day-to-day funding needs, as well as potential cash needs in a strained funding environment. In addition, we maintain committed and uncommitted credit facilities with a number of unaffiliated financial institutions. In connection with the uncommitted credit facilities, the lender is at no time under any obligation to make any advance under the credit line, and any outstanding loans must be repaid on demand from the lender.

Our liquidity pool comprises the following (in millions):

	September 30, 2012	December 31, 2011
Liquidity pool composition		
Cash held at banks	\$ 45.0	\$ 33.3
Money market and other highly liquid investments	280.4	200.6
Total liquidity pool	\$ 325.4	\$ 233.9
Cash and other highly liquid investments held by subsidiary entities	\$ 95.4	\$ 233.7

We maintain a contingency funding plan (CFP) which clearly delineates the roles, responsibilities and actions that will be utilized as the Company encounters various levels of liquidity stress with the goal of fulfilling all financial obligations as they arise while maintaining business activity. We periodically update and test the operational functionality of various aspects of the CFP to ensure it remains current with changing business activity.

Capital Risk

Government regulators, both in the U.S. and globally, as well as self-regulated organizations, have supervisory responsibility over our regulated activities and require us to maintain specified minimum levels of regulatory capital in our broker-dealer and mortgage originator subsidiaries. If not properly

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monitored, our regulatory capital levels could fall below the required minimum amounts set by our regulators, which could expose us to various sanctions ranging from fines and censure to imposing partial or complete restrictions on our ability to conduct business.

To mitigate this risk, we continuously evaluate the levels of regulatory capital at each of our regulated subsidiaries and adjust the amounts of regulatory capital as necessary to ensure compliance with regulatory capital requirements. We also maintain excess regulatory capital to accommodate periods of unusual or unforeseen market volatility. In addition, we monitor regulatory developments regarding capital requirements and prepare for changes in the required minimum levels of regulatory capital that may occur in the future.

Legal Risk

Legal risk includes the risk of non-compliance with applicable legal and regulatory requirements and standards. Legal risk also includes contractual and commercial risk such as the risk that counterparty's performance obligations will be unenforceable. We are generally subject to extensive regulation in the different jurisdictions in which we conduct our business. We have established procedures based on legal and regulatory requirements that are designed to foster compliance with applicable statutory and regulatory requirements. We have also established procedures that are designed to require that our policies relating to conduct, ethics and business practices are followed.

As a result of the technology issue on August 1, 2012, we have become subject to regulatory reviews and litigations by parties, including our shareholders, related to the technology issue. See "Legal Proceedings" in Part II, Item 1 herein.

Credit Risk

Credit risk represents the loss that we would incur if a counterparty fails to perform its contractual obligations in a timely manner. We manage credit risk with a global, independent credit risk management function that is responsible for measuring, monitoring and controlling the counterparty credit risks inherent in our business activities. To accomplish this, we have established credit policies for specific business lines.

Our credit risk function's process for managing credit risk includes a qualitative and quantitative risk assessment of significant counterparties prior to engaging in business activity, as well as, on an ongoing basis. The review includes formal financial analysis and due diligence when appropriate.

Our credit risk function is responsible for approving counterparties and establishing credit limits to manage credit risk exposure by counterparty and business line. The assigned limits reflect the various elements of assessed credit risk and are subsequently revised to correspond with changes in the counterparties' credit profiles. Our credit risk function communicates counterparty limits to the business areas as well as senior management, and monitors compliance with the established limits.

Where appropriate, counterparty exposure is monitored on a daily basis and the collateral, if required, is marked to market daily to accurately reflect the current exposure.

Foreign Currency Risk

Our exposure to foreign currency transaction gains and losses is the result of our foreign subsidiaries having a functional currency other than the U.S. dollar and transacting business in currencies other than the U.S. dollar, primarily the British pound and the Euro. A portion of these risks are hedged, but fluctuations in currency exchange rates could impact our results of operations, financial position and cash flows.

