

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1

ORGANIZATION AND DESCRIPTION OF THE BUSINESS

Knight Capital Group, Inc. (collectively with its subsidiaries, the "Company") has three operating segments, Global Markets, Asset Management and Corporate. As of December 31, 2008, the Company's operating segments comprised the following subsidiaries:

Global Markets

- Knight Equity Markets, L.P. ("KEM") primarily operates as a market-maker in over-the-counter ("OTC") equity securities, primarily those traded in the Nasdaq Stock Market and on the OTC Bulletin Board. KEM also operates the Company's primary domestic institutional sales business. Donaldson & Co., a division of KEM, offers soft dollar and commission recapture services. KEM is a broker-dealer registered with the U.S. Securities and Exchange Commission ("SEC") and is a member of the Nasdaq Stock Exchange ("Nasdaq"), the New York Stock Exchange ("NYSE"), Financial Industry Regulatory Authority ("FINRA"), the International Securities Exchange, LLC ("ISE"), the National Stock Exchange ("NSX"), the Chicago Board Options Exchange ("CBOE"), the National Futures Association ("NFA"), Nasdaq OMX and Nasdaq OMX BX.
- Knight Capital Markets LLC ("KCM") primarily operates as a market-maker in the over-the-counter market for NYSE, NYSE Alternext and NYSE Arca listed securities. KCM is a broker-dealer registered with the SEC and is a member of Nasdaq and FINRA.
- Knight Equity Markets International Limited ("KEMIL") is a U.K. registered broker-dealer that provides execution services for institutional and broker-dealer clients in U.S., European and international equities. KEMIL is authorized and regulated by the U.K. Financial Services Authority ("FSA") and is a member of the London Stock Exchange, Deutsche Börse AG, Euronext N.V. (incorporating Euronext Amsterdam, Euronext Brussels, Euronext Lisbon and Euronext Paris), Borsa Italiana, OMX (incorporating the Copenhagen Stock Exchange, Helsinki Stock Exchange and Stockholm Stock Exchange), Oslo Børs, SWX Europe Limited, Weiner Börse, Chi-X Europe Limited and Turquoise.
- Knight Direct LLC ("Knight Direct") provides institutions with direct market access trading through Knight Direct EMS™, an advanced electronic platform. EdgeTrade, LLC ("EdgeTrade"), an agency-only trade execution and algorithmic software firm that allows buy- and sell-side clients to more effectively source liquidity and manage the trading process as well as maintain anonymity, reduce market impact and lower transaction costs, was acquired by the Company in January 2008 and merged into Knight Direct in August 2008. Knight Direct is a broker-dealer registered with the SEC and is a member of Nasdaq, FINRA and the NFA.

- Hotspot FX, Inc. and its subsidiaries ("Hotspot") provide institutions and dealers with spot foreign exchange executions through advanced, fully electronic platforms. One Hotspot subsidiary is regulated by the FSA, and another Hotspot subsidiary is a Futures Commission Merchant ("FCM") registered with the Commodity Futures Trading Commission ("CFTC") and is a member of the NFA.
- Knight BondPoint, Inc. ("Knight BondPoint") (formerly known as ValuBond Securities, Inc.) provides electronic access and trade execution products for the retail fixed income market. Knight BondPoint is a broker-dealer registered with the SEC and is a member of FINRA and the Municipal Securities Rulemaking Board ("MSRB").
- Knight Libertas Holdings LLC (formerly known as Libertas Holdings LLC) and its subsidiaries (collectively, "Knight Libertas") provide trade execution services and investment research across a broad range of fixed income securities, including high-yield and high-grade corporate bonds, distressed debt, asset- and mortgage-backed securities, convertible bonds and syndicated loans. Knight Libertas also provides capital markets services to growing companies in need of financing to support expansion. One Knight Libertas domestic subsidiary is a broker-dealer registered with the SEC and is a member of FINRA and MSRB, while its U.K. subsidiary is regulated by the FSA. Knight Libertas also has a Hong Kong registered broker-dealer that is regulated by the Securities and Futures Commission ("SFC"). Knight Libertas was acquired by the Company in July 2008.

Direct Edge ECN LLC ("Direct Edge ECN") operates as an electronic communications network ("ECN"). Direct Edge ECN is a liquidity destination offering the ability to match and route trades in Nasdaq, NYSE, NYSE Alternext and NYSE Arca listed securities. Direct Edge ECN is a broker-dealer registered with the SEC and is a member of Nasdaq and FINRA.

At the close of business on September 28, 2007 (the "Deconsolidation Date") the Company deconsolidated Direct Edge ECN as it no longer controlled Direct Edge ECN as of that date. The results of Direct Edge ECN's operations have been included in the Consolidated Statements of Operations up through the Deconsolidation Date. The Company accounts for its interest in Direct Edge Holdings LLC ("Direct Edge Holdings"), the newly formed immediate parent company of Direct Edge ECN (together, "Direct Edge") under the equity method for periods subsequent to the Deconsolidation Date. See Footnote 10 "Direct Edge ECN" for further discussion of Direct Edge ECN.

Asset Management

Deephaven Capital Management LLC ("Deephaven") is the registered investment adviser to, and sponsor of, the Deephaven investment funds (the "Deephaven Funds"). In addition to being registered as an Investment Adviser with the SEC, Deephaven is also registered with the CFTC as a "commodity pool operator" and a "commodity trading adviser," and is a member of the NFA. Due to the nature of Deephaven's investor

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base, however, Deephaven is not registered as either a FCM or "Introducing Broker" with the CFTC or NFA and is exempt from many of the CFTC and NFA regulations. Deephaven also has a U.K. registered investment adviser subsidiary, which is regulated by the FSA, and a Hong Kong registered investment adviser subsidiary, which is regulated by the SFC.

