

KNIGHT CAPITAL GROUP, INC.

Form 10-Q

May 09, 2013

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2013

OR

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

001-14223

Commission File Number

KNIGHT CAPITAL GROUP, INC.

(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of incorporation or organization)

22-3689303

(I.R.S. Employer Identification Number)

545 Washington Boulevard, Jersey City, NJ 07310

(Address of principal executive offices and zip code)

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

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

Title of each class

Name of each exchange on which registered

Class A Common Stock, \$0.01 par value

New York Stock Exchange

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

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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 the 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  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 May 3, 2013, the number of shares outstanding of the Registrant's Class A Common Stock was 374,779,671 and there were no shares outstanding of the Registrant's Class B Common Stock or Series A-1 Cumulative Perpetual Convertible Preferred Stock.

KNIGHT CAPITAL GROUP, INC.  
 FORM 10-Q QUARTERLY REPORT  
 For the Quarter Ended March 31, 2013  
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PART I. FINANCIAL INFORMATION  
Item 1. Financial Statements

KNIGHT CAPITAL GROUP, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)

|   | For the three months ended March 31,     |            |
|---|--|------------|
|   | 2013                                     | 2012       |
|   | (In thousands, except per share amounts) |            |
| Revenues  |  |            |
| Commissions and fees  | \$ 125,225                               | \$ 141,295 |
| Net trading revenue   | 148,838                                  | 153,134    |
| Interest, net   | 6,390                                    | 5,611      |
| Investment income and other, net                                | 4,703                                    | 2,432      |
| Total revenues  | 285,156                                  | 302,472    |
| Expenses  |  |            |
| Employee compensation and benefits                              | 107,823                                  | 112,269    |
| Execution and clearance fees                                    | 50,450                                   | 52,330     |
| Payments for order flow   | 35,093                                   | 21,688     |
| Communications and data processing                              | 22,225                                   | 20,284     |
| Interest  | 13,052                                   | 13,154     |
| Professional fees   | 13,030                                   | 4,948      |
| Depreciation and amortization                                   | 9,709                                    | 11,577     |
| Occupancy and equipment rentals                                 | 5,398                                    | 5,388      |
| Business development  | 3,973                                    | 4,214      |
| Other   | 6,499                                    | 5,522      |
| Total expenses  | 267,252                                  | 251,374    |
| Income from continuing operations before income taxes           | 17,904                                   | 51,098     |
| Income tax expense  | 6,890                                    | 19,878     |
| Income from continuing operations, net of tax                   | 11,014                                   | 31,220     |
| (Loss) income from discontinued operations, net of tax          | (20,371                                  | ) 1,886    |
| Net (loss) income   | \$(9,357                                 | ) \$33,106 |
| Basic earnings per share from continuing operations             | \$0.04                                   | \$0.35     |
| Diluted earnings per share from continuing operations           | \$0.03                                   | \$0.34     |
| Basic (loss) earnings per share from discontinued operations    | \$(0.08                                  | ) \$0.02   |
| Diluted (loss) earnings per share from discontinued operations  | \$(0.06                                  | ) \$0.02   |
| Basic (loss) earnings per share                                 | \$(0.04                                  | ) \$0.37   |
| Diluted (loss) earnings per share                               | \$(0.03                                  | ) \$0.36   |
| Shares used in computation of basic (loss) earnings per share   | 253,007                                  | 89,764     |
| Shares used in computation of diluted (loss) earnings per share | 361,053                                  | 92,175     |

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



KNIGHT CAPITAL GROUP, INC.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME  
(Unaudited)

|                                    | For the three months ended March |             |
|------------------------------------|----------------------------------|-------------|
|                                    | 31,                              |             |
|                                    | 2013                             | 2012        |
| Net (loss) income                  | \$ (9,357                        | ) \$ 33,106 |
| Other comprehensive (loss) income: |                                  |             |
| Cumulative translation adjustment  | (1,110                           | ) 325       |
| Comprehensive (loss) income        | \$ (10,467                       | ) \$ 33,431 |

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

KNIGHT CAPITAL GROUP, INC.  
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION  
(Unaudited)

|   | March 31,<br>2013 | December 31,<br>2012 |
|---|-------------------|----------------------|
|   | (In thousands)    |                      |
| Assets  |                   |                      |
| Cash and cash equivalents   | \$439,182         | \$413,926            |
| Cash and securities segregated under federal and other regulations  | 172,962           | 166,992              |
| Financial instruments owned, at fair value, including securities pledged to counterparties that had the right to deliver or repledge of \$5,188,944 at March 31, 2013 and \$4,605,155 at December 31, 2012: |                   |                      |
| Equities  | 1,538,856         | 1,463,916            |
| Debt securities   | 146,518           | 111,157              |
| Listed equity options   | 231,044           | 202,091              |
| Loan inventory  | 152,349           | 191,712              |
| Other financial instruments   | 3,778             | 237                  |
| Securitized HECM loan inventory   | 4,792,350         | 4,054,905            |
| Total financial instruments owned, at fair value  | 6,864,895         | 6,024,018            |
| Collateralized agreements:  |                   |                      |
| Securities borrowed   | 1,414,794         | 1,008,720            |
| Receivable from brokers, dealers and clearing organizations   | 1,107,202         | 868,805              |
| Fixed assets and leasehold improvements, at cost, less accumulated depreciation and amortization  | 92,277            | 94,226               |
| Investments   | 79,052            | 78,348               |
| Goodwill  | 213,900           | 213,900              |
| Intangible assets, less accumulated amortization  | 53,234            | 55,654               |
| Income taxes receivable   | 122,980           | 152,576              |
| Assets of business held for sale  | 145,674           | 449,509              |
| Other assets  | 206,628           | 251,773              |
| Total assets  | \$10,912,780      | \$9,778,447          |
| Liabilities, convertible preferred stock & equity   |                   |                      |
| Liabilities   |                   |                      |
| Financial instruments sold, not yet purchased, at fair value:   |                   |                      |
| Equities  | \$1,490,972       | \$1,164,999          |
| Debt securities   | 56,478            | 118,991              |
| Listed equity options   | 179,404           | 155,942              |
| Other financial instruments   | —                 | 5,505                |
| Total financial instruments sold, not yet purchased, at fair value  | 1,726,854         | 1,445,437            |
| Collateralized financings:  |                   |                      |
| Securities loaned   | 687,012           | 504,082              |
| Financial instruments sold under agreements to repurchase   | 555,000           | 355,000              |
| Other secured financings  | 104,461           | 146,330              |
| Liability to GNMA trusts, at fair value   | 4,742,776         | 4,002,704            |
| Total collateralized financings   | 6,089,249         | 5,008,116            |
| Payable to brokers, dealers and clearing organizations  | 403,998           | 378,724              |
| Payable to customers  | 462,028           | 388,676              |
| Accrued compensation expense  | 64,891            | 141,794              |
| Accrued expenses and other liabilities  | 201,663           | 186,746              |
| Liabilities of business held for sale   | 85,618            | 357,661              |

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|  |              |              |
|--|--------------|--------------|
| Long-term debt   | 392,470      | 388,753      |
| Total liabilities  | 9,426,771    | 8,295,907    |
| Convertible Preferred Stock  |              |              |
| Series A convertible preferred stock   |              |              |
| Shares issued: 400 at December 31, 2012, Shares outstanding: 243 at December 31, 2012  | —            | 229,857      |
| Equity   |              |              |
| Class A common stock   |              |              |
| Shares authorized: 500,000 at March 31, 2013 and at December 31, 2012; Shares issued: 449,323 at March 31, 2013 and 274,821 at December 31, 2012; Shares outstanding: 375,130 at March 31, 2013 and 202,056 at December 31, 2012 | 4,493        | 2,748        |
| Additional paid-in capital   | 1,647,895    | 1,400,317    |
| Retained earnings  | 701,264      | 710,621      |
| Treasury stock, at cost; 74,193 at March 31, 2013 and 72,765 shares at December 31, 2012   | (864,437     | ) (858,907 ) |
| Accumulated other comprehensive loss   | (3,206       | ) (2,096 )   |
| Total equity   | 1,486,009    | 1,252,683    |
| Total liabilities, convertible preferred stock and equity  | \$10,912,780 | \$9,778,447  |

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



## KNIGHT CAPITAL GROUP, INC.

## CONSOLIDATED STATEMENT OF CHANGES IN CONVERTIBLE PREFERRED STOCK AND EQUITY

For the three months ended March 31, 2013

(Unaudited)

| Knight Capital Group, Inc. Stockholders' Equity<br>(in thousands)                 |  |           |                            |         |             |                                  |                      |                |           |   |                 |
|---|--|-----------|----------------------------|---------|-------------|----------------------------------|----------------------|----------------|-----------|---|-----------------|
|   | Series A<br>convertible<br>preferred stock |           | Class A<br>common<br>stock |         |             | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Treasury Stock |           | Accumulated<br>other<br>comprehensive<br>loss | Total<br>Equity |
|   | Series<br>A-1                              | Amount    | Shares                     | Amount  | Shares      |                                  |                      | Amount         | Shares    |   |                 |
| Balance,<br>December 31,<br>2012  | 243  | \$229,857 | 274,821                    | \$2,748 | \$1,400,317 | \$710,621                        | (72,765)             | \$(858,907)    | \$(2,096) | \$1,252,683                                   |                 |
| Net loss  | —  | —         | —                          | —       | —           | (9,357)                          | —                    | —              | —         | (9,357)                                       |                 |
| Series A-1<br>convertible<br>preferred<br>stock<br>converted into<br>common stock | (243)                                      | (229,857) | 162,309                    | 1,623   | 228,234     | —                                | —                    | —              | —         | 229,857                                       |                 |
| Common<br>stock<br>repurchased  | —  | —         | —                          | —       | (4)         | —                                | (1,428)              | (5,530)        | —         | (5,534)                                       |                 |
| Stock-based<br>compensation   | —  | —         | 12,193                     | 122     | 19,348      | —                                | —                    | —              | —         | 19,470  |                 |
| Cumulative<br>translation<br>adjustment   | —  | —         | —                          | —       | —           | —                                | —                    | —              | (1,110)   | (1,110)                                       |                 |
| Balance,<br>March 31,<br>2013   | —  | \$—       | 449,323                    | \$4,493 | \$1,647,895 | \$701,264                        | (74,193)             | \$(864,437)    | \$(3,206) | \$1,486,009                                   |                 |

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

KNIGHT CAPITAL GROUP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

|   | For the three months ended March |             |
|---|----------------------------------|-------------|
|   | 31,                              | 2012        |
|   | 2013                             | 2012        |
|   | (In thousands)                   |             |
| Cash flows from operating activities  |                                  |             |
| Net (loss) income   | \$ (9,357                        | ) \$ 33,106 |
| (Loss) income from discontinued operations, net of tax  | (20,371                          | ) 1,886     |
| Income from continuing operations, net of tax   | 11,014                           | 31,220      |
| Adjustments to reconcile income from continuing operations, net of tax to net cash provided by (used in) operating activities |                                  |             |
| Stock-based compensation  | 11,976                           | 11,022      |
| Depreciation and amortization   | 9,709                            | 11,577      |
| Debt discount accretion and other debt related expenses   | 4,456                            | 4,201       |
| Unrealized and realized gains on investments, net   | (4,194                           | ) (1,561    |
| Deferred rent   | (326                             | ) (20       |
| Operating activities from discontinued operations   | 15,523                           | (96,905     |
| (Increase) decrease in operating assets   |                                  |             |
| Cash and securities segregated under federal and other regulations  | (5,970                           | ) 35,001    |
| Financial instruments owned, at fair value  | (841,116                         | ) (794,157  |
| Securities borrowed   | (406,073                         | ) (35,932   |
| Receivable from brokers, dealers and clearing organizations   | (238,396                         | ) (34,721   |
| Income taxes receivable   | 29,596                           | 16,560      |
| Other assets  | 44,404                           | (87,367     |
| Increase (decrease) in operating liabilities  |                                  |             |
| Financial instruments sold, not yet purchased, at fair value  | 281,652                          | 141,669     |
| Securities loaned   | 182,931                          | (8,273      |
| Financial instruments sold under agreements to repurchase   | 200,000                          | 176,063     |
| Other secured financings  | (41,869                          | ) (15,825   |
| Liability to GNMA trusts, at fair value   | 740,072                          | 519,446     |
| Payable to brokers and dealers and clearing organizations   | 25,274                           | 81,128      |
| Payable to customers  | 73,353                           | 33,971      |
| Accrued compensation expense  | (73,839                          | ) (91,806   |
| Accrued expenses and other liabilities  | 16,440                           | 7,055       |
| Net cash provided by (used in) operating activities   | 34,617                           | (97,654     |
| Cash flows from investing activities  |                                  |             |
| Proceeds and distributions from investments   | 4,610                            | 1,440       |
| Purchases of investments  | (1,120                           | ) (9,532    |
| Purchases of fixed assets and leasehold improvements  | (5,340                           | ) (7,628    |
| Purchase of intangible asset  | —                                | (50         |
| Investing activities from discontinued operations   | —                                | (551        |
| Net cash used in investing activities   | (1,850                           | ) (16,321   |
| Cash flows from financing activities  |                                  |             |
| Stock options exercised   | —                                | 891         |
| Income tax provision related to stock-based compensation  | —                                | 129         |
| Cost of common stock repurchased  | (5,184                           | ) (18,680   |
| Payment of dividend related to convertible preferred shares   | (1,217                           | ) —         |
| Net cash used in financing activities   | (6,401                           | ) (17,660   |

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|  |           |           |   |
|--|-----------|-----------|---|
| Effect of exchange rate changes on cash and cash equivalents | (1,110    | ) 325     |   |
| Increase (decrease) in cash and cash equivalents             | 25,256    | (131,310  | ) |
| Cash and cash equivalents at beginning of period             | 413,926   | 467,633   |   |
| Cash and cash equivalents at end of period                   | \$439,182 | \$336,323 |   |
| Supplemental disclosure of cash flow information:            |           |           |   |
| Cash paid for interest                                       | \$12,260  | \$12,295  |   |
| Cash paid for income taxes                                   | \$1,086   | \$8,565   |   |

The accompanying notes are an integral part of these 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. In the first quarter of 2013, the Company changed from four operating segments: (i) Market Making, (ii) Institutional Sales and Trading, (iii) Electronic Execution Services and (iv) Corporate and Other to three operating segments: (i) Market Making; (ii) Global Execution Services; and (iii) Corporate and Other. This change was made to better reflect the Company's client offerings, changes in senior management, the combination of the institutional equities sales teams and how the businesses are managed. As of March 31, 2013, the Company's operating segments comprised the following:

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 electronic 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, marketplaces operated by the OTC Markets Group Inc. and the Alternative Investment Market (“AIM”) of the London Stock Exchange. The segment also provides trade executions as an equities Designated Market Maker (“DMM”) on the NYSE and NYSE Amex. Market Making also includes the Company's option market making business which trades on substantially all domestic electronic exchanges.

Global Execution Services

The Global 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 Global Execution Services segment generally does not act as a principal to transactions that are executed within this segment, however, it will commit capital on behalf of clients as needed, and generally earns commissions for acting as agent between the principals to the trade. Global Execution Services also includes equity sales and trading (including exchange traded funds (“ETFs”)), reverse mortgage origination and securitization and asset management. This segment also facilitates client orders through program, block, and riskless principal trades and provides capital markets services, including equity offerings as well as private placements. Additionally, the Global Execution Services segment includes the futures commission merchant (“FCM”) business, which comprises certain assets and liabilities that the Company acquired or assumed from the futures division of Penson Financial Services, Inc. on June 1, 2012. This business provides futures execution and clearing services on major U.S. and European futures and options exchanges for clients.

Management of the Company from time to time conducts a strategic review of its businesses and evaluates their potential value in the marketplace relative to their current and expected returns. To the extent management and the Company's Board of Directors determine a business may return a higher value to shareholders through a divestiture, or is no longer core to the Company's strategy, management may pursue a sale process. As of the date of this report the Company is exploring the sale of certain non-core and non-strategic assets, including its reverse mortgage origination and securitization business. While the process is ongoing, there is no assurance that any transaction will occur, or if a transaction is entered into, what the terms would be. Any potential transaction would be subject to the approval of the Company's Board of Directors, and the consummation would likely be subject to customary closing conditions, including receipt of required regulatory approvals and applicable consents.