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Item 4. Controls and Procedures

As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of the Company's management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective. There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents**PART II OTHER INFORMATION****Item 1. 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 such matters at the present time. Although there can be no assurances, at this time we believe, 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.

As previously mentioned, we experienced a technology issue at the open of trading at the NYSE on August 1, 2012. This issue was related to the installation of trading software and resulted in our broker-dealer subsidiary, Knight Capital Americas LLC (the "firm"), sending numerous erroneous orders in NYSE-listed and NYSE Arca securities into the market. As noted below, we have since been named in two putative class actions and have received several derivative demand letters and/or requests for the inspection or production of certain books and records pursuant to Delaware law related to the technology issue and the August 6, 2012 recapitalization. In addition, the Company and/or the firm are the subject of regulatory investigations. While we are unable to predict the outcome of any possible litigation or investigation related to the technology issue or the August 6, 2012 recapitalization, an unfavorable outcome in one or more of these matters could have a material adverse effect on our financial condition or ongoing operations. In addition, we expect to incur additional expenses in defending against litigation and in connection with investigations.

Legal

On August 17, 2012, we were named as a defendant in an action entitled *Osgood v. Knight Capital Group, Inc.* in the U.S. District Court for the Western District of Tennessee. Generally, this putative class action complaint alleges that Knight failed to disclose both its intention to install a new algorithm and the risks associated with such an algorithm. The plaintiff asserts claims under Section 10(b) and Rule 10b-5 of the federal securities laws and Tennessee statutes and common law, claiming that he and a class of Knight shareholders who purchased the Company's Class A common stock between February 29, 2012 and August 1, 2012, paid an inflated price. The plaintiff has 120 days to serve Knight with the complaint, but has not yet done so.

On October 26, 2012, the Company, its Chairman and Chief Executive Officer, Thomas M. Joyce, and its Executive Vice President, Chief Operating Officer and Chief Financial Officer, Steven Bisgay, were named as defendants in an action entitled *Fernandez v. Knight Capital Group, Inc.* in the U.S. District Court for the District of New Jersey. Generally, this putative class action complaint alleges that the defendants made material misstatements and/or failed to disclose matters related to the events of August 1. The plaintiff asserts claims under Sections 10(b) and 20 and Rule 10b-5 of the federal securities laws, claiming that he and a class of the Company's shareholders who purchased the Company's Class A common stock between January 19, 2012 and August 1, 2012 paid an inflated price. The plaintiff has not yet served any of the defendants with the complaint.

As noted above, we have received several derivative demand letters requesting that we commence a lawsuit against certain directors and officers for alleged breaches of fiduciary duties, waste, wrongdoing, mismanagement and/or demanding that we produce certain books and records pursuant to Delaware law concerning the technology issue and the August 6 recapitalization. The Company has responded to the derivative demand letters. To date, no derivative lawsuit has been commenced.

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Regulatory

Subsequent to the August 1 technology issue, the SEC and other regulators commenced on-site examinations of the firm's capital and liquidity condition. Those onsite examinations have concluded. Further, on or about August 9, 2012, the SEC began an examination, related to the technology issue, of the firm's compliance with SEC Rule 15c3-5 (the Market Access Rule) and other rules and regulations. The SEC issued a formal order of investigation concerning the Company and the firm on August 29, 2012. The Company is cooperating with the regulators.

Other Matters

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 regulators in the U.S. and abroad. As a major order flow execution destination and reverse mortgage originator, 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 business activities. We are currently the subject of various regulatory reviews and investigations. In some instances, these matters may rise to a disciplinary action and/or civil or administrative action.

Item 1A. Risk Factors

In addition to the other information set forth below and in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2011, which were updated in our Quarterly Report on Form 10-Q for the period ended June 30, 2012, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K, as updated in our Quarterly Report on Form 10-Q for the period ended June 30, 2012, and in this Quarterly Report on Form 10-Q 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.

