UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 59504 / March 4, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13393

In the Matter of **Knight Financial Products, LLC,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 15(b)(4) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Knight Financial Products, LLC ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 ("Order") as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

A. RESPONDENT

1. **Knight Financial Products, LLC** ("KFP") was a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act, from 2000 until March 2005. During the period relevant to this Order, KFP was a member of the American Stock Exchange ("AMEX"), the Chicago Board Options Exchange ("CBOE") and the Philadelphia Stock Exchange ("PHLX," and together with the CBOE and the AMEX, the "Exchanges"). During the period relevant to this Order, KFP acquired, merged with, or conducted joint venture operations with other specialist firms. A certain portion of the conduct that forms the basis of the findings herein took place at those predecessor firms or joint venture entities. As used herein, the terms "KFP" and "Respondent" refer to KFP, as well as its predecessor firms and joint venture entities. KFP sold its specialist operations in December, 2004.

B. FACTS

Summary

2. This matter involves violations by KFP of its basic obligation as a specialist to serve public customer orders over its own proprietary interests. As a specialist firm on each of the Exchanges,[2] KFP had a general duty to match executable public customer or "agency" buy and sell orders and not to fill customer orders through trades from the firm's own account when those customer orders could be matched with other customer orders. From 1999 through 2004 (the "Relevant Period"), KFP violated this obligation by filling orders through proprietary trades rather than through other customer orders, thereby causing customer orders to be disadvantaged by approximately $1.7 million.

3. By effecting proprietary transactions that were not part of a course of dealings reasonably necessary to maintain a fair and orderly market, KFP violated Section 11(b) of the Exchange Act and Rule 11b-1 thereunder. KFP also violated the following Exchange rules in effect during the Relevant Period: AMEX rules 150(a), 150(b), 155 and 170(d); CBOE rules 8.80 and 8.85; and PHLX rules 1020(c), 1019 and 707.

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[1] The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

[2] On the CBOE, specialist firms like KFP are known as Designated Primary Market-Makers, or DPMs.

Overview of Specialists' Obligations

4. On each of the Exchanges, specialist firms are responsible for the quality of the markets in the securities in which individual specialists are registered. A specialist is expected to maintain, insofar as is reasonably practicable, a "fair" and "orderly" market. A "fair" market is one that, among other things, affords no undue advantage to any participant. An "orderly" market is characterized by regular, reliable operation, with price continuity and depth, in which price movements are accompanied by appropriate volume, and unreasonable price variations between sales are avoided.

5. Specialists have two primary duties: performing their "negative obligation" to execute customer orders at the most advantageous price with minimal dealer intervention, and fulfilling their "affirmative obligation" to offset imbalances in supply and demand.[3] Specialists participate as both broker (or agent), absenting themselves from the market to pair executable customer orders against each other, and as dealer (or principal), trading for the specialists' dealer or proprietary accounts when needed to facilitate price continuity and fill customer orders when there are no available contra parties to those orders.

6. Whether acting as brokers or dealers, specialists are required to hold the public's interest above their own and, as such, are prohibited from trading for their dealers' accounts ahead of pre-existing customer buy or sell orders that could be executed against each other. When matchable customer buy and sell orders are received by the specialists – generally delivered either through one of the Exchange's order processing systems to a specialist's workstation, or, under certain circumstances, by floor brokers gathered in front of specialists' workstations ("the crowd") – specialists are required to act as agent and cross or pair off those orders and to abstain from participating as principal or dealer.

Improper Proprietary Trading by KFP

7. During the Relevant Period, KFP breached its duty to refrain from dealing for its own account while in possession of executable buy and sell customer orders. Instead, KFP effected improper proprietary trades that disadvantaged customer orders.

8. On each of the Exchanges, KFP specialists possessed or had access to information concerning customer orders on both sides of the market. Where there are matchable orders on both sides of the market, specialists are obligated to "pair off" or cross the buy and sell orders by executing each side of the market for identical prices and in commensurate order quantities. In numerous instances, however, KFP specialists did not "pair off" or cross these buy and sell orders with each other. Sometimes, KFP specialists did this by effecting a proprietary trade with an order that arrived electronically through the order processing system. At other times, KFP specialists effected improper proprietary trades with orders that came in from the crowd. In either case, the

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[3] A specialist's obligations on the Exchanges also included acting as a market maker, and the Exchanges' rules generally required a specialist to provide continuous quotations for each option for which it acted as a specialist.

disadvantaged order was an order that the KFP specialist should have paired with the other order, instead of filling that other order through a proprietary trade retained by the specialist. The violative conduct took three basic forms described in paragraphs 9-11 below.