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 stock lending activities.

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KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – Continued

(Unaudited)

Discontinued Operations

During the first quarter of 2013, the Company agreed to sell its institutional fixed income sales and trading business, which operates in the United States and the United Kingdom, to Stifel, Nicolaus & Company, Inc ("Stifel"). The Company expects to complete the transaction during the second quarter of 2013. As a result, this business is considered to be held for sale and its results of operations have been reported as discontinued operations.

Discontinued operations also include the Company's correspondent clearing business, which the Company announced that it was discontinuing in the first quarter of 2013. See Footnote 5 "Business held for sale and discontinued operations" for further discussion.

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"), include the accounts of the Company and its subsidiaries and should be read in conjunction with the audited Consolidated Financial Statements for the year ended December 31, 2012. All significant intercompany transactions and balances have been eliminated.

Certain reclassifications have been made to the prior periods' Consolidated Financial Statements in order to conform to the current period presentation. Such reclassifications are immaterial to both current and all previously issued financial statements taken as a whole and have no effect on previously reported Consolidated Net (loss) income.

The Company consolidates all of its subsidiaries as well as any variable interest entity ("VIE") investment in which it is considered to be the primary beneficiary. The Company performs a qualitative assessment to determine if a VIE should be consolidated. As described in more detail below, 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 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 March 31, 2013 and December 31, 2012, 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 U.S. Securities and Exchange Commission ("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) is 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 within Interest, net on the Consolidated Statements of Operations are as follows (in thousands):

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KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – Continued

(Unaudited)

|                  | For the three months ended March 31, |           |
|------------------|--------------------------------------|-----------|
|                  | 2013                                 | 2012      |
| Interest Income  | \$53,361                             | \$29,444  |
| Interest Expense | (46,971                              | ) (23,833 |
| Interest, net    | \$6,390                              | \$5,611   |

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 March 31, |          |
|------------------|--------------------------------------|----------|
|                  | 2013                                 | 2012     |
| Dividend Income  | \$6,243                              | \$6,960  |
| Dividend Expense | (4,241                               | ) (5,026 |

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 7 "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 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.

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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.

**Investments**

Investments primarily comprise strategic investments and deferred compensation investments. Strategic investments include noncontrolling equity ownership interests 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 or at cost. The equity method of accounting is used when the Company has significant influence, generally considered to be between 20% and 50% equity ownership in a corporation or greater than 3% to 5% of a partnership interest. 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

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(Unaudited)

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.

**Discontinued operations and Assets and Liabilities held for sale**

Revenues and expenses associated with a business line that has been disposed of through closure or held for sale are included in (Loss) income from discontinued operations, net of tax on the Consolidated Statements of Operations.

Assets and liabilities of businesses held for sale are included in Assets of business held for sale and Liabilities of business held for sale, respectively, on the Consolidated Statements of Financial Condition. Cash flows from discontinued operations are presented on the Consolidated Statements of Cash Flows within operating, investing and financing activities, as applicable.

**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.

**Foreign currency translation and foreign currency forward contracts**

The Company's U.K. 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 loss on the Consolidated Statements of Financial Condition and Cumulative translation adjustment on the Consolidated Statements of Comprehensive (Loss) 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 March 31, 2013 and 2012, the Company recorded a gain of \$17,000 and a loss of \$0.1 million, 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 loss on the Consolidated Statements of Financial Condition and the Consolidated Statements of Comprehensive (Loss) Income. The ineffective portion, if any, is recorded in Investment income and other, net on the Consolidated Statements of Operations.

**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.

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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.

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 sublease 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.

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.

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.

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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 March 31, 2013 and December 31, 2012 (in thousands):

|  | March 31, 2013                        |  |
|--|---------------------------------------|--|
|  | Securitized<br>HECM loan<br>inventory | MBS held within<br>Assets of business<br>held for sale |
| Carrying value of the VIEs                       |                                       |  |
| Assets   | \$—                                   | \$23,860   |
| Liabilities                                      | 1,085                                 | —  |
| Maximum exposure to loss in nonconsolidated VIEs |                                       |  |
| Commitments                                      | 34,660                                | —  |
| Purchased interests                              | —                                     | 23,860   |
|  | December 31, 2012                     |  |
|  | Securitized<br>HECM loan<br>inventory | MBS held within<br>Assets of business<br>held for sale |
| Carrying value of the VIEs                       |                                       |  |
| Assets   | \$—                                   | \$108,999  |
| Liabilities                                      | 912                                   | —  |
| Maximum exposure to loss in nonconsolidated VIEs |                                       |  |
| Commitments                                      | 29,017                                | —  |
| Purchased interests                              | —                                     | 108,999  |
| Use of estimates                                 |                                       |  |

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

Recently adopted accounting guidance

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 agreements. The new disclosures are required for reporting periods beginning on or after January 1, 2013, and are to be applied retrospectively. Other than



requiring additional disclosures, the adoption of this ASU did not have an impact on the Company's Consolidated Financial Statements.

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In February 2013, the FASB issued an ASU that requires additional disclosure requirements for items reclassified out of accumulated other comprehensive income. This new guidance requires entities to present either on the face of the income statement or in the notes to the financial statements the effects on the specific line items of the income statement for amounts reclassified out of accumulated other comprehensive income. This ASU is effective for reporting periods beginning after December 15, 2012. Other than additional disclosure requirements, the adoption of this ASU did not have an impact on the Company's Consolidated Financial Statements.

Recent accounting guidance to be adopted in future periods

In March 2013, the FASB issued an ASU concerning the parent's accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries or groups of assets within a foreign entity or of an investment in a foreign entity. This ASU provides for the release of the cumulative translation adjustment into net income when a parent sells a part or all of its investment within a foreign entity, no longer holds a controlling interest in an investment in a foreign entity or obtains control of an investment in a foreign entity that was previously recognized as an equity method investment. This ASU is effective for reporting periods beginning after December 15, 2013, however early adoption is permitted. The Company is evaluating the impact of this ASU on the Company's Consolidated Financial Statements.

### 3. Series A Convertible Preferred Stock

On August 1, 2012, the Company experienced a technology issue at the opening of trading at the NYSE. 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 which culminated in a \$457.6 million trading loss. As a result of this loss, the Company, on August 6, 2012, raised \$400.0 million in equity financing through a convertible preferred stock offering to certain investors (the "August 2012 Recapitalization"). Under the terms of the August 2012 Recapitalization, the Company sold 400,000 shares of Series A Cumulative Perpetual Convertible Preferred Stock, par value \$0.01 per share (the "Series A Preferred Stock"). The Series A 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"). The Series A Preferred Stock were 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 Preferred Stock into Class A common stock. All of the Series A-2 Shares were converted into Series A-1 Shares in 2012.

The Company incurred approximately \$40.5 million of fees and costs related to the issuance of the Series A Preferred Stock 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 was classified as temporary equity as described below.

The \$359.5 million initial temporary equity balance had been reduced on a pro-rata basis as the 400,000 shares of Series A Preferred Stock were converted into Class A common stock. During the third and fourth quarters of 2012, 156,537 shares or approximately 39%, of the original Series A Preferred Stock were converted to Class A common stock (resulting in 243,463 shares of Series A Preferred Stock outstanding at December 31, 2012 all of which were Series A-1 Shares). These conversions resulted in a \$129.6 million reduction in the temporary equity balance to \$229.9 million at December 31, 2012, which was offset by a \$1.0 million increase in Class A common stock and a \$128.6 million increase in Additional paid-in capital.

On February 28, 2013, the remaining shares of Series A Preferred Stock were mandatorily converted into shares of the Company's Class A common stock as a result of the Company's Class A common stock having traded for 60 consecutive trading days above the price of \$3.00, or 200% of the \$1.50 per share conversion price.

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 Preferred Stock became 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, the Series A Preferred Stock were classified as temporary equity on the Company’s Consolidated Statements of Financial Condition.

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Dividends

Dividends on the Series A Preferred Stock accrued daily and were payable quarterly, in arrears, on each January 15, April 15, July 15 and October 15, commencing on October 15, 2012, in cash at a rate per annum equal to 2% of the liquidation preference of \$1,000 per share. During 2012, the Company's Board of Directors declared two quarterly dividends with respect to the Series A Preferred Stock. The first dividend which was paid on October 15, 2012 totaled \$1.1 million based upon 274,215 Series A Preferred Stock outstanding as of the record date covering the period from August 6, 2012 through October 14, 2012. The second dividend which was paid on January 15, 2013 totaled \$1.2 million based upon 243,463 Series A Preferred Stock outstanding as of the record date covering the period from October 15, 2012 through January 15, 2013. As the second dividend was declared prior to December 31, 2012, it was reflected in the Consolidated Financial Statements for the year ended December 31, 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. There were no dividends declared in 2013 as all of the Series A Preferred Stock had been converted into Class A common stock.

4. Merger Agreement with GETCO Holding Company, LLC

On December 19, 2012, Knight, GETCO Holding Company, LLC ("GETCO") and an affiliate of GETCO entered into an agreement, and plan of merger, as subsequently amended and restated on April 15, 2013 (the "Merger Agreement"), for a strategic business combination. As a result of the proposed strategic business combination (the "Merger"), Knight and GETCO will each become a wholly owned subsidiary of KCG Holdings, Inc. (formerly known as Knight Holdco, Inc.), a newly-formed Delaware corporation ("KCG"). The business of KCG will be the combined business of Knight and GETCO.

Under the Merger Agreement, existing Company common stockholders (other than GETCO and holders of Company restricted stock or other equity awards granted after December 19, 2012) will have the right to elect to receive \$3.75 per share in cash or one third of a share of common stock of KCG for each share of Company Class A common stock they own immediately prior to the completion of the transaction. The cash consideration will be subject to pro-ration if the holders of more than 66.7% of the Company's Class A common stock eligible for election in the transaction properly elect to receive the cash consideration for their Company shares. Jefferies & Company, Inc. and its affiliates ("Jefferies"), the largest stockholders of the Company, have agreed to limit their cash election to 50.0% of their Company shares to the extent the total cash consideration would otherwise exceed \$720.0 million. This is intended to enable other Company stockholders (excluding GETCO and holders of Company restricted stock or other equity awards granted after December 19, 2012) to receive up to 66.7% of their total consideration in cash, while limiting the total cash consideration to be paid by KCG to not more than \$720.0 million in the aggregate.

If the transaction is completed, GETCO unitholders are expected to receive, in aggregate, approximately 76 million shares of common stock of KCG and up to 25 million warrants to acquire shares of common stock of KCG. The warrants will be comprised of 8.33 million Class A warrants, having a \$12.00 exercise price and exercisable for a four-year term; 8.33 million Class B warrants, having a \$13.50 exercise price and exercisable for a five-year term; and 8.33 million Class C warrants, having a \$15.00 exercise price and exercisable for a six-year term. The number of shares of common stock may increase or decrease based on the number of GETCO units outstanding as of the closing date.

If the transaction is completed, all of the Company's existing long-term debt will be accelerated and will become due and payable. See Footnote 12 "Long-Term Debt" for further details of the impact of the transaction on the Company's long-term debt. The vesting of certain stock based compensation awards that have been issued to Company employees will accelerate upon completion of the Merger, while other such awards will be converted into awards for shares of KCG on the same terms and conditions (including vesting). See Footnote 14 "Stock-Based Compensation" for further

details.

The Merger is expected to be completed in mid-2013, subject to the approval by Knight's stockholders and GETCO's voting unitholders, customary regulatory approvals and satisfaction of customary closing conditions.

5. Business held for sale and discontinued operations

During the first quarter of 2013, the Company announced that it was discontinuing its correspondent clearing business. As a result, this business has been classified as discontinued operations and the results of its operations have been classified in (Loss) income from discontinued operations, net of tax on the Consolidated Statements of Operations for all periods presented.

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(Unaudited)

During the first quarter of 2013, the Company agreed to sell its institutional fixed income sales and trading business, which operates in the United States and in the United Kingdom, to Stifel. The Company expects to complete the transaction during the second quarter of 2013. As a result of the Company's decision to sell the business, it has been classified as a business held for sale on the Consolidated Statements of Financial Condition and the results of its operations have been included in (Loss) income from discontinued operations, net of tax within the Consolidated Statements of Operations for all periods presented. The assets and liabilities related to the business have been recorded as Assets of business held for sale and Liabilities of business held for sale, respectively, on the Consolidated Statements of Financial Condition for all periods presented.

The revenues and results of operations of the discontinued operations are summarized as follows (in thousands):

|  | For the three months ended March 31, |            |
|--|--------------------------------------|------------|
|  | 2013                                 | 2012       |
| Revenues   | \$28,878                             | \$46,554   |
| Expenses:  |                                      |            |
| Compensation   | \$30,162                             | \$34,985   |
| Other expenses   | 10,019                               | 8,667      |
| Writedown of assets and lease loss accrual, net        | 21,504                               | —          |
| Total Expenses   | 61,685                               | 43,652     |
| Pre-tax (loss) income from discontinued operations     | (32,807                              | ) 2,902    |
| Income tax benefit (expense)                           | 12,436                               | (1,016     |
| (Loss) income from discontinued operations, net of tax | \$ (20,371                           | ) \$ 1,886 |

Assets and liabilities related to business held for sale are presented in the following table (in thousands):

|  | March 31, 2013 | December 31, 2012 |
|--|----------------|-------------------|
| Assets:  |                |                   |
| Financial instruments owned, at fair value, including securities pledged | \$24,066       | \$138,689         |
| Receivable from brokers, dealers and clearing organizations              | 108,932        | 281,178           |
| Other assets   | 12,676         | 29,642            |
| Total assets   | \$145,674      | \$449,509         |
| Liabilities:   |                |                   |
| Financial instruments sold, not yet purchased, at fair value             | \$43           | \$199,167         |
| Financial instruments sold under agreements to repurchase                | 33,394         | 111,487           |
| Accrued compensation expense   | 9,432          | 12,140            |
| Accrued expenses and other liabilities                                   | 42,749         | 34,867            |
| Total liabilities  | \$85,618       | \$357,661         |

During the first quarter of 2013, the Company sold certain private company warrants held by its institutional fixed income sales and trading business for an after tax gain of \$3.1 million, a portion of which should have been recorded in prior periods. The Company evaluated the impact of correcting the error by recording portions of this 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. The Company also concluded that recording the gain in 2013 would not be material to its forecasted results for the year. Accordingly, the Company recorded the entire \$3.1

million after tax gain in the first quarter of 2013 within (Loss) income from discontinued operations, net of tax.