Prior to February 1, 2008, Deephaven was a wholly-owned subsidiary of the Company. On February 1, 2008, the Company contributed its interest in Deephaven to Deephaven Capital Management Holdings LLC ("Deephaven Holdings") in exchange for a 51% interest in Deephaven Holdings. In addition, certain Deephaven managers acquired a 49% interest in Deephaven Holdings in exchange for the termination of their employment agreements and associated profit sharing bonuses and an equity contribution. See Footnote 19 "Deephaven Transaction" for a further discussion of Deephaven.

On January 27, 2009, Deephaven entered into an Asset Purchase Agreement along with Deephaven Managing Partners, LLC ("Deephaven Partners"), the Company, and each of the three Deephaven managers to sell substantially all of its assets to Stark & Roth, Inc. ("Stark") with Stark assuming certain limited liabilities of Deephaven. See Footnote 25 "Subsequent Events" for a further discussion of the Deephaven Asset Sale.

Corporate

The Corporate segment includes investment income earned on strategic investments, corporate investment in the Deephaven Funds and all corporate overhead expenses. Corporate overhead expenses primarily consist of compensation for certain senior executives and other individuals employed at the corporate holding company, legal and other professional expenses related to corporate matters, directors' fees, investor and public relations expenses and directors' and officers' insurance.

Discontinued Operations

The Company completed the sale of its Derivative Markets business to Citigroup Financial Products Inc. ("Citigroup") in December of 2004. Costs associated with the Derivative Markets segment have been included within discontinued operations. For a further discussion of the sale of the Company's Derivative Markets business and its associated accounting treatment, see Footnote 14 "Discontinued Operations and Regulatory Charges and Related Matters."

NOTE 2

SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation and form of presentation

The accompanying 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. All significant intercompany transactions and balances have been eliminated. The Company records Minority interest expense on the Consolidated Statements of Operations, which reflects the portion of earnings of consolidated subsidiaries that are applicable to the minority interest owners.

Certain reclassifications have been made to the prior years' Consolidated Financial Statements in order to conform to the current year presentation. Such reclassifications are immaterial to both current and all previously issued financial statements taken as a whole and had no effect on previously reported Net income. These reclassifications are as follows:

- In 2008, the Company reclassified costs incurred during the year related to its commission recapture activity. The Company determined that it would be appropriate to report commissions associated with this activity net of the associated commission recapture payments instead of reporting such amounts on a gross basis, pursuant to the guidance provided in EITF Issue No. 01-9 *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)*. This reclassification resulted in a reduction of our reported Commissions and fees and Total revenues of approximately \$11.5 million and \$17.2 million for 2007 and 2006, respectively, with an equal and offsetting reduction in Soft dollar expense.
- The Company reclassified the Consolidated Statements of Cash Flows for the year ended December 31, 2007 to reflect Cash retained by deconsolidated entity as a component within Cash flows from investing activities rather than as a separate line item outside of Cash flows from operating, investing and financing activities. This presentation represents a change in classification of information rather than a change in accounting principle.
- For the years ended December 31, 2008 and 2007, the Company reported Non-operating gains from subsidiary stock issuance pursuant to SAB Topic 5J of \$15.9 million and \$8.8 million, respectively, as described in Footnote 10, "Direct Edge ECN." The 2007 Non-operating gain from subsidiary stock issuance, which had previously been reported as a separate line item within Revenues of the Consolidated Statements of Operations, has been reclassified to Other Income on such statement. The 2008 Non-operating gain from subsidiary stock issuance is also reported as Other Income.

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.

Market-making, trading and sales activities

Securities owned and securities sold, not yet purchased, which primarily consist of listed and OTC equities, are carried at market value and are recorded on a trade date basis. Net trading revenue (trading gains, net of trading losses) and commissions (which includes commission equivalents earned on institutional client orders) and related expenses are also recorded on a trade date basis. The Company's clearing

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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. Such, interest expense, which has been netted against interest income on the Consolidated Statements of Operations, was \$7.5 million, \$18.2 million and \$15.2 million in 2008, 2007 and 2006, respectively.

Dividend income relating to securities owned and dividend expense relating to securities sold, not yet purchased, derived 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 of \$20.1 million, \$5.5 million and \$6.2 million in 2008, 2007 and 2006, respectively. Net trading revenue includes dividend expense of \$11.7 million, \$5.2 million and \$6.8 million in 2008, 2007 and 2006, respectively.

Payments for order flow and ECN rebates represent payments to broker-dealer clients, in the normal course of business, for directing their order flow in U.S. equities to the Company, and rebates for providing liquidity to Direct Edge ECN through the Deconsolidation Date. Soft dollar expense represents payments to or on behalf of institutions in connection with soft dollar programs.

Asset management fees

Deephaven earns asset management fees for managing the Deephaven Funds. Management fees, which are received monthly, are recorded as earned and are calculated as a percentage of each Deephaven Fund's monthly net assets.

Incentive allocation fees are earned based upon the performance of the Deephaven Funds and are calculated based upon a percentage of a new high net asset value as defined in the applicable private placement offering memorandum, for the six-month performance period ended June 30 or December 31, for some funds, and for the twelve-month performance period ended December 31 for other funds. A new high net asset value is defined as the amount by which the net asset value of an investor's account in a particular Deephaven fund exceeds the greater of either the investor's highest previous net asset value in that Deephaven fund or the net asset value at the time the investor made a purchase.

The Company records incentive allocation fees in accordance with Method 2 of Emerging Issues Task Force ("EITF") Topic D-96. Under this methodology, the Company recognizes incentive allocation fee income for each interim period based upon the amount that would be due if the investment advisory relationship with the Deephaven Funds were terminated at the end of such period.

Incentive allocation fees may increase or decrease during the year based on the performance of the Deephaven Funds. As such, the incentive allocation fees, in certain circumstances, may be negative for certain periods, but not lower than zero

for any six-month performance period ended June 30 or December 31, for some funds, or the twelve-month performance period ended December 31 for other funds. Incentive allocation fees are paid upon the close of each six-month performance period, or twelve-month performance period, as the case may be, and are not subject to repayment (i.e., claw-back) once such performance period has closed. If a fund which has a six-month performance period incurs losses in the performance period ended December 31, the Company may make the determination, at its sole discretion, to return all or a portion of incentive allocation fees collected for the prior six-month performance period ended June 30 of that year.