9. *Trading Ahead*. In certain instances, KFP specialists filled one agency order through a proprietary trade for the firm's account while a matchable agency order was present on the opposite side of the market, thereby improperly "trading ahead" of such opposite-side executable agency order. The customer order that was traded ahead of was then disadvantaged when it was subsequently executed at a price that was inferior to the price received by the firm's proprietary account. For example, if a specialist has present on his book, at the same time, a marketable customer order to buy five contracts of an options series and a marketable customer order to sell five contracts of the same options series, the specialist would be obligated to pair off those matchable orders. Trading ahead would occur if the specialist filled the sell order from the firm's proprietary account at $5.00 per share per contract, and then subsequently executed the buy order at the inferior price of $5.05 per share per contract. In this example, the buy order received a price inferior to that to which it was entitled ($5.00) and the customer was disadvantaged by $25.00 (5 contracts x $0.05 per share per contract x 100 shares per contract).

10. *Interpositioning*. In certain instances, after trading ahead, KFP specialists also traded proprietarily with the matchable opposite-side agency order that had been traded ahead of, thereby "interpositioning" themselves between the two agency orders that should have been paired off in the first instance. By participating on both sides of trades, the specialist captured the spread between the purchase and sale prices, thereby disadvantaging the other parties to the transactions. Interpositioning occurred in a relatively small number of instances.

11. *Trading Ahead of Unexecuted Open or Cancelled Orders*. In certain instances, KFP specialists traded ahead of opposite-side executable agency orders, as described in paragraph 9 above, but the unexecuted orders were left open until the end of the trading day, or were cancelled by the customer prior to the close of the trading day before receiving an execution. Because these orders were never executed, the calculation of customer harm for this type of misconduct was based on a formula that incorporated certain economic assumptions. A substantial amount of the customer harm discussed in paragraph 12 below relates to these unexecuted or cancelled orders.

12. During the Relevant Period, KFP engaged in tens of thousands of violative trades of the three types described in paragraphs 9-11, resulting in overall customer disadvantage of approximately $1.7 million across the Exchanges. Because of limitations in the source data maintained by the Exchanges, the calculation of the amount of customer disadvantage sometimes required the use of certain analytic formulas. The majority of the customer disadvantage relates to violative trading that occurred between 1999 and 2002.

C. APPLICABLE LAW

Section 11(b) of the Exchange Act

13. Section 11(b) of the Exchange Act and Rule 11b-1 thereunder impose various limitations on the operations of specialists, including limiting a specialist's dealer transactions to those "reasonably necessary to permit him to maintain a fair and orderly market." Section 11(b) and Rule 11b-1 require a national securities exchange to promulgate rules that allow a member to register as a specialist and to act as a dealer. Under Rule 11b-1(b), if the Commission finds, after appropriate notice and opportunity for hearing, that a specialist has for any account in which he has an interest "effected transactions... which were not part of a course of dealings reasonably necessary to permit such specialist to maintain a fair and orderly market," the Commission may impose sanctions.

14. Where specialists effect trades for their accounts that are not "reasonably necessary to permit [such specialists] to maintain a fair and orderly market," they have violated Section 11(b) and Rule 11b-1 of the Exchange Act. *See In the Matter of LaBranche & Co. LLC*, Exchange Act Release No. 49500, 2004 WL 626573, at *6 (Mar. 30, 2004); *In the Matter of Weiskopf, Silver & Co.*, Exchange Act Release No. 17361, 1980 WL 22091, at *2 (Dec. 10, 1980); *In the Matter of Albert Fried & Co. and Albert Fried, Jr.*, Exchange Act Release No. 15293, 1978 WL 196046, at *6 (Nov. 3, 1978).[4]

15. Here, KFP violated its negative obligation by engaging in the three types of conduct described in paragraphs 9 through 11 above. Accordingly, KFP willfully[5] violated Section 11(b) of the Exchange Act and Rule 11b-1 thereunder.

Exchange Rules

16. Several AMEX, CBOE and PHLX rules prohibit the same conduct as is prohibited by Section 11(b) of the Exchange Act and Rule 11b-1 thereunder. These rules effectively prohibit a specialist from trading ahead of, or interpositioning between, eligible customer orders, and require agency orders to be matched whenever possible.