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## 6. Assets Segregated or Held in Separate Accounts Under Federal or Other Regulations

Cash and securities segregated under U.S. federal and other regulations primarily relate to the Company's FCM business acquired by the Company in June 2012 and consist of the following (in thousands):

|   | March 31, 2013 | December 31, 2012 |
|---|----------------|-------------------|
| Cash and securities segregated under federal or other regulations                       |                |                   |
| Cash and cash equivalents   | \$ 172,962     | \$ 163,992        |
| U.S. government obligations   | —              | 3,000             |
| Total cash and securities segregated under federal or other regulations                 | 172,962        | 166,992           |
| Receivables from brokers, dealers and clearing organizations                            | 311,812        | 266,951           |
| Total assets segregated or held in separate accounts under federal or other regulations | \$484,774      | \$433,943         |

## 7. Fair Value of Financial Instruments

The Company's financial instruments recorded at fair value have been categorized based upon a fair value hierarchy in accordance with accounting standards, as described 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 (in thousands):



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(Unaudited)

| March 31, 2013   | Assets and Liabilities Measured at<br>Fair Value on a Recurring Basis |             |         | Total       |
|--|---|-------------|---------|-------------|
|  | Level 1   | Level 2     | Level 3 |             |
| Assets   |   |             |         |             |
| Financial instruments owned, at fair value:                        |   |             |         |             |
| Equities (1)   | \$1,538,856   | \$—         | \$—     | \$1,538,856 |
| U.S. government and Non-U.S. government obligations                | 21,220  | —           | —       | 21,220      |
| Corporate debt (2)   | 125,298   | —           | —       | 125,298     |
| Listed equity options  | 231,044   | —           | —       | 231,044     |
| Loan inventory   | —   | 152,349     | —       | 152,349     |
| Foreign currency forward contracts                                 | —   | 3,778       | —       | 3,778       |
| Securitized HECM loan inventory (3)                                | —   | 4,792,350   | —       | 4,792,350   |
| Total Financial instruments owned, at fair value                   | 1,916,418   | 4,948,477   | —       | 6,864,895   |
| Securities on deposit with clearing organizations (4)              | 145,506   | —           | —       | 145,506     |
| Deferred compensation investments (5)                              | —   | 21,607      | —       | 21,607      |
| Investment in Deephaven Funds (5)                                  | —   | 1,363       | —       | 1,363       |
| Assets of business held for sale:                                  |   |             |         |             |
| Mortgage-backed securities   | —   | 23,860      | —       | 23,860      |
| Corporate debt   | 206   | —           | —       | 206         |
| Total fair value of financial instrument assets                    | \$2,062,130   | \$4,995,307 | \$—     | \$7,057,437 |
| Liabilities  |   |             |         |             |
| Financial instruments sold, not yet purchased, at fair value:      |   |             |         |             |
| Equities (1)   | \$1,490,972   | \$—         | \$—     | \$1,490,972 |
| U.S. government obligations  | 11,753  | —           | —       | 11,753      |
| Corporate debt (2)   | 44,725  | —           | —       | 44,725      |
| Listed equity options  | 179,404   | —           | —       | 179,404     |
| Total Financial instruments sold, not yet purchased, at fair value | 1,726,854   | —           | —       | 1,726,854   |
| Liability to GNMA trusts, at fair value (3)                        | —   | 4,742,776   | —       | 4,742,776   |
| Liabilities of business held for sale:                             |   |             |         |             |
| Corporate debt   | 43  | —           | —       | 43          |
| Total fair value of financial instrument liabilities               | \$1,726,897   | \$4,742,776 | \$—     | \$6,469,673 |

(1) Equities of \$623.3 million have been netted by their respective CUSIP number and their long and short positions.

(2) Corporate debt of \$29,000 has been netted by respective CUSIP number and their long and short positions.

Represents HECMs that have been securitized into HECM Mortgage Backed Securities (“HMBS”) where the  
 (3) 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. The securities on deposit with clearing organizations are recorded within Receivable from brokers, dealers and clearing organizations on the Consolidated Statements of Financial Condition.

(5) Deferred compensation investments and investment in the Deephaven Funds are included within Investments on the Consolidated Statements of Financial Condition.

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| December 31, 2012  | Assets and Liabilities Measured at<br>Fair Value on a Recurring Basis |             |         | Total       |
|--|---|-------------|---------|-------------|
|  | Level 1   | Level 2     | Level 3 |             |
| Assets   |   |             |         |             |
| Financial instruments owned, at fair value:                        |   |             |         |             |
| Equities (1)   | \$1,463,916   | \$—         | \$—     | \$1,463,916 |
| U.S. government and Non-U.S. government obligations                | 34,339  | —           | —       | 34,339      |
| Corporate debt (2)   | 76,818  | —           | —       | 76,818      |
| Listed equity options  | 202,091   | —           | —       | 202,091     |
| Loan inventory   | —   | 191,712     | —       | 191,712     |
| Purchased call options   | —   | 237         | —       | 237         |
| Securitized HECM loan inventory (3)                                | —   | 4,054,905   | —       | 4,054,905   |
| Total Financial instruments owned, at fair value                   | 1,777,164   | 4,246,854   | —       | 6,024,018   |
| Securities segregated under federal and other regulations (4)      | 3,000   | —           | —       | 3,000       |
| Securities on deposit with clearing organizations (4)              | 182,280   | —           | —       | 182,280     |
| Deferred compensation investments (5)                              | —   | 21,339      | —       | 21,339      |
| Investment in Deephaven Funds (5)                                  | —   | 1,342       | —       | 1,342       |
| Assets of business held for sale:                                  |   |             |         |             |
| Mortgage-backed securities   | —   | 108,999     | —       | 108,999     |
| Corporate debt   | 29,690  | —           | —       | 29,690      |
| Total fair value of financial instrument assets                    | \$1,992,134   | \$4,378,534 | \$—     | \$6,370,668 |
| Liabilities  |   |             |         |             |
| Financial instruments sold, not yet purchased, at fair value:      |   |             |         |             |
| Equities (1)   | \$1,164,999   | \$—         | \$—     | \$1,164,999 |
| U.S. government obligations  | 71,728  | —           | —       | 71,728      |
| Corporate debt (2)   | 47,263  | —           | —       | 47,263      |
| Listed equity options  | 155,942   | —           | —       | 155,942     |
| Embedded conversion derivative                                     | —   | 237         | —       | 237         |
| Foreign currency forward contracts                                 | —   | 5,268       | —       | 5,268       |
| Total Financial instruments sold, not yet purchased, at fair value | 1,439,932   | 5,505       | —       | 1,445,437   |
| Liability to GNMA trusts, at fair value (3)                        | —   | 4,002,704   | —       | 4,002,704   |
| Liabilities of business held for sale:                             |   |             |         |             |
| Corporate debt   | 22,858  | —           | —       | 22,858      |
| U.S. government obligations  | 176,309   | —           | —       | 176,309     |
| Total fair value of financial instrument liabilities               | \$1,639,099   | \$4,008,209 | \$—     | \$5,647,308 |

(1)Equities of \$676.8 million have been netted by their respective CUSIP number and their long and short positions.

(2)Corporate debt of \$0.1 million has been netted by respective CUSIP number and their long and short positions.

(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) Securities segregated under federal and other regulations and Securities on deposit with clearing organizations consist of U.S. government obligations. The securities on deposit with clearing organizations are recorded within Receivable from brokers, dealers and clearing organizations on the Consolidated Statements of Financial Condition.

(5) Deferred compensation investments and investment in the Deephaven Funds are included within Investments 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.

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(Unaudited)

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 March 31, 2013 and December 31, 2012, 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 11 "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 March 31, 2013 and December 31, 2012, 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 12 "Long-Term Debt"), deferred compensation investments and its remaining investment in the Deephaven Funds are classified within Level 2 of the fair value hierarchy.

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

**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 March 31, 2013 and December 31, 2012 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 March 31, 2013 and December 31, 2012, 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 December 31, 2012, the Company also had a foreign currency forward contract with a notional value of 10.3 million Euros, which was used to hedge a Euro denominated strategic investment. This Euro hedge was terminated in the first quarter of 2013 because the underlying strategic investment was written down in late 2012. 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. Mortgage-backed securities are primarily held within Assets of business held for sale on the Consolidated Statements of Financial Condition.

**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.

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## 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.

## Investment in the Deephaven Funds

Investment in the Deephaven Funds represents the Company's 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 12 “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<br>Condition Location                   | Fair Value as of<br>March 31, 2013 | December 31,<br>2012 |
|--|---|------------------------------------|----------------------|
| <b>Asset Derivatives</b>   |   |                                    |                      |
| Derivative instruments not<br>designated as hedging instruments: | Financial instruments owned, at<br>fair value                   |                                    |                      |
| Purchased call options   |   | \$—                                | \$237                |
| Listed equity options <sup>(1)</sup>                             |   | 231,044                            | 202,091              |
|  |   | \$231,044                          | \$202,328            |
| Derivative instruments designated<br>as hedging instruments:     | Financial instruments owned, at<br>fair value                   |                                    |                      |
| Foreign currency forward contracts                               |   | \$3,778                            | \$—                  |
| <b>Liability Derivatives</b>                                     |   |                                    |                      |
| Derivative instruments not<br>designated as hedging instruments: | Financial instruments sold, not<br>yet purchased, at fair value |                                    |                      |
| Embedded conversion derivative                                   |   | \$—                                | \$237                |
| Listed equity options <sup>(1)</sup>                             |   | 179,404                            | 155,942              |
| Foreign currency forward contracts                               |   | —                                  | 822                  |
|  |   | \$179,404                          | \$157,001            |
| Derivative instruments designated<br>as hedging instruments:     | Financial instruments sold, not<br>yet purchased, at fair value |                                    |                      |
| Foreign currency forward contracts                               |   | \$—                                | \$4,446              |

As of March 31, 2013, the Company held 0.9 million long and short listed equity option contracts. As of December (1)31, 2012, the Company held 0.9 million long and 1.0 million short listed equity option contracts. These contracts are not subject to collateral requirements and are not netted.





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|   | Financial Statements Location        | Gain (Loss) Recognized                    |            |
|---|--------------------------------------|---|------------|
|   |                                      | For the three months ended March 31, 2013 | 2012       |
| Derivative instruments not designated as hedging instruments: |                                      |   |            |
| Purchased call options  | Investment income and other, net     | \$(237)                                   | \$(5,216)  |
| Listed equity options <sup>(1)</sup>                          | Net trading revenue                  | (7,754)                                   | (15,586)   |
| Embedded conversion derivative                                | Investment income and other, net     | 237                                       | 5,216      |
| Foreign currency forward contracts                            | Investment income and other, net     | 151                                       | (203)      |
|   |                                      | \$(7,603)                                 | \$(15,789) |
| Derivative instruments designated as hedging instruments:     |                                      |   |            |
| Foreign currency forward contracts                            | Accumulated other comprehensive loss | \$6,341                                   | \$(3,328)  |

Realized gains and losses on listed equity options relate to the Company's market making activities in such options.

(1) 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. The gross amounts of assets and liabilities subject to netting and gross amounts offset in the Consolidated Statements of Financial Condition were as follows (in thousands):

| March 31, 2013                                 | Gross Amounts Recognized | Gross Amounts Offset in the Statements of Financial Condition | Net Amounts of Assets Presented in the Statements of Financial Condition | Gross Amounts Not Offset in the Statement of Financial Condition | Cash Collateral Received | Net Amount       |
|--|--------------------------|---|--|--|--------------------------|------------------|
| <b>Assets</b>                                  |                          |   |  |  |                          |                  |
| Listed equity options                          | \$231,044                | \$—   | \$231,044  | \$—  | \$—                      | \$231,044        |
| Foreign currency forward contracts             | 3,778                    | —   | 3,778  | —  | —                        | 3,778            |
| Securities borrowed                            | 1,414,794                | —   | 1,414,794  | 1,385,581  | —                        | 29,213           |
| <b>Total Assets</b>                            | <b>\$1,649,616</b>       | <b>\$—</b>  | <b>\$1,649,616</b>   | <b>\$1,385,581</b>   | <b>\$—</b>               | <b>\$264,035</b> |
| <b>Liabilities</b>                             |                          |   |  |  |                          |                  |
| Listed equity options                          | \$179,404                | \$—   | \$179,404  | \$—  | \$13,043                 | \$166,361        |
| Securities loaned                              | 687,012                  | —   | 687,012  | 680,971  | —                        | 6,041            |
| Financial instruments sold under agreements to | 588,394                  | —   | 588,394  | 588,394  | —                        | —                |

|                   |             |     |             |             |          |           |
|-------------------|-------------|-----|-------------|-------------|----------|-----------|
| repurchase (1)    |             |     |             |             |          |           |
| Total Liabilities | \$1,454,810 | \$— | \$1,454,810 | \$1,269,365 | \$13,043 | \$172,402 |

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(Unaudited)

| December 31, 2012   | Gross Amounts Recognized | Gross Amounts Offset in the Statements of Financial Condition | Net Amounts of Assets Presented in the Statements of Financial Condition | Gross Amounts Not Offset in the Statement of Financial Condition |                          | Net Amount        |
|---|--------------------------|---|--|--|--------------------------|-------------------|
|   |                          |   |  | Financial Instruments  | Cash Collateral Received |                   |
| <b>Assets</b>   |                          |   |  |  |                          |                   |
| Listed equity options   | \$ 202,091               | \$—   | \$ 202,091   | \$—  | \$—                      | \$ 202,091        |
| Securities borrowed   | 1,008,720                | —   | 1,008,720  | 991,302  | —                        | 17,418            |
| <b>Total Assets</b>   | <b>\$ 1,210,811</b>      | <b>\$—</b>  | <b>\$ 1,210,811</b>  | <b>\$ 991,302</b>  | <b>\$—</b>               | <b>\$ 219,509</b> |
| <b>Liabilities</b>  |                          |   |  |  |                          |                   |
| Listed equity options   | \$ 155,942               | \$—   | \$ 155,942   | \$—  | \$ 8,439                 | \$ 147,503        |
| Foreign currency forward contracts                            | 4,446                    | —   | 4,446  | —  | —                        | 4,446             |
| Securities loaned   | 504,082                  | —   | 504,082  | 500,545  | —                        | 3,537             |
| Financial instruments sold under agreements to repurchase (1) | 466,487                  | —   | 466,487  | 466,487  | —                        | —                 |
| <b>Total Liabilities</b>                                      | <b>\$ 1,130,957</b>      | <b>\$—</b>  | <b>\$ 1,130,957</b>  | <b>\$ 967,032</b>  | <b>\$ 8,439</b>          | <b>\$ 155,486</b> |

(1) Financial instruments sold under agreements to repurchase includes \$33.4 million and \$111.5 million at March 31, 2013 and December 31, 2012, respectively, recorded within Liabilities of business held for sale.

## 8. 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, foreign 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 for 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 as well as the fair value of financial instruments which could be further repledged by the receiving counterparty (in thousands):

|  | March 31, 2013 | December 31, 2012 |
|--|----------------|-------------------|
| Collateral permitted to be delivered or repledged                          | \$ 1,382,596   | \$ 989,279        |
| Collateral that was delivered or repledged                                 | 1,324,986      | 933,716           |
| Collateral permitted to be further repledged by the receiving counterparty | 295,256        | 65,878            |

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.



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

|   | March 31,<br>2013 | December 31,<br>2012 |
|---|-------------------|----------------------|
| Financial instruments owned, at fair value, pledged to counterparties that had the right to deliver or repledge             | \$5,188,944       | \$4,605,155          |
| Financial instruments owned, at fair value, pledged to counterparties that do not have the right to deliver or repledge (1) | 777,177           | 696,495              |

Financial instruments owned, at fair value, pledged to counterparties that do not have the right to deliver or (1)repledge includes \$33.4 million and \$111.5 million at March 31, 2013 and December 31, 2012, respectively, recorded within Assets of business held for sale.

## 9. 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):

|                                  | March 31, 2013 | December 31,<br>2012 |
|----------------------------------|----------------|----------------------|
| Receivable:                      |                |                      |
| Clearing organizations and other | \$886,359      | \$738,625            |
| Securities failed to deliver     | 220,843        | 130,180              |
| Total Receivable                 | \$1,107,202    | \$868,805            |
| Payable:                         |                |                      |
| Clearing organizations and other | \$335,226      | \$324,175            |
| Securities failed to receive     | 68,772         | 54,549               |
| Total Payable                    | \$403,998      | \$378,724            |

Management believes that the carrying value of amounts receivable from and payable to brokers, dealers and clearing organizations approximates fair value since they are short term in nature.

## 10. Investments

Investments comprise strategic investments, including limited partnership investments, deferred compensation investments related to employee and director deferred compensation plans and investment in the Deephaven Funds.

Investments consist of the following (in thousands):

|   | March 31,<br>2013 | December 31,<br>2012 |
|---|-------------------|----------------------|
| Strategic investments:  |                   |                      |
| Investments accounted for under the equity method   | \$54,296          | \$53,878             |
| Common stock of companies representing less than 20% equity ownership held at adjusted cost | 1,786             | 1,789                |
| Total Strategic investments   | 56,082            | 55,667               |
| Deferred compensation investments   | 21,607            | 21,339               |
| Investment in Deephaven Funds   | 1,363             | 1,342                |
| Total Investments   | \$79,052          | \$78,348             |



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## 11. 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 assess 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.

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.

As noted in Footnote 5 "Business held for sale and discontinued operations", the Company agreed to sell its institutional fixed income sales and trading business to Stifel. As a result of this triggering event, an assessment of the business's intangible assets relating to customer relationships was performed and resulted in a \$8.3 million writedown of this asset in the first quarter of 2013 which is included within (Loss) income from discontinued operations, net of tax on the Consolidated Statements of Operations.