Estimated fair value of financial instruments

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 157 *Fair Value Measurements* ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements.

Under SFAS 157, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the "exit price") in an orderly transaction between market participants at the measurement date. SFAS 157 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's belief about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of inputs 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.

The Company's securities owned and securities 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.

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The types of instruments that trade in markets that are not considered to be active, but are valued based on quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency are generally classified within Level 2 of the fair value hierarchy. As of December 31, 2008, the Company's Investment in Deephaven sponsored funds, one strategic investment, as well as Deferred compensation investments met the definition of 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 December 31, 2008, the Company did not hold any financial instruments that met the definition of Level 3.

In February 2008, FASB Staff Position FAS 157-2 ("FSP FAS 157-2") was issued. FSP FAS 157-2 delays the effective date of SFAS 157 for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The delay was intended to allow additional time to consider the effect of various implementation issues that have arisen from the application of SFAS 157. FSP FAS 157-2 is effective for fiscal years beginning after November 15, 2008. The Company believes that FSP FAS 157-2 will not have a material impact on the Company's Consolidated Financial Statements.

In October 2008, the FASB issued FASB Staff Position FAS 157-3 *Determining the Fair Value of a Financial Asset When the Market for that Asset is Not Active* ("FSP FAS 157-3"). FSP FAS 157-3 clarifies the application of SFAS 157 to consider various inputs in determining fair value under conditions when the market for certain financial assets are not active. FSP FAS 157-3 was effective immediately upon issuance. The implementation of FSP FAS 157-3 did not affect the Company's fair value measurements of financial assets or its financial condition as of December 31, 2008, nor did it affect the results of its operations for the year ended December 31, 2008.

In February 2007, the FASB issued SFAS No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115* ("SFAS 159"), which provides an option for entities to choose to measure many financial instruments and certain other items at fair value. On January 1, 2008, the Company elected not to take the option available under SFAS 159 for the purposes of valuing certain financial instruments at fair value.

Strategic investments

Strategic investments include non-controlling equity ownership interests held by the Company or its non-broker-dealer subsidiaries, primarily in financial services-related businesses. Strategic investments are accounted for under the equity

method, at cost or at fair value. The equity method of accounting is used for investments in limited partnerships and limited liability companies that are held by the Company or any of its non-broker-dealer subsidiaries. Investments in corporations by such non-broker-dealers are held at amortized cost. The equity method of accounting is used where the Company is considered to exert significant influence on the investee. Investments are held at adjusted cost when the Company is not considered to exert significant influence on the investee. Investments in liquid investment funds, including deferred compensation investments in mutual funds, are accounted for at fair value pursuant to SFAS 157.

Strategic investments are reviewed on an ongoing basis to ensure that the carrying values of the investments have not been impaired. If the Company assesses 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 impaired value.

Goodwill and intangible assets

The Company applies the provisions of SFAS No. 142 *Goodwill and Other Intangible Assets*, which requires that goodwill and intangible assets with an indefinite useful life to be tested for impairment annually or when an event occurs or circumstances change that signify the existence of impairment. Other intangible assets are amortized on a straight line basis over their useful lives and, as required by SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"), are tested for recoverability whenever events indicate that the carrying amounts may not be recoverable.

Deferred compensation investments

The Company has several deferred compensation plans related to certain employees and directors that provide a return to the participants based upon the performance of various investments. In order to hedge its liability under these plans, 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 (loss) income and other, net, with a corresponding charge or credit to Employee compensation and benefits on the Consolidated Statements of Operations.

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, related to the acquisition of new businesses.

Foreign currencies

The functional currency of the Company's foreign subsidiaries is the U.S. dollar. Assets and liabilities denominated in foreign currencies are translated into U.S. dollars using current exchange rates at the date of the Consolidated Statements of Financial

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Condition. Revenues and expenses are translated at average rates during the periods. Gains or losses resulting from foreign currency transactions are included in Investment (loss) income and other, net on the Consolidated Statements of Operations.

Soft dollar expense

Under a commission management program, the Company allows institutional clients to allocate a portion of their gross commissions to pay for research and other services provided by third parties. These payments are classified as Soft dollar expense on the Consolidated Statements of Operations and are reported gross of the related commission income pursuant to EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*.

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 life 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 follows SFAS No. 13 *Accounting for Leases*, as clarified by EITF and FASB Technical Bulletins, which states that rent expense under operating leases with fixed rent escalations, lease incentives and free rent periods should be recognized on a straight-line basis over the lease term beginning on the date the lessee takes possession of or controls the use of the space, including during free rent periods.

Lease loss accrual

It is the Company's policy to identify excess real estate capacity and where applicable, accrue for such future costs. In determining the accrual, a nominal cash flow analysis is performed for lease losses initiated prior to December 31, 2002, the effective date of SFAS No. 146 *Accounting for Costs Associated with Exit or Disposal Activities*, and costs related to the excess capacity are accrued. For lease losses initiated after December 31, 2002, the Company's policy is to accrue future costs related to excess capacity using a discounted cash flow analysis. In an event the Company is able to sublease the excess real estate after recording a lease loss accrual, such lease loss accrual is adjusted to the extent the actual terms of sub-leased property differ from the assumptions used in the calculation of the lease loss accrual.

Income taxes

Pursuant to SFAS No. 109 *Accounting for Income Taxes*, the Company records deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities and measures them using the enacted tax rates and laws that will be in effect when such differences are expected to

reverse. The Company evaluates the recoverability of future tax deductions by assessing the adequacy of future expected taxable income from all sources, including reversal of temporary differences and forecasted operating earnings. Net deferred tax assets and liabilities are included in Other assets and Accrued expenses and other liabilities, respectively, on the Consolidated Statements of Financial Condition.

On January 1, 2007 the Company adopted FASB Interpretation No. 48 *Accounting for Uncertainty in Income Taxes* ("FIN 48"). The Company recognized an immaterial adjustment in the liability for unrecognized income tax benefits as a result of the implementation of FIN 48.