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[4] The obligation to maintain a fair and orderly market "has a broader reach than the prohibition of 'fraud' and, thereby, imposes stricter standards of integrity and performance on specialists." *Albert Fried*, 1978 WL 196046, at *5. A transaction not reasonably necessary to maintain a fair and orderly market has been defined as one "'not reasonably calculated to contribute to the maintenance of price continuity [on the exchange] and to minimize the effects of temporary disparity between supply and demand.'" *Weiskopf*, 1980 WL 22091, at *2 n.5 (quoting Exchange Act Release No. 1117 at 2 (March 30, 1937)).

[5] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

AMEX

17. AMEX Rule 150(a) (Purchases and Sales While Holding Unexecuted Market Order) states that "No member shall (1) personally buy or initiate the purchase of any security on the Exchange for his own account…while such member personally holds…an unexecuted market order to buy…or (2) personally sell or initiate the sale of any such security on the Exchange for any such account, while he personally holds…an unexecuted market order to sell."

18. AMEX Rule 150(b) (Purchases and Sales While Holding Unexecuted Limit Order) states that: "No member shall (1) personally buy or initiate the purchase of any security on the Exchange for any such account, at or below a price at which he personally holds… an unexecuted limited price order to buy such security…or (2) personally sell or initiate the sale of any security on the Exchange for any such account, at or above the price at which he personally holds… an unexecuted limited price order to sell such security."

19. AMEX Rule 155 (Precedence Accorded to Orders Entrusted to Specialists) requires that a specialist "give precedence to orders entrusted to him as an agent before executing at the same price any purchase or sale in the same stock for an account in which he has an interest."

20. AMEX Rule 170(d) (Registration and Functions of Specialists) imposes upon specialists the obligation to refrain from engaging in transactions for his own account "in the securities in which he is registered" unless that conduct constitutes "a course of dealings reasonably calculated to contribute to the maintenance of price continuity with reasonable depth, and to the minimizing of the effects of temporary disparity between supply and demand, immediate or reasonably to be anticipated, in either the full lot or the odd lot market." The rule goes on to provide that: "Transactions in such securities not part of such a course of dealings are not to be effected by a specialist for his own account."

21. KFP violated each of the aforementioned AMEX rules by reason of the activities set forth in paragraphs 9 through 11 above.

CBOE

22. CBOE Rules 8.80 (DPM Defined) and 8.85 (DPM Obligations) require that a CBOE specialist cede priority to customer orders which the specialist represents as agent.

23. KFP violated each of the aforementioned CBOE rules by reason of the activities set forth in paragraphs 9 through 11 above.

PHLX

24. PHLX Rule 1020(c) (Registration and Functions of Options Specialists) states, in relevant part: "A specialist or his member organization shall not effect... purchases or sales of any option in which such specialist is registered, ... unless such dealings are reasonably necessary to permit such specialist to maintain a fair and orderly market."

25. PHLX Rule 1019 (Precedence Accorded to Orders Entrusted to Specialists) provides: "A specialist shall give precedence to orders entrusted to him as an agent in any option in which he is registered before executing at the same price any purchase or sale in the same option for an account in which he has an interest."

26. PHLX Rule 707 (Conduct Inconsistent with Just and Equitable Principles of Trade) provides that specialists "shall not engage in conduct inconsistent with just and equitable principles of trade."

27. KFP violated each of the aforementioned PHLX rules by reason of the activities set forth in paragraphs 9 through 11 above.

D. CONCLUSION

28. KFP willfully committed violations of Section 11(b) of the Exchange Act, and Rule 11b-1 thereunder, as described above.

IV.

In view of the foregoing, the Commission finds that it is appropriate and in the public interest to impose the sanctions specified in the Offer submitted by KFP.

Accordingly it is hereby ORDERED that**:**

A. Pursuant to Section 21C of the Exchange Act, KFP cease and desist from committing or causing any violations and any future violations of Section 11(b) of the Exchange Act, and Rule 11b-1 thereunder.

B. Pursuant to Section 15(b)(4) of the Exchange Act, KFP is hereby censured.

C. KFP shall, within ten days of the entry of the Order, pay disgorgement of $1.7 million to the Commission. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies KFP as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to David Rosenfeld, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 3 World Financial Center, New York, New York, 10281.

D. It is further ordered that KFP shall, within ten days of the entry of the Order, pay a civil money penalty in the amount of $340,000 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies KFP as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to David Rosenfeld, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 3 World Financial Center, New York, New York, 10281. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes.

By the Commission.

Elizabeth M. Murphy
Secretary