No other events occurred in the three months ended March 31, 2013 or 2012 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 by segment (in thousands):

|                           | March 31, 2013 | December 31, 2012 |
|---------------------------|----------------|-------------------|
| Market Making             | \$24,727       | \$24,727          |
| Global Execution Services | 189,173        | 189,173           |
| Total                     | \$213,900      | \$213,900         |

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 two to 17 years. The weighted average remaining life of the Company's intangible assets at March 31, 2013 and December 31, 2012 is approximately 11 years.

The following tables summarize the Company's Intangible assets, net of accumulated amortization by segment and type (in thousands):

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(Unaudited)

|  | March 31, 2013 | December 31,<br>2012 |
|--|----------------|----------------------|
| Market Making                                    |                |                      |
| Trading rights                                   | \$10,993       | \$11,381             |
| Other  | 38             | 41                   |
| Total  | 11,031         | 11,422               |
| Global Execution Services                        |                |                      |
| Customer and broker relationships                | 31,675         | 33,245               |
| Trade names                                      | 6,865          | 7,004                |
| Other  | 3,663          | 3,983                |
| Total  | 42,203         | 44,232               |
| Consolidated Total                               | \$53,234       | \$55,654             |
|  | March 31, 2013 | December 31,<br>2012 |
| Customer and broker relationships <sup>(1)</sup> |                |                      |
| Gross carrying amount                            | \$67,500       | \$67,500             |
| Accumulated amortization                         | (35,825)       | (34,255)             |
| Net carrying amount                              | 31,675         | 33,245               |
| Trading rights <sup>(2)</sup>                    |                |                      |
| Gross carrying amount                            | 15,520         | 15,520               |
| Accumulated amortization                         | (4,527)        | (4,139)              |
| Net carrying amount                              | 10,993         | 11,381               |
| Trade names <sup>(3)</sup>                       |                |                      |
| Gross carrying amount                            | 9,800          | 9,800                |
| Accumulated amortization                         | (2,935)        | (2,796)              |
| Net carrying amount                              | 6,865          | 7,004                |
| Other <sup>(4)</sup>                             |                |                      |
| Gross carrying amount                            | 13,880         | 13,880               |
| Accumulated amortization                         | (10,179)       | (9,856)              |
| Net carrying amount                              | 3,701          | 4,024                |
| Total  |                |                      |
| Gross carrying amount                            | 106,700        | 107,780              |
| Accumulated amortization                         | (53,466)       | (52,126)             |
| Net carrying amount                              | \$53,234       | \$55,654             |

Customer and broker relationships primarily relate to the Donaldson, Direct Trading, Hotspot, EdgeTrade, Urban, Astor and Penson Futures acquisitions. Excluded from December 31, 2012 is \$9.2 million related to the Company's

(1) institutional fixed income sales and trading business which is recorded within Assets of business held for sale on the Consolidated Statements of Financial Condition. The weighted average remaining life is approximately 13 years as of March 31, 2013 and December 31, 2012. Lives may be reduced depending upon actual retention rates.

(2) Trading rights provide the Company with the rights to trade on certain exchanges. The weighted average remaining life is approximately 7 years as of March 31, 2013 and December 31, 2012.

(3) Trade names relate to the acquisitions of Hotspot, EdgeTrade and Urban. The weighted average remaining life is approximately 13 years as of March 31, 2013 and December 31, 2012.

Other primarily includes technology and non-compete agreements acquired by the Company. The weighted

(4) average remaining life is approximately two and three years as of March 31, 2013 and December 31, 2012, respectively.



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

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(Unaudited)

|                      | For the three months ended March 31, |         |
|----------------------|--------------------------------------|---------|
|                      | 2013                                 | 2012    |
| Amortization expense | \$2,420                              | \$3,031 |

As of March 31, 2013, the following table summarizes the Company's estimated amortization expense for future years (in thousands):

|   | Amortization expense |
|---|----------------------|
| For the nine months ended December 31, 2013 | \$5,447              |
| For the year ended December 31, 2014        | 6,049                |
| For the year ended December 31, 2015        | 5,730                |
| For the year ended December 31, 2016        | 4,718                |
| For the year ended December 31, 2017        | 4,412                |

## 12. 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 is as follows (in thousands):

|  | March 31, 2013  |            | December 31, 2012 |            |
|--|-----------------|------------|-------------------|------------|
|  | Carrying Amount | Fair Value | Carrying Amount   | Fair Value |
| Term Credit Agreement                  | \$100,000       | \$100,000  | \$100,000         | \$100,000  |
| Convertible Notes                      | 342,470         | 341,064    | 338,753           | 332,003    |
| Total                                  | 442,470         | 441,064    | 438,753           | 432,003    |
| Less: Current portion recorded in      |                 |            |                   |            |
| Accrued expenses and other liabilities | 50,000          | 50,000     | 50,000            | 50,000     |
| Total Long-term debt                   | \$392,470       | \$391,064  | \$388,753         | \$382,003  |

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. In December 2012, the

Company entered into amendments to the Term Credit Agreement and Revolving Credit Agreement. These amendments were made to clarify the treatment of losses related to securities transactions and amend certain other provisions described therein.

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**Term Credit Agreement**

The proceeds of the Term Credit Agreement are being used for general corporate purposes. As of March 31, 2013, 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 March 31, 2013, the interest rate was 2.71% 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.

On May 7, 2013, the Company repaid all amounts outstanding under, and terminated, the Term Credit Agreement. The Company used a portion of the proceeds received from a federal tax refund to repay the Term Credit Agreement (see Footnote 15 "Income taxes"). The borrowings under the Term Credit Agreement were payable in full by June 27, 2014. There were no penalties for early termination.

**Revolving Credit Agreement**

The Revolving Credit Agreement comprises two classes of loans: Borrowing Base A and Borrowing Base B both of which 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.

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 March 31, 2013 and December 31, 2012, 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 March 31, 2013, 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.

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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 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 are accounted for as derivative instruments under GAAP. As of March 31, 2013 and December 31, 2012, the fair value of the purchased call options was zero and \$0.2 million, respectively. 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 bifurcable 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 March 31, 2013 and December 31, 2012, the fair value of the embedded conversion derivative was zero and \$0.2 million, respectively.

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(Unaudited)

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 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 March 31, |         |
|--|--------------------------------------|---------|
|  | 2013                                 | 2012    |
| Interest expense                       | \$7,654                              | \$7,399 |
| Amortization of debt issuance cost (1) | 740                                  | 778     |
| Commitment fee (1)                     | 125                                  | 126     |
| Total                                  | \$8,519                              | \$8,303 |

(1) Included in Other expense.

If the proposed Merger with GETCO is completed (See Footnote 4 “Merger Agreement with GETCO Holding Company, LLC”) it is intended that the Credit Agreements and the Notes will be paid in full. The amounts that would be payable as of March 31, 2013 comprise \$100.0 million for the Credit Agreements, which is equal to the carrying amount of this liability at March 31, 2013, and \$375.0 million for the Notes, which is equal to the \$342.5 million carrying value of this liability plus \$32.5 million of unamortized original issue discount at March 31, 2013.

## 13. Related Parties

As a result of the August 2012 Recapitalization, three investors held more than 10% of the outstanding Class A common stock as of March 31, 2013 and therefore are considered related parties.

The Company interacts with each of these three investors, or their affiliates, as part of its normal day-to-day operations. It earns revenues, incurs expenses and maintains balances with these related parties or their affiliates. 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):

| Statement of Operations                                 | For the three months ended March 31, 2013 |
|---|---|
| Revenues  |   |
| Commissions and fees                                    | \$186                                     |
| Total revenues from related parties                     | \$186                                     |
| Expenses  |   |
| Execution and clearance fees                            | 11  |
| Total expenses incurred with respect to related parties | \$11                                      |



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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – Continued

(Unaudited)

| Statements of Financial Condition                           | March 31,<br>2013 | December 31,<br>2012 |
|---|-------------------|----------------------|
| Assets  |                   |                      |
| Securities borrowed   | \$—               | \$42,196             |
| Receivable from brokers, dealers and clearing organizations | 144               | 728                  |
| Other assets  | 1,564             | 1,608                |
| Liabilities   |                   |                      |
| Securities loaned   | \$—               | \$3,754              |
| Payable to brokers, dealers and clearing organizations      | 5                 | 57                   |
| Accrued expenses and other liabilities                      | —                 | 359                  |

In the ordinary course of business, the Company enters into foreign exchange contracts with related parties.

## 14. 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 (“SARs”), 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 March 31, 2013, the Company has not issued any SARs.

At a special meeting of the Company’s stockholders on December 27, 2012, the Company’s stockholders approved the Amended and Restated 2010 Equity Incentive Plan (the “Amended 2010 Plan”) to increase the number of shares authorized for grant under the 2010 Plan from 10,580,044 to 64,580,044 and amend certain provisions of the 2010 Plan. Key changes to the 2010 Plan that were adopted in the Amended 2010 Plan included: (i) an amendment to require a qualifying termination of employment before vesting provisions in new awards accelerate in the event of a change-in-control, also known as “double-trigger” accelerated vesting; (ii) an amendment to the modification provision to require stockholder approval before (x) SARs may be repriced, replaced, regranted through cancellation or modified if such change would reduce the exercise price for the shares underlying such SAR and (y) options or SARs may be exchanged for cash if such exchange would reduce the exercise price for the shares underlying such option or SAR; (iii) an amendment to limit the number of shares subject to awards granted to each non-employee member of the Company’s Board during any calendar year to 200,000; and (iv) an extension of the time after which no awards may be granted under the Amended 2010 Plan to ten years from the date the stockholders approved the Amended 2010 Plan. 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. If the proposed Merger with GETCO is completed (See Footnote 4 “Merger Agreement with GETCO Holding Company, LLC”) each outstanding stock option, whether vested or unvested, will automatically be replaced with an option to purchase common stock of KCG equal to one third of the number of shares of Company common stock

subject to such original stock option immediately prior to the completion of the Merger (rounded down to the nearest whole share of KCG common stock). The exercise price per share of KCG common stock will be equal to the exercise price per share of Company common stock subject to such Company stock option multiplied by three (rounded up to the nearest whole cent). Pursuant to the terms of the applicable Company stock plans and award agreements, each option granted on or prior to December 19, 2012 will immediately vest and each stock option granted after December

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – Continued

(Unaudited)

19, 2012 will continue to vest in accordance with its existing vesting schedule, subject to acceleration under certain circumstances. There were no stock options granted subsequent to December 19, 2012.

Additionally, upon the completion of the Merger, each restricted share granted after December 19, 2012 and each outstanding restricted stock unit will be replaced with a restricted stock share or restricted stock unit, as applicable, equal to one third of a share of common stock of KCG (rounded to the nearest whole share). Awards granted on or prior to December 19, 2012 (except for restricted stock units that vest based upon performance) will automatically vest upon the completion of the Merger. Awards granted after December 19, 2012 (and restricted stock units granted prior to December 19, 2012 that vest based on performance) will continue to vest in accordance with their existing vesting schedule, subject to acceleration under certain circumstances.

**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 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 from continuing operations relating to restricted awards, primarily recorded in Employee compensation and benefits, and the corresponding income tax benefit, which was recorded in Income tax expense on the Consolidated Statements of Operations are presented in the following table (in thousands):

|                                  | For the three months ended March 31, |          |
|----------------------------------|--------------------------------------|----------|
|                                  | 2013                                 | 2012     |
| Stock award compensation expense | \$11,966                             | \$10,793 |
| Income tax benefit               | 4,547                                | 4,317    |

Included in the stock award compensation expense for the three months ended March 31, 2013 is \$4.0 million related to acceleration of stock awards in conjunction with the reduction in workforce in the first quarter of 2013.

The following tables summarize restricted awards activity, including awards related to employees working in businesses that are included within discontinued operations, for the three months ended March 31, 2013 (awards in thousands):

|                           | March 31, 2013    |  | Restricted Stock Units |  |
|---------------------------|-------------------|--|------------------------|--|
|                           | Restricted Shares | Weighted-Average Grant date Fair Value | Number of Units        | Weighted-Average Grant date Fair Value |
| Outstanding at January 1, | 82                | \$15.08                                | 8,172                  | \$11.44                                |
| Granted                   | —                 | —                                      | 12,735                 | 3.69                                   |
| Vested                    | (68               | ) 15.49                                | (3,128                 | ) 10.96                                |
| Forfeited                 | —                 | —                                      | (542                   | ) 7.19                                 |
| Outstanding at March 31,  | 14                | \$13.09                                | 17,237                 | \$5.93                                 |

There is \$77.2 million of unamortized compensation related to the unvested restricted awards outstanding at March 31, 2013. The cost of these unvested restricted shares is expected to be recognized over a weighted average life of 2.3 years.

Stock Options

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

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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 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 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 common stock on the grant date and the volatility of the Company's 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. There were no stock options granted during the three months ended March 31, 2013 or 2012.

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

|                                   | For the three months ended March 31, |       |
|-----------------------------------|--------------------------------------|-------|
|                                   | 2013                                 | 2012  |
| Stock option compensation expense | \$10                                 | \$229 |
| Income tax benefit                | 4                                    | 92    |

The following tables summarize stock option activity and stock options exercisable for the three months ended March 31, 2013 (options in thousands):

| 2013                                       | Number of Stock Options | Weighted-Average Exercise Price | Aggregate Intrinsic Value (in thousands) | Weighted-Average Remaining Life (years) |
|--|-------------------------|---------------------------------|--|---|
| Outstanding at January 1,                  | 2,536                   | \$13.66                         |  |   |
| Granted at market value                    | —                       | —                               |  |   |
| Exercised                                  | —                       | —                               |  |   |
| Forfeited or expired                       | (38                     | ) 11.95                         |  |   |
| Outstanding at March 31,                   | 2,498                   | \$13.66                         | \$—                                      | 3.05                                    |
| Exercisable at March 31,                   | 2,498                   | \$13.66                         | \$—                                      | 3.05                                    |
| Available for future grants at March 31, * | 50,491                  |                                 |  |   |

\* Represents both options and awards available for grant.

The aggregate intrinsic value is the amount by which the closing price of the Company's common stock exceeds the exercise price of the stock options multiplied by the number of shares. There were no stock options exercised during the three months ended March 31, 2013.

There is no unamortized compensation related to the unvested stock options outstanding at March 31, 2013.

15. 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:

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(Unaudited)

|   | For the three months ended<br>March 31, |        |   |
|---|---|--------|---|
|   | 2013                                    | 2012   |   |
| U.S. federal statutory income tax rate                                      | 35.0                                    | % 35.0 | % |
| U.S. state and local income taxes, net of U.S.<br>Federal income tax effect | 3.6                                     | % 3.7  | % |
| Nondeductible charges and Other, net  | (0.1)                                   | )% 0.2 | % |
| Actual income tax rate  | 38.5                                    | % 38.9 | % |

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.

Based on the weight of the positive and negative evidences considered, management believes that it is more likely than not that the Company will be able to realize its deferred tax assets in the future, and therefore no valuation allowance has been recorded at March 31, 2013 or December 31, 2012. Due to the losses generated in 2012, the Company currently is in a three year cumulative loss position. Management believes that this negative evidence is outweighed by positive evidence including the Company's long standing history of sustainable profitability, and its forecasts of future profitability. A significant portion of the customer base has remained unchanged and the business has generally demonstrated a return to profitability following the technology related losses of August 1, 2012, and the Company does not expect such a loss to recur. The goodwill and intangible asset impairment that the Company recorded in 2012, which contributed to its three year cumulative loss position, related to businesses that have not performed well and is not reflective of any weakness in the Company's electronic market making business, which has historically been its most profitable business. A significant portion of this 2012 impairment as well as additional impairment charges in the first quarter of 2013 relate to the institutional fixed income sales and trading business which is classified as held for sale.

A significant portion of the Company's 2012 U.S. federal net operating loss has been 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. For the year ended December 31, 2012, the Company's taxable loss was \$358.2 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. During the first quarter of 2013 the Company filed a claim to carryback \$338.0 million of its 2012 tax loss back to 2010 and 2011. This carryback resulted in a refund of approximately \$107.0 million of federal taxes paid in such prior years and the creation of a federal Alternative Minimum Tax ("AMT") credit of \$6.8 million which can be utilized to offset future federal income tax liabilities. This refund was received by the Company in April 2013 and is included within Income taxes receivable on the Company's Consolidated Statements of Financial Condition as of March 31, 2013 and December 31, 2012. The balance of the \$123.0 million Income taxes receivable on the Company's Consolidated Statements of Financial Condition as of March 31, 2013 also includes the aforementioned \$6.8 million AMT tax credit.