Discontinued operations

In accordance with SFAS 144, the revenues and expenses associated with a separate segment or reporting unit that has been disposed of through closure or sale are included in Loss from discontinued operations, net of tax, on the Consolidated Statements of Operations.

Stock-based compensation

On January 1, 2006, the Company adopted SFAS No. 123(R), *Share-Based Payment* ("SFAS 123(R)"), using the "modified prospective method." Under SFAS 123(R), the grant date of stock-based employee awards that require future service is amortized over the relevant service period.

Upon the adoption of SFAS 123(R), the Company changed its expense attribution method for options. For option awards granted subsequent to the adoption of SFAS 123(R), compensation cost is recognized on a straight-line basis over the requisite service period for the entire award, which is the same methodology that the Company uses to account for restricted share awards. For unvested option awards granted prior to the adoption of SFAS 123(R), the Company continues to recognize compensation cost using a graded-vesting method (as it had on a pro-forma basis previously). The graded-vesting method recognizes compensation cost separately for each vesting tranche.

SFAS 123(R) requires expected forfeitures to be considered in determining stock-based employee compensation expense. Prior to the adoption of SFAS 123(R), forfeiture benefits were recorded as a reduction to the Company's actual compensation expense in the case of restricted shares, or pro-forma compensation expense in the case of options, when an employee left the Company and forfeited the award. For all years 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 years presented.

For stock-based payments issued after the adoption of SFAS 123(R), the Company applies a non-substantive vesting period approach 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. Prior to the adoption of SFAS 123(R),

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the Company applied a nominal vesting approach for employee stock-based compensation awards with retirement eligible provisions. Under the nominal vesting approach, the Company recognized actual and pro-forma compensation cost over the vesting period and, if the employee retired before the end of the vesting period, the Company recognized any remaining unrecognized compensation cost at the date of retirement. The impact of this change in the vesting period approach did not have a material impact on the results of operations for the periods presented herein.

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 issued accounting standards

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115* (“SFAS 159”), which permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 was effective for the Company beginning on January 1, 2008. The adoption of SFAS 159 did not have a material impact on the Company’s Consolidated Financial Statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (“SFAS 141(R)”). SFAS 141(R) requires the acquiring entity in a business combination to recognize the acquisition date fair value for all identifiable assets acquired, and liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141(R) changes the recognition of assets acquired and liabilities assumed arising from contingencies, requires the capitalization of in-process research and development and requires the expensing of acquisition-related and restructuring costs as incurred. SFAS 141(R) is effective as of the beginning of an entity’s fiscal year that begins after December 15, 2008. The Company will apply the provisions of SFAS 141(R) to business combinations occurring after December 31, 2008. Adoption of SFAS 141(R) will not affect our Consolidated Financial Statements, but may have an effect on accounting for future business combinations.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51* (“SFAS 160”). SFAS 160 states that accounting and reporting for minority interests will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent’s ownership interest and the

valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This statement is effective as of the beginning of an entity’s first fiscal year beginning after December 15, 2008 with retrospective application. The Company does not expect the adoption of SFAS 160 to have a material effect on its Consolidated Financial Statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133* (“SFAS 161”). SFAS 161 requires enhanced disclosures about an entity’s derivative and hedging activities. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2008, with early adoption encouraged. Since SFAS 161 requires only additional disclosures concerning derivatives and hedging activities, adoption of SFAS 161 will not affect our Consolidated Financial Statements.

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets* (“FSP FAS 142-3”). FSP FAS 142-3 removes the requirement of SFAS No. 142, *Goodwill and Other Intangible Assets* for an entity to consider, when determining the useful life of an acquired intangible asset, whether the intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions associated with the intangible asset. FSP FAS 142-3 replaces the previous useful-life assessment criteria with a requirement that an entity consider its own experience in renewing similar arrangements. If the entity has no relevant experience, it would consider market participant assumptions regarding renewal. FSP FAS 142-3 is effective for the Company on December 1, 2009. The Company is currently evaluating the potential impact of the adoption of FSP FAS 142-3 on its Consolidated Financial Statements.

In June 2008, the FASB issued FASB Staff Position EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (“FSP EITF 03-6-1”). FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and therefore need to be included in calculating earnings per share under the two-class method described in SFAS No. 128, *Earnings per Share*. Additionally, FSP EITF 03-6-1 requires companies to treat unvested share-based payment awards that have non-forfeitable rights to dividend or dividend equivalents as a separate class of securities in calculating earnings per share and is effective for financial statements issued for fiscal years beginning after December 15, 2008; early adoption is not permitted. The Company does not expect FSP EITF 03-6-1 to affect its results of operations or earnings per share.

In September 2008, the FASB issued FSP FAS 133-1 and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161* (“FSP FAS 133-1 and FIN 45-4”).

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FSP FAS 133-1 and FIN 45-4 require enhanced disclosures about credit derivatives and guarantees and amends FIN 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* to exclude credit derivative instruments accounted for at fair value under SFAS No. 133. FSP FAS 133-1 and FIN 45-4 were effective for financial statements issued for reporting periods ending after November 15, 2008. Since FSP FAS 133-1 and FIN 45-4 only require additional disclosures concerning credit derivatives and guarantees, adoption of FSP FAS 133-1 and FIN 45-4 did not have an effect on our Consolidated Financial Statements.

NOTE 3

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 SFAS 157, as described more fully in Footnote 2 "Significant Accounting Policies." The following fair value hierarchy table presents information about the Company's financial assets and liabilities measured at fair value on a recurring basis (in millions):

December 31, 2008	Assets and Liabilities Measured at Fair Value on a Recurring Basis			Total
	Level 1	Level 2	Level 3	
Assets				
Securities owned, held at clearing brokers, at fair value:				
Equities ⁽¹⁾	\$469.4	\$ -	\$-	\$469.4
U.S. government obligations	6.7	-	-	6.7
Investment in Deephaven sponsored funds	-	47.2	-	47.2
Strategic investment	-	27.9	-	27.9
Deferred compensation investments	-	72.7	-	72.7
Total fair value of financial instrument assets	\$476.1	\$147.8	\$-	\$623.9
Liabilities				
Securities sold, not yet purchased, at fair value:				
Equities ⁽¹⁾	\$385.0	\$ -	\$-	\$385.0
Total fair value of financial instrument liabilities	\$385.0	\$ -	\$-	\$385.0

⁽¹⁾ Equities of \$93.8 million have been netted by their respective long and short positions as of December 31, 2008.