The following risk factor updates risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011 and our Quarterly Report on Form 10-Q for the period ended June 30, 2012.

We may not be able to use our net operating loss carryforwards because we may not generate taxable income.

The use of our net operating loss carryforwards is subject to uncertainty because it is dependent upon the amount of taxable income we generate. There can be no assurance that we will have sufficient taxable income in future years to use the net operating loss carryforwards before they expire.

The amount of our net operating loss carryforwards has not been audited or otherwise validated by the Internal Revenue Service (IRS). The IRS could challenge the amount of our net operating loss carryforwards, which could significantly reduce our net operating loss carryforwards. In addition, calculating whether an ownership change has occurred is subject to uncertainty, both because of the complexity and ambiguity of Section 382 of the Internal Revenue Code. Therefore, the calculation of the amount of our net operating loss carryforwards may be changed. Also, possible changes in legislation could negatively affect our ability to use the tax benefits associated with our net operating loss carryforwards.

Table of Contents**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table contains information about our purchases of our Class A Common Stock during the third quarter of 2012 (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
July 1, 2012				
July 31, 2012				
Common stock repurchases	-		-	\$ 120,886
Employee transactions ⁽²⁾	349		-	
Total	349	\$ 10.41	-	
August 1, 2012				
August 31, 2012				
Common stock repurchases	-		-	\$ 120,886
Employee transactions ⁽²⁾	119		-	
Total	119	\$ 2.78	-	
September 1, 2012				
September 30, 2012				
Common stock repurchases	-		-	\$ 120,886
Employee transactions ⁽²⁾	19		-	
Total	19	\$ 2.67	-	
Total				
Common stock repurchases	-		-	
Employee transactions ⁽²⁾	486		-	
Total	486	\$ 8.24	-	

Totals may not add due to rounding.

- (1) The Company's Board of Directors previously announced the authorization of a stock repurchase program, which allowed for the purchase of Class A Common Stock up to a total amount of \$1.00 billion. The Company may repurchase shares from time to time in the open market, through 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 current and future financing needs, 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 employee restricted awards.

Item 3. Defaults Upon Senior Securities

None.

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Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit No.	Exhibit
10.1*	Waiver of Accelerated Vesting of Unvested Equity Awards and Other Contractual Provisions between Thomas Joyce and Knight Capital Group, Inc., dated August 16, 2012
10.2*	Waiver of Accelerated Vesting of Unvested Equity Awards between Steven Bisgay and Knight Capital Group, Inc., dated August 16, 2012
10.3*	Waiver of Accelerated Vesting of Unvested Equity Awards between George Sohos and Knight Capital Group, Inc., dated August 16, 2012
10.4*	Waiver of Accelerated Vesting of Unvested Equity Awards between Steven Sadoff and Knight Capital Group, Inc., dated August 17, 2012
31.1**	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2**	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1**	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2**	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101***	The following materials from Knight Capital Group, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Operations for the three and nine months ended September 30, 2012 and 2011; (ii) Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2012 and 2011; (iii) Consolidated Statements of Financial Condition at September 30, 2012 and December 31, 2011; (iv) Consolidated Statements of Changes in Equities for the year ended December 31, 2011 and for the nine months ended September 30, 2012; (v) Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011; and (vi) Notes to Consolidated Financial Statements

* Filed herewith and related to management contract or compensatory plan or arrangement identified in compliance with Item 6 of the rules governing the preparation of this report.

** Filed herewith.

*** Pursuant to rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Jersey City, State of New Jersey, on this 9th day of November, 2012.

KNIGHT CAPITAL GROUP, INC.

By: /s/ THOMAS M. JOYCE

Chairman of the Board and Chief Executive Officer
(Principal Executive Officer)

By: /s/ STEVEN BISGAY

Chief Financial Officer
(Principal Financial and Accounting Officer)