The portion of the \$358.2 million taxable loss that could not be carried back, approximately \$20.2 million, will generate a U.S. federal net operating loss carryforward related to the year ended December 31, 2012. The Company

has generated taxable income for the quarter ended March 31, 2013 and therefore currently projects that it will be able to utilize a portion of the net operating loss carryforward. At March 31, 2013 and December 31, 2012, the Company had projected overall U.S. federal net operating loss carryforwards of \$42.9 million and \$70.4 million, respectively, of which \$31.3 million resulted from acquisitions for both periods. The Company recorded a related deferred income tax asset of \$15.0 million and \$24.6 million as of March 31, 2013 and December 31, 2012 respectively, and an offsetting valuation allowance of \$6.8 million and \$7.0 million, respectively, at each balance sheet date which represents the portion of these net operating loss carryforwards related to acquisitions that are considered more likely than not to expire unutilized.



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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 loss carryforwards that were 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 net operating loss 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 net operating loss carryforward. The Company's U.S. federal net operating loss carryforwards will begin to expire in 2019.

At March 31, 2013 and December 31, 2012, the Company had, in aggregate, state and local net operating loss carryforwards of \$1.49 billion and \$1.47 billion, respectively of which \$24.3 million resulted from acquisitions; \$432.9 million and \$424.8 million, respectively related to New Jersey; \$514.6 million and \$511.1 million, respectively related to New York; and \$514.5 million and \$510.5 million, respectively related to New York City. The Company recorded a related deferred income tax asset of \$23.2 million and \$22.9 million as of March 31, 2013 and December 31, 2012, respectively, and offsetting valuation allowances of \$23.2 million and \$22.9 million, respectively, which represents the portion of these net operating loss carryforwards that are considered more likely than not to expire unutilized. The Company recorded a valuation allowance for substantially all of its state and local tax loss carryforwards as it is more likely than not that the benefit of such items will not be realized due to limitations on utilization in the particular jurisdictions in which the Company operates. Certain of these carryforwards are subject to annual limitations on utilization and they will begin to expire in 2019.

At March 31, 2013 and December 31, 2012, the Company had non U.S. net operating loss carryforwards of \$67.1 million and \$65.5 million, respectively. The Company recorded a foreign deferred income tax asset of \$17.5 million and \$17.0 million for these loss carryforwards as of March 31, 2013 and December 31, 2012, respectively, along with an offsetting U.S. federal deferred tax liability of \$17.5 million and \$17.0 million, respectively 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. At both March 31, 2013 and December 31, 2012, the Company had foreign tax credit carryforwards of \$3.2 million and an offsetting valuation allowance of \$1.6 million. The Company also had general business credit carryforwards at March 31, 2013 and December 31, 2012 of \$2.5 million and \$3.7 million, respectively. The Company also had AMT credit carryforwards of \$6.8 million at March 31, 2013. At March 31, 2013 and December 31, 2012, the Company had \$1.4 million and \$1.5 million of unrecognized tax benefits, respectively, all of which would affect the Company's effective tax rate if recognized.

As of March 31, 2013, the Company is subject to U.S. Federal income tax examinations for the tax years 2008 through 2012, 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 2007 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.

16. Earnings Per Share

Basic loss or earnings per common share ("EPS") have been calculated by dividing net (loss) income from continuing operations attributable to common stockholders 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 number of such options excluded was approximately 2.5 million and 1.7 million for the three months ended March 31, 2013 and 2012, respectively. 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.

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations from continuing operations for the three months ended March 31, 2013 and 2012 (in thousands):

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|   | For the three months ended March 31, |               |             |               |
|---|--------------------------------------|---------------|-------------|---------------|
|   | 2013                                 | 2012          | 2013        | 2012          |
|   | Numerator /                          | Denominator / | Numerator / | Denominator / |
|   | net income                           | shares        | net income  | shares        |
| Income from continuing operations and shares used in basic calculations   | \$ 11,014                            | 253,007       | \$ 31,220   | 89,764        |
| Effect of dilutive stock based awards                                     | —                                    | 108,046       | —           | 2,411         |
| Income from continuing operations and shares used in diluted calculations | \$ 11,014                            | 361,053       | \$ 31,220   | 92,175        |
| Basic earnings per share  |                                      | \$ 0.04       |             | \$ 0.35       |
| Diluted earnings per share  |                                      | \$ 0.03       |             | \$ 0.34       |

## 17. Significant Clients

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 for the three months ended March 31, 2013 or 2012.

## 18. Commitments and Contingent Liabilities

## Litigation

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 disclosed in the Company's public filings, 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. As noted in the Company's Form 10-K for the year ended December 31, 2012, the Company has since been named in two putative class actions and one derivative lawsuit relating to the technology issue 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 2012 Recapitalization. In addition, the Company and/or KCA are the subject of regulatory investigations.

Since the announcement on December 19, 2012 of the signing of the Merger Agreement between the Company and GETCO, the Company, GETCO, as well as the individual members of the Company's Board of Directors (the "Individual Defendants"), have been named as defendants in several lawsuits brought by certain purported Knight

stockholders challenging the proposed Merger. The lawsuits generally allege, among other things, that the Merger fails to properly value Knight, that the Individual Defendants breached their fiduciary duties in approving the Merger Agreement and that those breaches were aided and abetted by GETCO. The lawsuits seek, among other things, to enjoin the defendants from completing the proposed Merger on the agreed-upon terms, rescission of the proposed Merger (to the extent it has already been consummated), monetary relief and attorneys' fees and costs.

While the Company is currently unable to predict the outcome of any possible litigation or investigation related to the technology issue, the August 2012 Recapitalization, or the proposed Merger with GETCO, an unfavorable outcome in one or more of these matters could have a material adverse effect on the Company's financial condition

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or ongoing operations. In addition, the Company expects to incur additional expenses in defending against litigation and in connection with investigations.

Legal

The following developments occurred in the lawsuit entitled *Fernandez v. Knight Capital Group, Inc. et al.* in the U.S. District Court for the District of New Jersey since the developments described in the Company's Form 10-K for the year ended December 31, 2012:

Following the appointment of a lead plaintiff and counsel, the plaintiff filed an amended complaint on March 14, 2013, alleging generally that the defendants made material misstatements and/or failed to disclose matters related to the events of August 1. More specifically, the plaintiff alleges that defendants made false and misleading statements concerning the Company's risk management procedures and protocols, available cash and liquidity, Value at Risk and internal controls over financial reporting. The plaintiff asserts claims under Sections 10(b) and 20 and Rule 10b-5 of the federal securities laws, claiming that it and a class of the Company's shareholders who purchased the Company's securities between November 30, 2011 and August 1, 2012 paid an inflated price. The Company intends to file a motion to dismiss the amended complaint. Pursuant to the parties' scheduling order, briefing on the motion to dismiss will be complete in August 2013.

Merger Litigation

Delaware Litigation. The following developments occurred in the lawsuit entitled *In re Knight Capital Group, Inc. Shareholder Litigation* (C.A. No. 8159-VCP), pending in the Court of Chancery of the State of Delaware since the developments described in the Company's Form 10-K for the year ended December 31, 2012:

On March 5, 2013, the co-lead plaintiffs in the Delaware Consolidated Action filed an amended complaint and motions for expedited discovery and a preliminary injunction. In addition to the allegations in the initial complaints, the Delaware amended complaint contains allegations that the Knight board of directors breached its fiduciary duties by providing stockholders with allegedly deficient disclosures about the proposed transaction in the Company's Preliminary Form S-4, filed with the SEC on February 13, 2013 (the "Preliminary Proxy"). The Delaware court has scheduled a hearing on the plaintiffs' motion for a preliminary injunction on June 5, 2013.

New Jersey Litigation. The following developments occurred in the lawsuits entitled *Bryan v. Knight Capital, Inc. et al.* (Case No. HUD-C-001-13), and *Ward v. Knight Capital, Inc. et al.* (Case No. HUD-C-003-13), both pending in the Superior Court of New Jersey, Chancery Division of Hudson County since the developments described in the Company's Form 10-K for the year ended December 31, 2012:

On February 20, 2013, Knight moved to dismiss or, in the alternative, stay the New Jersey actions in deference to the first-filed Delaware actions. The New Jersey court granted the motion on March 28, 2013, and ordered that the New Jersey actions be stayed for all purposes in deference to the first-filed Delaware actions.

New York Litigation. The following developments occurred in the lawsuit entitled *Rosenfeld v. Thomas M. Joyce, et al.* (Case No. 6540147/2013), in the Supreme Court of State of New York (New York County) since the developments described in the Company's Form 10-K for the year ended December 31, 2012:

On March 14, 2013, the plaintiff in the New York action filed an amended complaint, which, in addition to the allegations in the initial complaint, contains allegations that the Knight board of directors breached its fiduciary duties by providing stockholders with allegedly deficient disclosures about the proposed transaction in the Preliminary Proxy. On March 21, 2013, the plaintiff moved by order to show cause for expedited discovery in support of his claims. The New York court issued an order on March 25, 2013, setting a hearing on the plaintiff's motion for April 4, 2013. On March 28, 2013, the parties in the New York action reached an agreement with respect to the matters raised in the plaintiff's motion and other aspects of the action, and as a result, on March 29, 2013, the plaintiff withdrew his motion for expedited discovery. On April 9, 2013, the New York court granted permission for the plaintiff to

withdraw his motion.

Regulatory

As previously disclosed in the Company's public filings, subsequent to the August 1, 2012 technology issue, the SEC and other regulators commenced on-site examinations of KCA's capital and liquidity condition. Those onsite examinations have concluded. Further, on or about August 9, 2012, the SEC began an examination of KCA's compliance with SEC Rule 15c3-5 (the "Market Access Rule") and other rules and regulations as they relate to the August 1, 2012 technology issue. The SEC issued a formal order of investigation concerning the Company and KCA on August 29, 2012. The investigation is ongoing and the Company is continuing to cooperate with the regulators. As noted in the

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Company's Form 10-K filing for the year ended December 31, 2012, the Company is engaged in preliminary discussions with the SEC staff concerning a possible resolution of the investigation. The Company currently believes that any financial penalty in connection with a possible resolution of the SEC investigation would not have a material adverse effect on the consolidated long-term financial condition of the Company, although any financial penalty could be material to operating results for a particular period, depending, in part, upon operating results for that period.

**Other Legal and Regulatory Matters**

The Company owns 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 the Company's systems and order handling procedures. The Company makes 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 the Company's regulators in the U.S. and abroad. As a major order flow execution destination and reverse mortgage originator, the Company is named from time to time in, or is asked to respond to a number of regulatory matters brought by U.S. regulators, foreign regulators and SROs that arise from its business activities. The Company is 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.

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 was approved by the SEC on March 22, 2013 which would allow Nasdaq to compensate market participants for certain claims related to system difficulties in connection with the Facebook IPO in an amount not to exceed \$62.0 million. On April 2, 2013, the Company submitted an accommodation claim to Nasdaq totaling approximately \$13.0 million comprising approximately \$2.6 million which would be reimbursed to customers and approximately \$10.4 million to be retained by the Company (related to customer trades which had previously been reimbursed to customers by the Company). Nasdaq acknowledged receipt of the April 2, 2013 claim but the Company has not received any indication from Nasdaq as to whether the Company will receive the full amount of the claim.

**Lease & Contract Obligations**

The Company leases office space under noncancelable operating leases. Certain office leases contain fixed dollar-based escalation clauses. Rental expense from continuing operations under the office leases was \$3.8 million, and \$3.4 million for the three months ended March 31, 2013 and 2012, respectively, and is included in Occupancy and equipment rentals on the Consolidated Statements of Operations.

The Company leases certain computer and other equipment under noncancelable operating leases and has entered into guaranteed employment contracts with certain employees. As of March 31, 2013, 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):

|                                      | Gross Lease<br>Obligations | Sublease<br>Income | Net Lease<br>Obligations | Other<br>Obligations |
|--------------------------------------|----------------------------|--------------------|--------------------------|----------------------|
| Nine months ending December 31, 2013 | \$16,973                   | \$1,656            | \$15,317                 | \$—                  |
| Year ending December 31, 2014        | 21,526                     | 1,634              | 19,892                   | —                    |

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|                                    |           |         |           |     |
|------------------------------------|-----------|---------|-----------|-----|
| Year ending December 31, 2015      | 20,759    | 1,353   | 19,406    | —   |
| Year ending December 31, 2016      | 20,352    | 1,333   | 19,019    | —   |
| Year ending December 31, 2017      | 20,178    | 1,412   | 18,766    | —   |
| Thereafter through August 31, 2023 | 79,040    | 194     | 78,846    | —   |
| Total                              | \$178,828 | \$7,582 | \$171,246 | \$— |

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. At March 31, 2013, the Company had provided a letter of credit for \$1.0 million, collateralized by U.S. Treasury Bills, as a guarantee for one of the Company's lease



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obligations. In the ordinary course of business, Knight Capital Group, Inc. also 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 floating rate HECMs which the borrowers have additional borrowing capacity of approximately \$577.2 million and \$478.1 million as of March 31, 2013 and December 31, 2012, respectively. This additional borrowing capacity is primarily in the form of undrawn lines of credit, with the balance generally available on a scheduled payments basis.

During the normal course of business, the Company 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      | Statements of Financial<br>Condition Location             | Fair Value of (liability)               |                      |
|------------------------|---|---|----------------------|
|                        |   | March 31, 2013                          | December 31,<br>2012 |
| Notional Value         | Not Applicable  | \$ (309,536 )                           | \$ (172,302 )        |
| Fair Value             | Payable to brokers, dealers and clearing<br>organizations | \$ (371 )                               | \$ (1,921 )          |
|                        |   | Gain (loss) Recognized                  |                      |
|                        |   | For the three months ended March<br>31, |                      |
| Futures Contracts      | Statements of<br>Operations Location                      | 2013                                    | 2012                 |
| Unrealized gain (loss) | Net trading revenue                                       | \$ 25                                   | \$ (6,462 )          |

## 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, the Company began providing execution and clearing services in futures 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 FCM customer is unable to fulfill its contracted obligation as the Company guarantees the performance of its clients 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 March 31, 2013 and December 31, 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

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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.

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

## 20. Business segments

In the first quarter of 2013, the Company changed its reporting segments from four operating segments: (i) Market Making, (ii) Institutional Sales and Trading, (iii) Electronic Execution Services and (iv) Corporate and Other to three operating segments: (i) Market Making; (ii) Global Execution Services; and (iii) Corporate and Other. This change was made to better reflect the Company's client offerings, changes in senior management, the combination of the institutional equities sales teams and how the businesses are managed.

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.

The Global 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 segment, Global Execution Services segment generally does not act as a principal to transactions that are executed within this segment, however, it will commit capital on behalf of clients as needed, and generally earns commissions for acting as agent between the principals to the trade. Global Execution Services also includes equity sales and trading (including ETFs), reverse mortgage origination and securitization and asset management. This segment also facilitates client orders through program, block, and riskless principal trades and provides capital markets services, including equity offerings as well as private placements. Additionally, the Global Execution Services segment includes the FCM business, which comprises certain assets and liabilities that the Company acquired or assumed from the futures division of Penson Financial Services, Inc. on June 1, 2012. This business provides execution and clearing services on major U.S. and European futures and options exchanges for clients.

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 stock lending.