NOTE 4

RECEIVABLE FROM/PAYABLE TO BROKERS AND DEALERS

Amounts receivable from and payable to brokers and dealers consist of the following (in millions):

December 31,	2008	2007
Receivable:		
Clearing brokers and other	\$281.9	\$207.1
Securities failed to deliver	47.6	134.3
Deposits for securities borrowed	11.8	41.1
	\$341.4	\$382.5
Payable:		
Securities failed to receive	\$ 32.6	\$ 79.5
Clearing brokers and other	65.5	37.5
	\$ 98.1	\$117.0

Totals may not add due to rounding.

NOTE 5

INVESTMENT IN AND RECEIVABLE FROM DEEPHAVEN SPONSORED FUNDS AND ASSET MANAGEMENT FEES

Deephaven is the registered investment adviser and sponsor of the Deephaven Funds, which engage in various trading strategies involving equities, debt instruments and derivatives. The underlying

investments in the Deephaven Funds are carried at market value. Of the \$2.0 billion and \$3.9 billion of assets under management in the Deephaven Funds as of December 31, 2008 and 2007, respectively, the Company had corporate investments as a limited partner or non-managing member of \$47.2 million and \$83.7 million, respectively. At December 31, 2007, the Company also had an \$85.0 million receivable from Deephaven sponsored funds, which represented a redemption that was effective December 31, 2007 and was received in January 2008. Deferred compensation investments on the Consolidated Statements of Financial Condition at December 31, 2008 and 2007 included \$35.8 million and \$49.8 million, respectively, of investments as a limited partner or non-managing member in the Deephaven Funds related to employee and director deferred compensation plans. Separately, certain officers, directors and employees of the Company held direct investments of approximately \$47.1 million and \$27.6 million as limited partners or non-managing members in the Deephaven Funds, in the aggregate, as of December 31, 2008 and 2007, respectively.

Asset management fees represent fees earned by Deephaven for sponsoring and managing the Deephaven Funds as well as fees earned from separately managed accounts. These fees consist of management fees, calculated as fixed percentages of assets under management, and incentive allocation fees, generally calculated as a percentage of the funds' and managed accounts' year-to-date profits, if any. Incentive allocation fees

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

may be negative in certain interim periods if the funds or managed accounts lose money for such period; however, such fees will not be negative on a year-to-date basis. Management fees were \$33.9 million, \$44.3 million and \$35.5 million for 2008, 2007 and 2006, respectively. Incentive allocation fees were \$12.4 million, \$72.5 million and \$178.4 million for 2008, 2007 and 2006, respectively.

Included in Investment (loss) income and other, net on the Company's Consolidated Statements of Operations is (loss) income from the Company's corporate investments in the Deephaven Funds of (\$28.3) million, \$17.8 million and \$34.2 million for 2008, 2007 and 2006, respectively. For additional information on Deephaven, see Footnote 19, "Deephaven Transaction" and Footnote 25, "Subsequent Events."

NOTE 6

FIXED ASSETS AND LEASEHOLD IMPROVEMENTS

Fixed assets and leasehold improvements comprise the following (in millions):

December 31,	Depreciation Period	2008	2007
Computer hardware and software	3 years	\$110.8	\$101.9
Leasehold improvements	*	69.5	52.5
Telephone systems	5 years	9.5	9.6
Furniture and fixtures	7 years	9.5	7.5
Trading systems and equipment	5 years	2.7	2.6
		201.9	174.1
Less – Accumulated depreciation and amortization		118.1	112.0
		\$ 83.8	\$ 62.1

*Shorter of life of lease or useful life of assets

NOTE 7

STRATEGIC INVESTMENTS

Strategic investments of \$83.7 million at December 31, 2008 consisted of a \$27.9 million short-term investment in a liquid investment fund carried at fair value, \$49.8 million in seven limited liability companies, limited partnership investments and a corporation accounted for under the equity method, \$1.0 million investment in common stock of two private companies representing less than 20% equity ownership which is held at cost, and \$5.0 million in three debt instruments, which are held at adjusted cost. See Footnote 2 "Significant Accounting Policies" for a discussion of valuation of Strategic investments. Included in the \$49.8 million investment in limited liability companies at December 31, 2008 is a \$33.7 million equity investment in Direct Edge ECN, which is described further in Footnote 10 "Direct Edge ECN."

Strategic investments of \$73.7 million at December 31, 2007 consisted of a \$30.8 million short-term investment in a liquid investment fund carried at fair value, \$37.4 million in eight limited liability companies, limited partnership investments and a corporation accounted for under the equity method, and \$5.5 million in common stock of two private companies

representing less than 20% equity ownership, which are held at cost. Included in the \$37.4 million investment in limited liability companies at December 31, 2007 is a \$19.1 million equity investment in Direct Edge ECN.

NOTE 8

GOODWILL AND INTANGIBLE ASSETS

Goodwill and intangible assets with indefinite useful lives are tested for impairment annually or when an event occurs or circumstances change that signify the existence of impairment. As part of the test for impairment, the Company considers the profitability of the respective segment or reporting unit, an assessment of the fair value of the respective segment or reporting unit as well as the overall market value of the Company compared to its net book value. In June 2008 and 2007, the Company tested for the impairment of goodwill and intangible assets with indefinite lives and concluded that there was no impairment. Amortizable intangibles are tested for recoverability whenever events indicate that the carrying amounts may not be recoverable. In 2008, the Company discontinued the use of the Direct Trading Institutional trade name and wrote off the remaining book value of \$2.5 million. In 2007, the Company wrote off \$110,000 related to the discontinued use of the trade name of ValuBond Securities, Inc. No other events occurred in 2008 or 2007 that would indicate that the carrying amounts of the Company's goodwill or intangible assets may not be recoverable.