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<br>Making | Global<br>Execution<br>Services | Corporate<br>and Other | Consolidated<br>Total |
|--|------------------|---------------------------------|------------------------|-----------------------|
| For the three months ended March 31, 2013: |                  |                                 |                        |                       |
| Revenues                                   | \$ 150,729       | \$ 122,373                      | \$ 12,054              | \$ 285,156            |
| Pre-tax earnings                           | 36,550           | 10,717                          | (29,363)               | ) 17,904              |
| Total assets                               | 2,107,033        | 6,501,730                       | 2,158,343              | 10,767,106            |
| For the three months ended March 31, 2012: |                  |                                 |                        |                       |
| Revenues                                   | \$ 152,166       | \$ 140,270                      | \$ 10,036              | \$ 302,472            |
| Pre-tax earnings                           | 45,131           | 23,845                          | (17,878)               | ) 51,098              |

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|              |           |           |           |           |
|--------------|-----------|-----------|-----------|-----------|
| Total assets | 2,001,430 | 3,794,641 | 1,817,959 | 7,614,030 |
|--------------|-----------|-----------|-----------|-----------|

Total Assets do not include Assets of business held for sale of \$145.7 million and \$389.7 million at March 31, 2013 and 2012, respectively.

Prior year amounts have been recast to conform with current year segment presentation.

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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, 2012 included in our Form 10-K/A as filed with the U.S. Securities and Exchange Commission ("SEC"). This discussion contains forward-looking statements that involve risks and uncertainties, including those discussed in our Form 10-K/A for the year ended December 31, 2012 and our Quarterly Report on Form 10-Q 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 and in our Form 10-K/A for the year ended December 31, 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 herein and statements containing the words "believes," "intends," "expects," "anticipates," and words of similar meaning, may constitute forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are not historical facts and are based on current expectations, estimates and projections about Knight Capital Group, Inc.'s (the "Company" or "Knight") industry, management's beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, readers are cautioned that any such forward-looking statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict including, without limitation, risks associated with: (i) the pending strategic business combination of Knight and GETCO Holding Company, LLC ("GETCO") (the "Merger"); (ii) the August 1, 2012 technology issue that 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 and the impact to the Company's capital structure and business as well as actions taken in response thereto and consequences thereof; (iii) the sale of the Company's institutional fixed income sales and trading business; (iv) 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; (v) changes in market structure, legislative, regulatory or financial reporting rules; (vi) past or future changes to the Company's organizational structure and management; and (vii) the costs, integration, performance and operation of businesses previously acquired or developed organically, or that may be acquired or developed organically in the future. Since such statements involve risks and uncertainties, the actual results and performance of the Company may turn out to be materially different from the results expressed or implied by such forward-looking statements. Given these uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. Unless otherwise required by law, the Company also disclaims any obligation to update its view of any such risks or uncertainties or to announce publicly the result of any revisions to the forward-looking statements made herein.

Readers should carefully review the risks and uncertainties disclosed in the Company's reports with the SEC, including those detailed under "Certain Factors Affecting Results of Operations" in MD&A herein and under "Risk Factors" herein and in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2012 and in other reports or documents the Company or the new Knight/GETCO holding company (KCG Holdings, Inc.) 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.

In addition to factors previously disclosed in the Company's reports filed with the SEC and those identified elsewhere in our Annual Report on Form 10-K, the following factors related to the Merger, among others, could cause actual results to differ materially from forward-looking statements or historical performance: ability to obtain regulatory approvals and meet other closing conditions to the Merger, including approval by Knight and GETCO stockholders, on the expected terms and schedule; delay in closing the Merger; difficulties and delays in integrating the Knight and GETCO businesses or fully realizing cost savings and revenue opportunities; business disruption following the Merger; the inability to sustain revenue and earnings growth; and customer and client actions.

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.

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On December 19, 2012, Knight, GETCO Holding Company, LLC (“GETCO”) and an affiliate of GETCO entered into an agreement and plan of merger, which was subsequently amended and restated on April 15, 2013 to adjust the exchange ratios but not the aggregate consideration (the “Merger Agreement”) for a strategic business combination. As a result of the proposed strategic business combination (the “Merger”), Knight and GETCO will each become a wholly owned subsidiary of KCG Holdings, Inc. (formerly known as Knight Holdco, Inc.), a newly-formed Delaware corporation (“KCG”). The business of KCG will be the combined business of Knight and GETCO. The Merger is expected to be completed in mid-2013, subject to approval by our stockholders and GETCO's voting unitholders, customary regulatory approvals and satisfaction of customary closing conditions.

In the first quarter of 2013, the Company changed its reporting segments from Market Making, Institutional Sales and Trading, Electronic Execution Services and Corporate and Other to (i) Market Making, (ii) Global Execution Services and (iii) Corporate and Other. This change was made to better reflect our client offerings, changes in our senior management, the combination of our institutional equities sales teams and how our businesses are managed. As of March 31, 2013, our operating segments comprised the following:

**Market Making**—Knight's 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 electronic 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, Knight's cash trading business handles specialized orders and also transacts on the OTC Bulletin Board, marketplaces operated by the OTC Markets Group Inc. and the Alternative Investment Market (“AIM”) of the London Stock Exchange. The segment also provides 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.

**Global Execution Services**— Knight's Global 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 the Market Making segment, the Global Execution Services segment generally does not act as a principal to transactions that are executed within this segment, however, it will commit capital on behalf of clients as needed, and generally earns commissions for acting as agent between the principals to the trade. Global Execution Services also includes equity sales and trading (including exchange traded funds (“ETFs”)), reverse mortgage origination and securitization and asset management. This segment also facilitates client orders through program, block, and riskless principal trades and provides capital markets services, including equity offerings as well as private placements. Additionally, the Global Execution Services segment includes the futures commission merchant (“FCM”) business, which comprises certain assets and liabilities that we acquired or assumed from the futures division of Penson Financial Services, Inc. on June 1, 2012. This business provides futures execution and clearing services on major U.S. and European futures and options exchanges for clients.

Management from time to time conducts a strategic review of our businesses and evaluates its potential value in the marketplace relative to their current and expected returns. To the extent management and our Board of Directors determine a business may return a higher value to shareholders through a divestiture, or is no longer core to our strategy, management may pursue a sale process. As of the date of this report we are exploring the sale of certain non-core and non-strategic assets, including our reverse mortgage origination and securitization business. While the process is ongoing, there is no assurance that any transaction will occur, or if a transaction is entered into, what the terms would be. Any potential transaction would be subject to the approval of our Board of Directors, and the consummation would likely be subject to customary closing conditions, including receipt of required regulatory approvals and applicable consents.

**Corporate and Other**— Knight's 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 Knight's other segments such as self-clearing services, including stock lending activities.





The following table sets forth: (i) Revenues, (ii) Expenses and (iii) Pre-tax earnings (loss) from continuing operations of our segments and on a consolidated basis (in thousands):

|                           | For the three months ended March 31, |                     |
|---------------------------|--------------------------------------|---------------------|
|                           | 2013                                 | 2012 <sup>(1)</sup> |
| Market Making             |                                      |                     |
| Revenues                  | \$ 150,729                           | \$ 152,166          |
| Expenses                  | 114,178                              | 107,035             |
| Pre-tax earnings          | 36,550                               | 45,131              |
| Global Execution Services |                                      |                     |
| Revenues                  | 122,373                              | 140,270             |
| Expenses                  | 111,656                              | 116,425             |
| Pre-tax earnings          | 10,717                               | 23,845              |
| Corporate and Other       |                                      |                     |
| Revenues                  | 12,054                               | 10,036              |
| Expenses                  | 41,417                               | 27,914              |
| Pre-tax loss              | (29,363                              | ) (17,878           |
| Consolidated              |                                      |                     |
| Revenues                  | 285,156                              | 302,472             |
| Expenses                  | 267,252                              | 251,374             |
| Pre-tax earnings          | \$ 17,904                            | \$ 51,098           |

Totals may not add due to rounding.

(1) Prior period amounts have been recast to conform with current period segment presentation.

Consolidated revenues for the three months ended March 31, 2013 decreased \$17.3 million, or 5.7%, from the same period a year ago, while consolidated expenses increased \$15.9 million. Consolidated pre-tax earnings from continuing operations for the three months ended March 31, 2013 was \$17.9 million as compared to consolidated pre-tax earnings of \$51.1 million for the same period a year ago.

The changes in our Pre-tax earnings (loss) from continuing operations by segment from the three months ended March 31, 2012 are summarized as follows:

Market Making— Our pre-tax earnings from Market Making for the three months ended March 31, 2013 was \$36.6 million, compared to pre-tax earnings of \$45.1 million for the comparable period in 2012. The decrease in results was due to lower volumes, increases in payments for order flow and a decrease in market volumes and volatility.

Global Execution Services—Our pre-tax earnings from Global Execution Services for the three months ended March 31, 2013 was \$10.7 million, compared to pre-tax earnings of \$23.8 million from the comparable period in 2012. The decrease in results was due to a decline in client volumes from our listed derivatives and institutional sales businesses and an additional \$4.4 million in compensation costs related to workforce reductions incurred in 2013 in an effort to combine our voice and electronic sales teams offset, in part, by increased earnings from our reverse mortgage business.

Corporate and Other—Our pre-tax loss from our Corporate and Other segment of \$29.4 million for the three months ended March 31, 2013 increased by \$11.5 million from the comparable period in 2012. The increase in loss is primarily due to higher professional fees related to the announced merger and the August 1, 2012 trading loss, and additional compensation costs related to workforce reductions offset, in part, by higher gains in our strategic investments. Excluding the additional professional fees and compensation costs, the pre-tax loss from our Corporate and Other segment was \$15.8 million for the three months ended March 31, 2013.

#### Certain Factors Affecting Results of Operations

We may experience significant variation in our future results of operations. Fluctuations in our future performance may result from numerous factors, including, among other things, global financial market conditions and the resulting competitive, credit and counterparty risks; cyclical, seasonality and other economic conditions; the value of our

securities positions and other financial instruments and our ability to manage the risks attendant thereto; the volume, notional dollar value traded and volatility levels within the core markets where our market making and trade execution businesses operate; the composition, profile and scope of our relationships with institutional and broker-dealer clients; the performance, size and volatility of our client market making portfolios; the performance, size and volatility of our non-client principal trading activities; HECMs origination and HMBS securitization volumes and spreads; 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 technology infrastructure; 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; our ability to prevent erroneous trade orders from being submitted due to of technology or other issues (such as occurred on August 1, 2012) and avoiding the consequences thereof; the performance, operation and connectivity to various market centers; our ability to manage personnel, compensation, overhead and other expenses, including our occupancy expenses under our office leases and expenses and charges relating to legal and regulatory proceedings; the strength of our client relationships; changes in payments for order flow; changes to execution quality and changes in clearing, execution and regulatory transaction costs; interest rate movements; the addition or loss of executive management, sales, trading and technology professionals; geopolitical, legislative, legal, regulatory and financial reporting changes specific to financial services and global trading; legal or regulatory matters and proceedings; the pending strategic business combination of the Company and GETCO and the costs and integration associated therewith; the amount, timing and cost of business divestitures/acquisitions or capital expenditures; the integration, performance and operation of acquired businesses; the incurrence of costs associated with acquisitions and dispositions; investor sentiment; and technological changes and events.

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 three 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 to achieve the level of revenues 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 March 31, 2013, trade volume and volatility levels across equity markets decreased as compared to the previous quarter. Secondary trading volumes in the equity markets were down significantly from prior years. 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 continue to increase the level of sophistication and automation within their operations and the extent of price improvement. The continued 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 and Global 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 and Global 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 venues which compete within the OTC and listed trading venues. For example, on July 3, 2012, the SEC approved 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 similar programs established by other national stock exchanges) could draw market share away from the Company, 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 offer 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 continue to ask the SEC and other regulators to closely review the financial markets 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 adopted and will continue to 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, colocation, 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, liquidity 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 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.

Over the last few years, some of the largest reverse mortgage originators exited the reverse mortgage business. Declining home values, the inability to assess borrowers’ financial health and the focus on other business lines were cited as factors contributing to their respective decisions.

The U.S. Department of Housing and Urban Development (“HUD”) has stated 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 and unsecuritized 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, 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 and unsecuritized 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 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 and unsecuritized 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 reverse mortgage loan origination volume.

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

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.

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

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.

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.

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 March 31, 2013 and 2012

##### Revenues

##### Market Making

|   | For the three months ended |           |           |             |   |
|---|----------------------------|-----------|-----------|-------------|---|
|   | March 31,                  |           |           |             |   |
|   | 2013                       | 2012      | Change    | % of Change |   |
| Commissions and fees (millions)                                   | \$17,701                   | \$22,366  | \$(4,665) | -20.9       | % |
| Net trading revenue (millions)                                    | 136,317                    | 127,091   | 9,226     | 7.3         | % |
| Interest, net (millions)  | (3,290)                    | ) 2,707   | (5,997)   | N/M         |   |
| Total Revenues from Market Making (millions)                      | \$150,728                  | \$152,165 | (1,437)   | -0.9        | % |
| U.S. equity Market Making statistics:                             |                            |           |           |             |   |
| Average daily dollar value traded (\$ billions)                   | 22.2                       | 21.9      | 0.3       | 1.4         | % |
| Average daily trades (thousands)                                  | 2,973.3                    | 3,334.6   | (361.3)   | -10.8       | % |
| Nasdaq and Listed shares traded (billions)                        | 43.0                       | 47.3      | (4.3)     | -9.1        | % |
| FINRA OTC Bulletin Board and Other shares traded (billions)       | 183.1                      | 171.2     | 11.9      | 7.0         | % |
| Average revenue capture per U.S. equity dollar value traded (bps) | 1.00                       | 0.99      | 0.01      | 1.0         | % |

Totals may not add due to rounding.

N/M - Not meaningful

Total revenues from the Market Making segment, which primarily comprises Net trading revenues and Commissions and fees from our domestic businesses, decreased slightly to \$150.7 million for the three months ended March 31, 2013, from \$152.2 million for the comparable period in 2012. Revenues were negatively impacted by fewer trades which was impacted by a decrease in market volumes as well as a decrease in market volatility offset, in part, by higher revenues from our European market making and option market making businesses.

Average revenue capture per U.S. equity dollar value traded was 1.0 basis point (“bps”) for the first quarter of 2013, up 1.0% from 0.99 bps from the first quarter of 2012. 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

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Revenues”), divided by the total dollar value of the related equity transactions. Domestic U.S. Equity Market Making Revenues were \$133.3 million and \$134.6 million for the three months ended March 31, 2013 and 2012, respectively. Global Execution Services

|   | For the three months ended |           |            |             |   |  |
|---|----------------------------|-----------|------------|-------------|---|--|
|   | March 31,<br>2013          | 2012      | Change     | % of Change |   |  |
| Commissions and fees (millions)   | \$107,524                  | \$118,898 | \$(11,374) | -9.6        | % |  |
| Net trading revenue (millions)  | 12,591                     | 26,065    | (13,474)   | -51.7       | % |  |
| Other revenues (millions)   | 2,259                      | (4,693)   | ) 6,952    | N/M         |   |  |
| Total Revenues from Electronic Execution Services (millions)                | \$122,373                  | \$140,270 | (17,897)   | -12.8       | % |  |
| Average daily Knight Direct equity shares (millions)                        | 184.6                      | 182.7     | 1.9        | 1.0         | % |  |
| Average daily Knight Hotspot FX notional dollar value traded (\$ billions)* | 27.8                       | 27.8      | —          | —           |   |  |

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 2011.

N/M - Not meaningful

Total revenues from the Global Execution Services segment, which primarily comprises Commissions and fees and Net trading revenues from agency execution activity, decreased 12.8% to \$122.4 million for the three months ended March 31, 2013, from \$140.3 million for the comparable period in 2012. Revenues were negatively impacted by a decline in client volumes from our listed derivatives and institutional equities businesses offset, in part, by increased revenues from our reverse mortgage business and the addition of our futures business, which was acquired in June 2012.

Corporate and Other

|  | For the three months ended |          |         |             |   |  |
|--|----------------------------|----------|---------|-------------|---|--|
|  | March 31,<br>2013          | 2012     | Change  | % of Change |   |  |
| Total Revenues from Corporate and Other (millions) | \$12,054                   | \$10,036 | \$2,018 | 20.1        | % |  |

Total revenues from the Corporate and Other segment, which primarily represent interest income from our stock borrow activity, gains or losses on strategic investments and deferred compensation investments related to certain employees and directors increased to \$12.1 million for the three months ended March 31, 2013, from \$10.0 million for the comparable period in 2012. The primary driver for the increase in revenues was higher gains from our strategic investments.

Expenses

Employee compensation and benefits expense decreased to \$107.8 million for the three months ended March 31, 2013 from \$112.3 million for the comparable period in 2012. As a percentage of total revenues, Employee compensation and benefits increased slightly to 37.8% for the three months ended March 31, 2013, from 37.1% for the comparable period in 2012. As a percentage of revenues, excluding compensation expenses related to reductions in our workforce of \$8.9 million, Employee compensation and benefits decreased to 34.7% for the three months ended March 31, 2013, from 37.1% for the comparable period in 2012. 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 in addition to a reduction in the number of employees offset, in part, by higher costs associated with a reduction in our workforce.

The number of full time employees decreased to 1,269 at March 31, 2013 as compared to 1,299 at March 31, 2012. Both periods exclude employees affected by the announced sale of our institutional fixed income sales and trading business. The decrease is due to the first quarter 2013 reduction in workforce offset, in part, by the acquisition of our

futures business. 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 3.6% to \$50.5 million for the three months ended March 31, 2013, from \$52.3 million for the comparable period in 2012. Execution and clearance fees decreased on a dollar basis due to

decrease in equity volumes. 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 increased 61.8% to \$35.1 million for the three months ended March 31, 2013, from \$21.7 million for the comparable period in 2012. The increase is primarily due to a lower revenue base, additional costs as we regain market share, and adjustments to payment rates as well as an increase in fees paid to third party brokers on increased wholesale reverse mortgage loan production. As a percentage of total revenue, Payments for order flow increased to 12.3% for the three months ended March 31, 2013, from 7.2% for the comparable period in 2012.

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.

Professional fees increased to \$13.0 million for the three months ended March 31, 2013, from \$4.9 million for the comparable period in 2012 due to higher consulting expenses and legal costs related to our August 1, 2012 trading loss and the announced GETCO Merger. Excluding the \$9.3 million fees related to the Merger and August 1, 2012 trading loss, Professional fees decreased to \$3.8 million for the three months ended March 31, 2013.

All other expenses increased by 13.5%, or \$8.8 million, to \$73.9 million for the three months ended March 31, 2013 from \$65.1 million for the comparable period in 2012. Communications and data processing expense increased primarily due to higher market data and connectivity expenses as a result of the addition of our futures business.

Interest expense decreased slightly primarily due to decrease in our securities lending activity. Occupancy and equipment rentals expense remained relatively flat. Business development expense decreased due to fewer client-related events and lower advertising costs. Other expenses increased due to higher reserves associated with the increase in our GNMA issuances.

Our effective tax rate for the three months ended March 31, 2013 from continuing operations of 38.5% differed from the federal statutory rate of 35% primarily due to state and local income taxes and non-deductible charges. Our effective tax rate for the three months ended March 31, 2012 from continuing operations of 38.9% differed from the federal statutory rate of 35% primarily due to state and local income 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. The adjustments incorporate the effects of professional fees related to the announced merger with GETCO and August 1, 2012 technology issue, and compensation expenses related to a reduction in workforce. We believe this presentation provides meaningful information to shareholders and investors as they provide comparability for our results of operations for the quarter ended March 31, 2013 with the results for the quarter ended March 31, 2012. The following table provides a full reconciliation of GAAP to non-GAAP pre-tax results for the three months ended March 31, 2013 (in thousands):

| Three months ended March 31, 2013                                     | Market Making | Global Execution Services | Corporate and Other | Consolidated |
|---|---------------|---------------------------|---------------------|--------------|
| Reconciliation of GAAP Pre-Tax to Non-GAAP Pre-Tax:                   |               |                           |                     |              |
| GAAP Income (loss) from continuing operations before income taxes     | \$36,550      | \$10,717                  | \$(29,363)          | \$17,904     |
| Professional fees related to merger and August 1st Loss               | —             | —                         | 9,252               | 9,252        |
| Compensation expenses related to reduction in workforce               | 230           | 4,410                     | 4,277               | 8,917        |
| Non-GAAP Income (loss) from continuing operations before income taxes | \$36,780      | \$15,127                  | \$(15,834)          | \$36,073     |
| 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 March 31, 2013 and December 31, 2012, we had total assets of \$10.91 billion and \$9.78 billion, respectively, a portion of which consisted of cash or assets readily convertible into cash as follows (in thousands):

|  | March 31,<br>2013 | December 31,<br>2012 |
|--|-------------------|----------------------|
| Cash and cash equivalents                                    | \$439,182         | \$413,926            |
| Financial instruments owned, at fair value:                  |                   |                      |
| Equities   | 1,538,856         | 1,463,916            |
| U.S. government and Non-U.S. government obligations          | 21,220            | 34,339               |
| Corporate debt   | 125,298           | 76,818               |
| Listed equity options  | 231,044           | 202,091              |
| Collateralized agreements:                                   |                   |                      |
| Securities borrowed  | 1,414,794         | 1,008,720            |
| Receivables from brokers, dealers and clearing organizations | 1,107,202         | 868,805              |
| Assets of business held for sale                             | 109,138           | 310,868              |
| Total cash and assets readily convertible to cash            | \$4,986,734       | \$4,379,483          |

Totals may not add due to rounding.

Substantially all of the amounts disclosed in the table above can be liquidated into 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 our August 1, 2012 trading loss. In April 2013, we received a tax refund of \$107.8 million from the Internal Revenue Service as a result of the carryback of 2012 tax losses which were primarily as a result of our August 1, 2012 trading loss. The receivable was included within Income taxes receivable on our Consolidated Statements of Financial Condition.

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.

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 March 31, 2013 and December 31, 2012, \$1.05 billion and \$1.08 billion, respectively, of equities have been pledged as collateral to third-parties under financing arrangements.

Other assets primarily represent deposits, net deferred tax assets and other miscellaneous receivables.

Total assets increased 1.13 billion, or 11.6%, from \$9.78 billion at December 31, 2012 to \$10.91 billion at March 31, 2013. The majority of the increase in assets relates to the growth of our financial instruments owned. Financial instruments owned increased by \$840.9 million, or 14.0%, from \$6.02 billion at December 31, 2012, to \$6.86 billion at March 31, 2013, primarily due to the \$737.4 million 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 while the remaining increase relates to increases in our inventory related to our market making business. Our securities inventory fluctuates based on trading volumes, market conditions, trading strategies utilized and our pre-determined risk limits. Securities borrowed increased by \$406.1 million, from \$1.01 billion at December 31, 2012 to \$1.41 billion at March 31, 2013. This increase is related to the increases in our short trading inventory in addition to the increase in our balance at clearing brokers included within Receivable from brokers, dealers and clearing organizations that also assist in funding our inventory.



Receivable from brokers, dealers and clearing organizations increased by \$238.4 million, from \$868.8 million at December 31, 2012 to \$1.11 billion at March 31, 2013, 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. The increase was offset, in part, by a decrease in Assets of business held for sale which decreased \$303.8 million from \$449.5 million at December 31, 2012 to \$145.7 million at March 31, 2013, primarily due to a decrease in fixed income securities positions as we near the agreed upon sale of our fixed income business. Total liabilities increased \$1.13 billion, or 13.6%, from \$8.3 billion at December 31, 2012 to \$9.43 billion at March 31, 2013. The majority of the increase in liabilities relates to increases in Collateralized financings and Payable to customers. Collateralized financings increased by \$1.08 billion, or 21.6%, from \$5.01 billion at December 31, 2012, to \$6.09 billion at March 31, 2013 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. Financial instruments sold, not yet purchased increased by \$281.4 million, or 19.5%, from \$1.45 billion at December 31, 2012, to \$1.73 billion at March 31, 2013, primarily due to a increase in the size of the securities inventory utilized in our equity and option market making activities. Our securities inventory fluctuates based on trading volumes, market conditions, trading strategies utilized and our pre-determined risk limits. The increase in Financial instruments sold, not yet purchased is consistent with the increase in our long securities position within our market making business. Payable to customers increased by \$73.4 million, from \$388.7 million at December 31, 2012 to \$462.0 million at March 31, 2013, primarily due to the expansion of our futures business. Liabilities of business held for sale decreased by \$272.0 million, from \$357.7 million at December 31, 2012 to \$85.6 million at March 31, 2013, primarily due to the agreed upon sale of our institutional fixed income sales and trading business. Stockholders' equity, increased by \$233.3 million, from \$1.25 billion at December 31, 2012 to \$1.49 billion at March 31, 2013. The increase in stockholders' equity from December 31, 2012 was primarily a result of the conversion of our remaining convertible preferred stock into Class A common stock during the first quarter of 2013.

#### Liquidity and Capital Resources

Historically we have financed our business primarily through cash generated by operations, our long-term debt and other borrowings. On August 6, 2012 we raised \$400.0 million in equity financing through the issuance of Series A convertible preferred stock to certain investors (the "August 2012 Recapitalization"). We incurred approximately \$40.5 million of fees and costs related to the offering, resulting in net proceeds of \$359.5 million.

Effective February 28, 2013, all shares of our Series A convertible preferred stock ("Series A Preferred Stock") were mandatorily converted into shares of Class A common stock as a result of the Company's Class A common stock having traded above 200% of the \$1.50 per share conversion price for 60 consecutive trading days.

At March 31, 2013, we had net current assets, which consist of net assets readily convertible into cash less current liabilities, of approximately \$1.23 billion.

We have acquired several businesses over the last few years. In July 2010, we acquired 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 acquired certain assets and assumed 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 \$3.5 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.

Net income from continuing operations was \$11.0 million for the three months ended March 31, 2013 and \$31.2 million for the three months ended March 31, 2012. Included in these amounts were certain non-cash expenses such as stock-based compensation, depreciation, amortization and certain non-cash writedowns. Stock-based compensation was \$12.0 million and \$11.0 million for the three months ended March 31, 2013 and 2012, respectively. Depreciation and amortization expense was \$9.7 million and \$11.6 million for the three months ended March 31, 2013 and 2012, respectively. There were no non-cash writedowns for the three months ended March 31, 2013 or 2012.

Capital expenditures related to our continuing operations were \$5.3 million and \$7.6 million during the three months ended March 31, 2013 and 2012, respectively. Purchases of investments were \$1.1 million and \$9.5 million during the



three months ended March 31, 2013 and 2012, respectively. Dividends and distributions received from

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investments were \$4.6 million and \$1.4 million for the three months ended March 31, 2013 and 2012, respectively. There were no payments relating to acquisitions of businesses, trading rights and other items, net of cash received during the three months ended March 31, 2013 and 2012, respectively.

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 March 31, 2013 and 2012, we recognized interest expense related to the Notes of \$7.0 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 a consortium of banks. As of December 31, 2012, the Company has borrowed all the funds under the Term Credit Agreement and 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. For each of the three months ended March 31, 2013 and 2012, we recognized interest expense related to the Term Credit Agreement of \$0.7 million.

On May 7, 2013, we repaid all amounts outstanding under, and terminated, the Term Credit Agreement. We used a portion of the proceeds received from a federal tax refund to repay the Term Credit Agreement. The borrowings under the Term Credit Agreement were payable in full by June 27, 2014. There were no penalties for early termination.

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 (“KECS”) 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. 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. 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 March 31, 2013, and December 31, 2012 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 each of the three months ended March 31, 2013 and 2012, we recorded \$0.1 million in commitment fees. The Revolving Credit Agreement was renewed with substantially the same consortium of banks on substantially the same terms and conditions as the Term Credit Agreement on June 27, 2012 and will expire on June 26, 2013.

In December 2012, Knight entered into amendments to the Term Credit Agreement and Revolving Credit Agreement. These amendments were made to clarify treatment of losses related to securities transactions and amend certain other provisions described therein.

In August 2012, we raised \$400.0 million in equity financing through the August 2012 Recapitalization. Under the terms of the August 2012 Recapitalization, we sold 400,000 shares of Series A Preferred Stock. 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 Preferred Stock accrued daily and were payable quarterly, in arrears, on each January 15, April 15, July 15 and October 15, commencing on October 15, 2012, in cash at a rate per annum equal to 2% of the liquidation preference of \$1,000 per share. During 2012, we declared two quarterly dividends with respect to the Series A Preferred Stock. The first dividend which was paid on October 15, 2012 totaled \$1.1 million based upon 274,215 Series A Preferred Stock outstanding as of the record date covering the period from August 6, 2012 through October 14, 2012. The second dividend which was paid on January 15, 2013 totaled \$1.2 million based upon 243,463 Series A Preferred Stock outstanding as of the record date covering the period from October 15, 2012 through January 15, 2013. As the second dividend was declared prior to December 31, 2012, it was reflected in the

Consolidated Financial Statements for the year ended December 31, 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. There were no dividends declared in 2013 as all of the Series A Preferred Stock had been converted into Class A common stock.

See Footnote 12 “Long-Term Debt,” and Footnote 3 “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 have an authorized stock repurchase program of \$1.00 billion. We did not repurchase any shares under the stock repurchase program during the first quarter of 2013. Through March 31, 2013, 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 Preferred Stock prohibit us from repurchasing any shares if dividends on such shares are in arrears. We had 375.1 million shares of Class A common stock outstanding as of March 31, 2013.

Our U.S. registered broker-dealer is subject to regulatory requirements intended to ensure the general financial soundness and liquidity of broker-dealers and FCMs 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 March 31, 2013, our broker-dealers were in compliance with the applicable regulatory net capital rules. The following table sets forth the net capital level and requirements for our regulated U.S. broker-dealer subsidiary at March 31, 2013, as reported in its respective regulatory filing (in thousands):

| Entity                      | Net Capital | Net Capital Requirement | Excess Net Capital |
|-----------------------------|-------------|-------------------------|--------------------|
| Knight Capital Americas LLC | \$293,577   | \$23,963                | \$269,614          |

Our foreign registered broker-dealers are subject to certain financial resource requirements of either 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 March 31, 2013 (in thousands)

| Entity                        | Financial Resources | Resource Requirement | Excess Financial Resources |
|-------------------------------|---------------------|----------------------|----------------------------|
| Knight Capital Europe Limited | \$116,307           | \$43,651             | \$72,656                   |

On December 19, 2012, Knight, GETCO Holding Company, LLC (“GETCO”) and an affiliate of GETCO entered into an agreement and plan of merger, which was subsequently amended and restated on April 15, 2013 to adjust the exchange ratios but not the aggregate consideration (the “Merger Agreement”) for a strategic business combination. As a result of the proposed strategic business combination (the “Merger”), Knight and GETCO will each become a wholly owned subsidiary of KCG Holdings, Inc., a newly-formed Delaware corporation (“KCG”). The business of KCG will be the combined business of Knight and GETCO.

Under the Merger Agreement, existing Company common stockholders (other than GETCO and holders of Company restricted stock or other equity awards granted after December 19, 2012) will have the right to elect to receive \$3.75 per share in cash or one third of a share of common stock of KCG for each share of Company Class A common stock they own immediately prior to the completion of the transaction. The cash consideration will be subject to pro-ration if the holders of more than 66.7% of the Company’s Class A common stock eligible for election in the transaction properly elect to receive the cash consideration for their Company shares. Jefferies & Company, Inc. and its affiliates (“Jefferies”), the largest stockholders of the Company, have agreed to limit their cash election to 50.0% of their

Company shares to the extent the total cash consideration would otherwise exceed \$720.0 million. This is intended to enable

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other Company stockholders (excluding GETCO and holders of Company restricted stock or other equity awards granted after December 19, 2012) to receive up to 66.7% of their total consideration in cash, while limiting the total cash consideration to be paid by KCG to not more than \$720.0 million in the aggregate.

If the transaction is completed, GETCO unitholders are expected to receive, in aggregate, approximately 76 million shares of common stock of KCG and up to 25 million warrants to acquire shares of common stock of KCG. The warrants will be comprised of 8.33 million Class A warrants, having a \$12.00 exercise price and exercisable for a four-year term; 8.33 million Class B warrants, having a \$13.50 exercise price and exercisable for a five-year term; and 8.33 million Class C warrants, having a \$15.00 exercise price and exercisable for a six-year term. The number of shares of common stock may increase or decrease based on the number of GETCO units outstanding as of the closing date.