The goodwill balances of \$232.2 million and \$132.8 million at December 31, 2008 and 2007, respectively, relate to the Global Markets segment. Goodwill increased by \$99.4 million during 2008, due to the acquisitions of EdgeTrade and Knight Libertas. Goodwill primarily represents the Company's purchases of the businesses now operating as KCM, Knight Direct, Hotspot, Donaldson, Knight BondPoint and Knight Libertas.

The Company had intangible assets, net of accumulated amortization, of \$90.5 million and \$57.8 million at December 31, 2008 and 2007, respectively, all included within the Global Markets business segment. Intangible assets increased by \$32.6 million during 2008, primarily due to the acquisitions of EdgeTrade and Knight Libertas offset, in part, by the 2008 amortization expense and the writedown of the Direct Trading Institutional trade name. Intangible assets primarily represent client relationships and are being amortized over their remaining useful lives, the majority of which have been determined to range from four to 24 years. The weighted average remaining life of the Company's intangible assets at December 31, 2008 and 2007 is approximately 12 and 16 years, respectively.

In 2008, the Company recorded amortization expense, related to its intangible assets of \$9.4 million. The estimated amortization expense relating to the intangible assets for each of the next five years approximates \$10.8 million in 2009, \$10.6 million in 2010, \$10.4 million in 2011, \$10.1 million in 2012 and \$8.6 million in 2013.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following chart summarizes the Company's Goodwill and Intangible assets, net of accumulated amortization, as of December 31, 2008 and 2007 (in millions):

Goodwill		
December 31,	2008	2007
Purchase of Trimark business	\$ 10.1	\$ 10.1
Purchase of Tradetech business	3.0	3.0
Purchase of Donaldson business	3.6	3.6
Purchase of remaining shares in Knight Roundtable Europe	2.5	2.5
Purchase of Direct Trading business	43.8	43.8
Purchase of Hotspot business	55.7	55.7
Purchase of Knight BondPoint business	14.2	14.2
Purchase of EdgeTrade business	51.7	–
Purchase of Knight Libertas business	47.6	–
Total	\$232.2	\$132.8
Intangible Assets⁽¹⁾		
December 31,	2008	2007
Customer relationships⁽²⁾		
Gross carrying amount	\$ 84.8	\$ 51.9
Accumulated amortization	(15.4)	(9.1)
Net carrying amount	69.4	42.8
Trade names⁽³⁾		
Gross carrying amount	14.5	9.7
Accumulated amortization	(4.1)	(0.9)
Net carrying amount	10.4	8.8
Other⁽⁴⁾		
Gross carrying amount	16.1	9.2
Accumulated amortization	(5.4)	(2.9)
Net carrying amount	10.7	6.3
Total		
Gross carrying amount	115.3	70.8
Accumulated amortization	(24.9)	(13.0)
Net carrying amount	\$ 90.5	\$ 57.8

⁽¹⁾ The weighted average remaining life of the Company's intangible assets at December 31, 2008 is approximately 12 years.

⁽²⁾ Customer relationships primarily relate to the Donaldson, Direct Trading, Hotspot, EdgeTrade and Knight Libertas acquisitions. The weighted average remaining life is approximately 12 years as of December 31, 2008 and 16 years as of December 31, 2007. Lives may be reduced depending upon actual retention rates.

⁽³⁾ Trade names relate to the acquisitions of Donaldson, Hotspot, EdgeTrade and Knight Libertas. The weighted average remaining life is approximately 19 years as of December 31, 2008 and 25 years as of December 31, 2007. During 2008, the Direct Trading Institutional trade name with an unamortized cost of \$2.5 million was written off. During 2007, the ValuBond Securities, Inc. trade name with unamortized cost of \$110,000 was written off. See Footnote 13, "Writedown of Assets and Lease Loss Accrual."

⁽⁴⁾ Other includes technology, non-compete agreements and domain name rights acquired by the Company. The weighted average remaining life is approximately six years as of December 31, 2008 and five years as of December 31, 2007.

Totals may not add due to rounding.

NOTE 9

LONG TERM DEBT

On October 9, 2007, the Company entered into a three-year \$140.0 million credit agreement ("Credit Agreement") with a consortium of banks led by JPMorgan Chase Bank, N.A. ("JPM"). The Credit Agreement includes a three-year delayed-draw senior secured term loan facility of \$70.0 million and a three-year senior secured revolving facility of \$70.0 million. The proceeds of the credit facilities were used to finance share repurchases, finance selective acquisitions and for general corporate purposes. These credit facilities are repayable in full by October 3, 2010. Interest on the credit facilities is paid quarterly.

During the fourth quarter of 2007, the Company borrowed \$70.0 million under the three year delayed-draw senior secured term loan facility. During the second quarter of 2008, the Company borrowed \$70.0 million under the senior secured revolving facility, bringing the total amount borrowed at December 31, 2008 to \$140.0 million.

Under the terms of the Credit Agreement, at the Company's option, it may choose an interest rate based on the JPM Prime Rate or LIBOR rate. The interest and commitment fee rates vary based on changes in certain of the Company's financial covenant ratios. The interest rate can range from the JPM Prime Rate plus 0.25% to 0.50% or London Interbank Offered Rate ("LIBOR") plus 1.25% to 1.50%. The commitment fee can range from 0.30% to 0.35% on the average daily unused portion of the delayed-draw senior secured term loan facility and the senior secured revolving facility.

As of December 31, 2008 the \$140.0 million loan facilities bear interest at 2.78% per annum, which is based on the three month LIBOR rate plus 1.25% and will reset at the lower of the JPM Prime Rate or LIBOR rate prevailing in March 2009. Approximately \$4.8 million and \$132,000 of interest expense was recorded in 2008 and 2007, respectively.