GETCO entered into a commitment letter, with affiliates of Jefferies for the financing necessary to complete the business combination, including refinancing all existing Knight and GETCO debt. Pursuant to the commitment letter, Jefferies committed to provide a first lien term loan facility in an aggregate principal amount of up to \$450.0 million, a first lien revolving facility in an aggregate principal amount of \$20.0 million and a second lien bridge loan facility in an aggregate principal amount of up to \$550.0 million. On February 5, 2013, GETCO and Jefferies entered into a joinder agreement with Goldman Sachs Bank USA (“Goldman Sachs”). Pursuant to the joinder agreement, Goldman Sachs agreed to provide a portion of the financing agreed to in the commitment letter for the first lien term loan facility, the first lien revolving facility and the second lien bridge loan facility. In addition, Jefferies and Goldman are expected to arrange an offering of senior secured second lien notes by the new holding company yielding aggregate gross proceeds of up to \$550.0 million. The proceeds of the senior secured second lien notes, if any, would reduce the funded amount of the second lien bridge loan facility or, if the second lien bridge loan facility were previously funded, be used to repay the bridge loans made thereunder. These financings will be subject to customary affirmative and negative covenants.

The Merger is expected to be completed in mid-2013, subject to the approval by Knight’s stockholders and GETCO’s voting unitholders, customary regulatory approvals and satisfaction of customary closing conditions.

#### Off-Balance Sheet Arrangements

As of March 31, 2013, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

#### Effects of Inflation

The majority of our assets are liquid in nature and therefore 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.

#### Discontinued Operations and Assets Held for Sale

During the first quarter of 2013, we announced that we were discontinuing our correspondent clearing business. As a result, this business has been classified as a discontinued operation and the results of its operations have been included in discontinued operations on the Consolidated Statements of Operations for all periods presented.

During the first quarter of 2013, we agreed to sell our institutional fixed income sales and trading business which operates in the U.S. and in the U.K., to Stifel, Nicolaus & Company, Inc. We expect to complete the transaction during the second quarter of 2013. As a result of our decision to sell this business, this business has been classified as held for sale and the results of its operations have been included in discontinued operations within the Consolidated Statements of Operations for all periods presented. The assets and liabilities associated with this business are recorded as Assets of business held for sale and Liabilities of business held for sale, respectively on the Consolidated Statements of Financial Condition.

#### 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

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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.

As discussed in Footnote 12 “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, 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 March 31, 2013 and December 31, 2012, 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 \$213.9 million at March 31, 2013 primarily relates to our Global Execution Services segment. 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. No events occurred during the three months ended March 31, 2013 that would indicate that our goodwill may not be recoverable.

#### Intangible Assets

Intangible assets, less accumulated amortization, of \$53.2 million at March 31, 2013 are primarily attributable to our Global Execution Services segment. 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 17 years. We test amortizable intangibles for recoverability whenever events indicate that the carrying amounts may not be recoverable. No other events occurred during the three months ended March 31, 2013 that would indicate that the carrying amounts of our intangible assets may not be recoverable. During the first quarter of 2013, we wrote off intangible assets relating to customer relationships within our fixed income business of \$8.3 million which was included within (Loss) income from Discontinued operations, net of tax on the Consolidated Statements of Operations.

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 when we have significant influence, generally considered to be between 20% and 50% equity ownership or greater than 3% to 5% of a partnership interest. 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 value 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. In the event we are able to sublease 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 we conclude that previously determined excess real estate is needed for our use, such lease loss accrual is adjusted accordingly. Any such adjustments to previous lease loss accruals are recorded in Writedown of assets and lease loss accrual on the Consolidated Statements of Operations

**Income taxes**—We record 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 measure them using the enacted tax rates and laws that will be in effect when such differences are expected to reverse. We evaluate 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.

**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 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 discontinued operations, 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/A for the year ended December 31, 2012 and other reports or documents the Company files with, or furnishes, to the SEC from time to time.

Revenues and expenses associated with a business line that has been disposed of through closure or held sale are included in (Loss) income from discontinued operations, net of tax on the Consolidated Statements of Operations. Assets and liabilities of business held for sale or discontinued operations are included in Assets of business held for sale and discontinued operations and Liabilities of business held for sale and discontinued operations, respectively, on the Consolidated Statements of Financial Condition. Cash flows from discontinued operations are presented on the Consolidated Statements of Cash Flows within operating, investing and financing activities, as applicable

**Accounting Standards Updates**

**Recently adopted accounting guidance**

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 agreements. The new disclosures are required for reporting periods beginning on or after January 1, 2013, and are to be applied retrospectively. Other than requiring additional disclosures, the adoption of this ASU did not have an impact on our Consolidated Financial Statements.

In February 2013, the FASB issued an ASU that requires additional disclosure requirements for items reclassified out of accumulated other comprehensive income. This new guidance requires entities to present either on the face of the

income statement or in the notes to the financial statements; the effects on the specific line items of the income

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statement for amounts reclassified out of accumulated other comprehensive income. This ASU is effective for reporting periods beginning after December 15, 2012. Other than requiring additional disclosures, the adoption of this ASU did not have an impact on our Consolidated Financial Statements.

Recent accounting guidance to be adopted in future periods

In March 2013, the FASB issued an ASU concerning parent's accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries of groups of assets within a foreign entity or of an investment in a foreign entity. This ASU provides for the release of the cumulative translation adjustment into net income when a parent sells a part or all of its investment within a foreign entity, no longer holds a controlling interest in an investment in a foreign entity or obtains control of an investment in a foreign entity that was previously recognized as an equity method investment. This ASU is effective for reporting periods beginning after December 15, 2013, however early adoption is permitted. We are evaluating the impact of this ASU on our Consolidated Financial Statements.

### 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 equities, equity baskets and equity 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 lesser extent, listed equity options. The fair value of these financial instruments at March 31, 2013 and 2012 was \$1.96 billion and \$2.18 billion, respectively, in long positions and \$1.73 billion and \$1.83 billion, respectively, in short positions. The potential change in fair value, using a hypothetical 10% decline in prices, is estimated to be a loss of \$23.0 million and \$34.7 million as of March 31, 2013 and 2012, 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 broker dealer subsidiary, KCA, 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 the events of August 1, 2012, we carefully reviewed the matter internally and have subsequently taken several remedial measures designed to enhance our processes and controls, including: appointing



a Chief Risk Officer; establishing a formal Risk Committee of the Board; implementing change management controls which require at different stages an additional layer of review and supervisory approval for significant software installations; adding market access controls designed to more closely monitor outbound routers and enable the rapid automatic shut-down of the routers; and deploying various kill switches for specific applications and market access. We will continue to carefully monitor, enhance and strengthen our controls as needed.

Our businesses are highly dependent on our ability and our market centers ability 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. There is no assurance that such plans, policies, procedures and technologies will prevent a significant disruption to our business.

#### 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 subsidiary entity level.

We maintain a liquidity pool consisting of primarily 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 thousands):

|  | March 31, 2013 | December 31, 2012 |
|--|----------------|-------------------|
| Liquidity Pool Composition   |                |                   |
| Cash Held at Banks   | \$48,669       | \$35,174          |
| Money Market and Other Highly Liquid Investments                     | 332,808        | 285,804           |
| Total Liquidity Pool   | \$381,477      | \$320,978         |
| Cash and Other Highly Liquid Investments Held by Subsidiary Entities | \$57,705       | \$92,948          |

We regularly perform liquidity risk stress testing based on a scenario that considers both market-wide stresses and a company-specific stress over a two-week period. Given the nature of the Company’s business activity and balance sheet composition, survival over the first one to three days of a severe stress environment are most critical, after which management actions could be effectively implemented to navigate through prolonged periods of financial stress. The modeled cash inflows and outflows from the stress test serve as a quantitative input to assist us in establishing the Company’s liquidity risk appetite and amount of liquid assets to be held at the corporate level. The liquidity stress test considers cash flow risks arising from, but not limited to, a dislocation of the secured funding market, additional unexpected margin requirements, and operational events.

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 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 stockholders related to the technology issue. We are also subject to several lawsuits challenging the proposed Merger. 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.



Item 4. Controls and Procedures

(a) Disclosure Controls and Procedures. Knight's management, with the participation of Knight's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of Knight's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, Knight's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, Knight's disclosure controls and procedures are effective.

(b) Changes in Internal Control Over Financial Reporting. There have not been any changes in Knight's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, Knight's internal control over financial reporting.

**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 disclosed in the Company's public filings, 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, KCA, sending numerous erroneous orders in NYSE-listed and NYSE Arca securities into the market. As noted in the our Form 10-K for the year ended December 31, 2012, we have since been named in two putative class actions and one derivative lawsuit relating to the technology issue 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 KCA are the subject of regulatory investigations.

Since the announcement on December 19, 2012 of the signing of the Merger Agreement between the Company and GETCO, the Company, GETCO, as well as the individual members of the Company's Board of Directors (the "Individual Defendants"), have been named as defendants in several lawsuits brought by certain purported Knight stockholders challenging the proposed Merger. The lawsuits generally allege, among other things, that the Merger fails to properly value Knight, that the Individual Defendants breached their fiduciary duties in approving the Merger Agreement and that those breaches were aided and abetted by GETCO. The lawsuits seek, among other things, to enjoin the defendants from completing the proposed Merger on the agreed-upon terms, rescission of the proposed Merger (to the extent it has already been consummated), monetary relief and attorneys' fees and costs.

While we are currently unable to predict the outcome of any possible litigation or investigation related to the technology issue, the August 6, 2012 recapitalization, or the proposed Merger with GETCO, 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**

The following developments occurred in the lawsuit entitled *Fernandez v. Knight Capital Group, Inc. et al.* in the U.S. District Court for the District of New Jersey since the developments described in the Company's Form 10-K for the year ended December 31, 2012:

Following the appointment of a lead plaintiff and counsel, the plaintiff filed an amended complaint on March 14, 2013, alleging generally that the defendants made material misstatements and/or failed to disclose matters related to the events of August 1. More specifically, the plaintiff alleges that defendants made false and misleading statements concerning the Company's risk management procedures and protocols, available cash and liquidity, Value at Risk and internal controls over financial reporting. The plaintiff asserts claims under Sections 10(b) and 20 and Rule 10b-5 of the federal securities laws, claiming that it and a class of the Company's shareholders who purchased the Company's securities between November 30, 2011 and August 1, 2012 paid an inflated price. The Company intends to file a motion to dismiss the amended complaint. Pursuant to the parties' scheduling order, briefing on the motion to dismiss will be complete in August 2013.

**Merger Litigation**

**Delaware Litigation.** The following developments occurred in the lawsuit entitled *In re Knight Capital Group, Inc. Shareholder Litigation* (C.A. No. 8159-VCP), pending in the Court of Chancery of the State of Delaware since the developments described in the Company's Form 10-K for the year ended December 31, 2012:

On March 5, 2013, the co-lead plaintiffs in the Delaware Consolidated Action filed an amended complaint and motions for expedited discovery and a preliminary injunction. In addition to the allegations in the initial complaints,

the Delaware amended complaint contains allegations that the Knight board of directors breached its fiduciary duties by providing stockholders with allegedly deficient disclosures about the proposed transaction in the Company's Preliminary

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Form S-4, filed with the SEC on February 13, 2013 (the "Preliminary Proxy"). The Delaware court has scheduled the hearing on the plaintiffs' motion for a preliminary injunction on June 5, 2013.

**New Jersey Litigation.** The following developments occurred in the lawsuits entitled *Bryan v. Knight Capital, Inc. et al.* (Case No. HUD-C-001-13), and *Ward v. Knight Capital, Inc. et al.* (Case No. HUD-C-003-13), both pending in the Superior Court of New Jersey, Chancery Division of Hudson County since the developments described in the Company's Form 10-K for the year ended December 31, 2012:

On February 20, 2013, Knight moved to dismiss or, in the alternative, stay the New Jersey actions in deference to the first-filed Delaware actions. The New Jersey court granted the motion on March 28, 2013, and ordered that the New Jersey actions be stayed for all purposes in deference to the first-filed Delaware actions.

**New York Litigation.** The following developments occurred in the lawsuit entitled *Rosenfeld v. Thomas M. Joyce, et al.* (Case No. 6540147/2013), in the Supreme Court of State of New York (New York County) since the developments described in the Company's Form 10-K for the year ended December 31, 2012:

On March 14, 2013, the plaintiff in the New York action filed an amended complaint, which, in addition to the allegations in the initial complaint, contains allegations that the Knight board of directors breached its fiduciary duties by providing stockholders with allegedly deficient disclosures about the proposed transaction in the Preliminary Proxy. On March 21, 2013, the plaintiff moved by order to show cause for expedited discovery in support of his claims. The New York court issued an order on March 25, 2013, setting a hearing on the plaintiff's motion for April 4, 2013. On March 28, 2013, the parties in the New York action reached an agreement with respect to the matters raised in the plaintiff's motion and other aspects of the action, and as a result, on March 29, 2013, the plaintiff withdrew his motion for expedited discovery. On April 9, 2013, the New York court granted permission for the plaintiff to withdraw his motion.

#### Regulatory

As previously discussed in the Company's public filings, subsequent to the August 1, 2012 technology issue, the SEC and other regulators commenced on-site examinations of KCA's capital and liquidity condition. Those onsite examinations have concluded. Further, on or about August 9, 2012, the SEC began an examination of KCA's compliance with SEC Rule 15c3-5 (the "Market Access Rule") and other rules and regulations as they relate to the August 1, 2012 technology issue. The SEC issued a formal order of investigation concerning the Company and KCA on August 29, 2012. The investigation is ongoing and the Company is continuing to cooperate with the regulators. As noted in the Company's Form 10-K filing for the fiscal year ended December 31, 2012, the Company is engaged in preliminary discussions with the SEC staff concerning a possible resolution of the investigation. The Company currently believes that any financial penalty in connection with a possible resolution of the SEC investigation would not have a material adverse effect on the consolidated long-term financial condition of the Company, although any financial penalty could be material to operating results for a particular period, depending, in part, upon operating results for that period.

#### 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, 2012, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K 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.

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## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table contains information about our purchases of Knight Class A Common Stock during the first quarter of 2013 (in thousands, except average price paid per share):

| 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 |
|--------------------------------------|----------------------------------|------------------------------|--|--|
| January 1, 2013 -January 31, 2013    |                                  |                              |  |  |
| Common stock repurchases             | —                                |                              | —  | \$ 120,886   |
| Employee transactions (2)            | 854                              |                              | —  |  |
| Total                                | 854                              | \$3.70                       | —  |  |
| February 1, 2013 - February 28, 2013 |                                  |                              |  |  |
| Common stock repurchases             | —                                |                              | —  | \$ 120,886   |
| Employee transactions (2)            | 266                              |                              | —  |  |
| Total                                | 266                              | \$3.70                       | —  |  |
| March 1, 2013 - March 31, 2013       |                                  |                              |  |  |
| Common stock repurchases             | —                                |                              | —  | \$ 120,886   |
| Employee transactions (2)            | 277                              |                              | —  |  |
| Total                                | 277                              | \$3.72                       | —  |  |
| Total                                |                                  |                              |  |  |
| Common stock repurchases             | —                                |                              | —  |  |
| Employee transactions (2)            | 1,397                            |                              | —  |  |
| Total                                | 1,397                            | \$3.71                       | —  |  |

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. Through March 31, 2013, we had repurchased 76.7 million shares for \$879.1 million under this program.

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

## Item 3. Defaults Upon Senior Securities

None

## Item 4. Mine Safety Disclosures

Not applicable.

## Item 5. Other Information

None





Item 6. Exhibits  
 NUMBER ASSIGNED  
 TO EXHIBIT (I.E. 601  
 OF REGULATION S-K)

DESCRIPTION OF EXHIBITS

|       |   |
|-------|---|
| 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 financial statements from Knight Capital Group's Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Operations for the three months ended March 31, 2013 and 2012 (ii) Consolidated Statements of Comprehensive Income for the three months ended March 31, 2013 and 2012, (iii) Consolidated Statements of Financial Condition at March 31, 2013 and December 31, 2012, (iv) Consolidated Statements of Changes in Equity for the three months ended March 31, 2013 and the year ended December 31, 2012, (v) Consolidated Statements of Cash Flows for the three months ended March 31, 2013 and 2012, and (vi) the Notes to Consolidated Financial Statements. |

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\* 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.

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 May 2013.

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)