The Company was charged a commitment fee of 0.3% on the unused portion of the credit facilities. For the years ended December 31, 2008 and 2007, the Company recorded commitment fees of approximately \$0.1 million each year, which has been included in Other expenses on the Consolidated Statements of Operations.

Under the Credit Agreement, substantially all of the Company's material subsidiaries, other than its foreign subsidiaries, registered broker-dealer subsidiaries and subsidiaries thereof, guarantee the repayment of loans made pursuant to the credit facilities. Pursuant to the Credit Agreement, the credit facilities have been secured by substantially all of the assets of the Company.

The Credit Agreement includes customary representations, warranties, affirmative and negative covenants (including, among others, limitations on certain payments, investments and transactions) and events of default. It also contains

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

financial covenants tied to the maintenance of financial ratios and metrics. As of December 31, 2008 and 2007, the Company was in compliance with all covenants of the Credit Agreement.

NOTE 10

DIRECT EDGE ECN

Following the close of business on July 23, 2007, Direct Edge Holdings issued 1.33 million LLC units and a warrant to purchase an additional 1.9 million LLC units for \$20 million (the "Warrant") to Citadel in exchange for cash of \$11.7 million. On September 28, 2007 ("the Deconsolidation Date"), Direct Edge Holdings issued an additional 1.9 million LLC units to Citadel in exchange for \$20 million cash upon exercise of the Warrant. Immediately following the September 28, 2007 issuance to Citadel, the Company and Citadel sold a portion of their equity interests (1.2 million units and 1.0 million units, respectively) to Goldman Sachs for \$12.75 million and \$10.5 million cash, respectively.

As a result of Direct Edge Holdings' issuance of equity interest to Citadel, the Company recognized, pursuant to SEC Staff Accounting Bulletin Topic 5-H, a pre-tax non-operating gain from subsidiary stock issuance of \$8.8 million in the third quarter of 2007. The Company also realized a pre-tax gain of \$4.2 million from the sale of a portion of its interest in Direct Edge Holdings to The Goldman Sachs Group, Inc., which is included in Investment (loss) income and other, net for the year ended December 31, 2007. As a result of these transactions, the Company, through one of its non-broker-dealer subsidiaries, owned 38% of the LLC units of Direct Edge Holdings following the Deconsolidation date.

On December 23, 2008, Direct Edge Holdings and the International Securities Exchange Holdings, Inc. ("ISE") completed a transaction through which the ISE Stock Exchange became a wholly owned subsidiary of Direct Edge Holdings and the ISE gained a significant equity stake in Direct Edge Holdings. In conjunction with the closing of this transaction, the Company sold approximately 0.9 million of its 2.8 million Direct Edge Holdings units and its interest in the ISE Stock Exchange to the ISE for cash of \$47.5 million and recognized a pre-tax gain, which is subject to adjustment pending finalization of Direct Edge Holding's purchase accounting, of \$51.6 million of which \$35.7 million is included in Investment (loss) income and other, net and \$15.9 million is reported as Non-operating gain from subsidiary stock issuance. As a result of these transactions, the Company, through one of its non-broker-dealer subsidiaries, reduced its interest in Direct Edge Holdings from approximately 38% to 19.9%.

As Direct Edge was a subsidiary of the Company prior to the Deconsolidation Date, the results of its operations through the Deconsolidation Date are included in the Consolidated Statements of Operations for all periods presented. The Company recorded a minority interest benefit of \$337,000 which represents Citadel's minority interest share of Direct

Edge's pre-tax losses for the period July 24, 2007 through the Deconsolidation Date. This amount has been included within Other expenses on the Consolidated Statements of Operations for this period.

Since the Company no longer controls Direct Edge as of the Deconsolidation Date, it is no longer a consolidated subsidiary. The Company accounts for its investment in Direct Edge under the equity method following the Deconsolidation Date, and such investment is included in Strategic investments on the December 31, 2007 and 2008 Consolidated Statements of Financial Condition.

As required by SEC Regulation S-X, summarized financial information of Direct Edge is as follows (in millions):

December 31,	2008
Total assets	\$197.6
Total liabilities	\$ 27.7
Members' equity	169.9
Total liabilities and Members' equity	\$197.6
For the year ended December 31,	2008
Total revenue	\$392.3
Total expenses	373.3
Net income	\$ 19.1

NOTE 11

STOCK-BASED COMPENSATION

The Company has established the Knight Capital Group, Inc. 1998 Long Term Incentive Plan, the Knight Capital Group, Inc. 1998 Nonemployee Director Stock Option Plan, the Knight Capital Group, Inc. 2003 Equity Incentive Plan and the Knight Capital Group, Inc. 2006 Equity Incentive Plan (the "2006 Plan") (collectively, the "Stock Plans"). The purpose of the Stock Plans is to provide long-term incentive compensation to employees and directors of the Company. The Stock Plans are administered by the Compensation Committee of the Company's Board of Directors, and allow for the grant of options, stock appreciation rights (2006 Plan only), restricted stock and restricted stock units (collectively, the "awards"), as defined by the Stock Plans. The Stock Plans limit the number of awards that may be granted to a single individual as well as limit the amount of options, stock appreciation rights (2006 Plan only) or shares of restricted stock or restricted stock units that may be awarded. As of December 31, 2008, the Company has not issued any stock appreciation rights.

Restricted Awards

Eligible employees and directors receive restricted shares and/or restricted stock units, (collectively "restricted awards") as a portion of their total compensation. The substantial majority of restricted awards generally 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. Restricted awards are otherwise canceled if employment is terminated before the end of the relevant vesting period.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company measures compensation cost related to restricted awards based on the fair value of the Company's common stock at the date of grant, which the Stock Plans define as the average of the high and low sales price on the business day prior to the grant date. In 2008, 2007 and 2006, the Company recorded compensation expense relating to restricted awards of \$31.4 million, \$25.4 million and \$14.0 million, respectively, the majority of which has been included in Employee compensation

and benefits on the Consolidated Statements of Operations. The total income tax benefit recognized on the Consolidated Statements of Operations related to restricted awards was \$12.5 million, \$10.1 million and \$5.6 million in 2008, 2007 and 2006, respectively.

The following table summarizes restricted awards activity in 2008, 2007 and 2006 (awards in thousands):

	2008		2007		2006	
	Number of Awards	Weighted-Average Grant Date Fair Value	Number of Awards	Weighted-Average Grant Date Fair Value	Number of Awards	Weighted-Average Grant Date Fair Value
Outstanding at January 1	3,648.9	\$15.19	2,711.1	\$11.55	3,026.7	\$10.31
Granted	2,567.8	16.32	2,564.4	18.20	1,093.9	13.42
Vested	(2,034.4)	13.73	(1,416.8)	13.86	(995.7)	10.25
Forfeited	(151.3)	14.57	(209.8)	14.06	(413.8)	10.54
Outstanding at December 31	4,031.0	\$16.95	3,648.9	\$15.19	2,711.1	\$11.55

The weighted-average fair value of restricted awards granted in 2008, 2007 and 2006 was \$16.32, \$18.20 and \$13.42, respectively. Based upon the value at date of vest, the cumulative fair value of restricted awards that vested in 2008, 2007 and 2006 was \$33.5 million, \$22.9 million and \$13.3 million, respectively.

There is \$48.7 million of unamortized compensation related to the unvested restricted awards outstanding at December 31, 2008. The cost of these unvested restricted shares is expected to be recognized over a weighted average life of 1.9 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, which the Stock Plans define as the average of the high and low sales price on the business day prior to the grant date. Options generally vest ratably over a three or four-year period and expire on the fifth or tenth anniversary of the grant date, pursuant to the terms of the applicable option award agreement. The Company has the right to fully vest employees in their options upon retirement and in certain other circumstances. Options are otherwise canceled if employment is terminated before the end of the relevant vesting period. The Company's policy is to issue new shares upon share option exercises by its employees.

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 historical 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. Based on the results of the model, the weighted-average fair value of the stock options granted in 2008, 2007 and 2006 was \$5.45, \$6.09 and \$4.63, respectively. The weighted-average assumptions used were as follows in 2008, 2007 and 2006:

	2008	2007	2006
Dividend yield	0.0%	0.0%	0.0%
Expected volatility	40.0%	40.0%	40.0%
Risk-free interest rate	2.6%	4.3%	4.7%
Expected life (in years)	3.5	3.5	3.5

The Company recorded compensation expense relating to options of \$3.1 million, \$5.7 million and \$6.8 million in 2008, 2007 and 2006, respectively, all of which was recorded in Employee compensation and benefits on the Consolidated Statements of Operations. The total income tax benefit recognized on the Consolidated Statements of Operations related to stock options was \$1.3 million, \$2.3 million and \$2.7 million in 2008, 2007 and 2006, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes stock option activity and stock options exercisable in 2008, 2007 and 2006 (options in thousands):

	Number of Stock Options	Weighted- Average Exercise Price	Aggregate Intrinsic Value (in millions)	Weighted- Average Remaining Life (years)
2006				
Outstanding at January 1,	13,283.8	\$ 8.26		
Granted at market value	1,161.0	13.24		
Exercised	(4,522.9)	5.92		
Forfeited or expired	(1,092.7)	13.80		
Outstanding at December 31,	8,829.2	\$ 9.43	\$92.5	4.93
Vested at December 31,	5,404.5	\$ 8.61	\$62.8	2.94
Available for future grants at December 31,*	13,967.2			
2007				
Outstanding at January 1,	8,829.2	\$ 9.43		
Granted at market value	609.8	17.39		
Exercised	(3,487.3)	6.05		
Forfeited or expired	(236.1)	13.82		
Outstanding at December 31,	5,715.7	\$12.16	\$21.0	6.28
Vested at December 31,	3,355.5	\$12.11	\$19.7	6.17
Available for future grants at December 31,*	11,672.1			
2008				
Outstanding at January 1,	5,715.7	\$12.16		
Granted at market value	312.5	16.88		
Exercised	(1,186.8)	8.82		
Forfeited or expired	(93.1)	11.16		
Outstanding at December 31,	4,748.3	\$13.32	\$19.2	5.93
Vested at December 31,	3,697.1	\$12.60	\$18.0	5.51
Available for future grants at December 31,*	9,838.2			

*Represents both options and awards available for grant

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Outstanding at 12/31/08	Weighted- Average Remaining Contractual Life	Weighted- Average Exercise Price	Number Exercisable at 12/31/08	Weighted- Average Exercise Price
\$ 4.57-\$ 9.52	839.3	6.18	\$ 8.16	839.3	\$ 8.16
\$ 9.81-\$ 9.90	910.0	4.57	9.86	793.3	9.86
\$10.24-\$10.30	813.2	5.86	10.24	813.2	10.24
\$10.30-\$16.32	869.5	6.60	13.37	626.8	13.11
\$16.43-\$17.97	1,004.8	7.99	17.42	344.6	17.42
\$18.91-\$71.38	311.5	0.92	32.04	279.8	33.51

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. The total intrinsic value of options exercised in 2008, 2007 and 2006 was \$9.8 million, \$37.9 million and \$46.1 million, respectively. Cash received from the exercise of stock options in 2008 totaled \$10.4 million.

There is \$3.1 million of unrecognized compensation related to the unvested stock options outstanding at December 31, 2008. The cost of these unvested awards is expected to be recognized over a weighted average life of 1.3 years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12

EMPLOYEE BENEFIT PLAN

The Company sponsors a 401(k) profit sharing plan (the "Plan") in which substantially all of its employees are eligible to participate. Under the terms of the Plan, the Company is required to make annual contributions to the Plan equal to 100% of the contributions made by its employees, up to annual limits. The total expense, from continuing operations, recognized with respect to the Plan and included in Employee compensation and benefits on the Consolidated Statements of Operations, was as follows (in millions):

For the years ended December 31,

2008	\$4.9
2007	4.4
2006	4.1

NOTE 13

WRITEDOWN OF ASSETS AND LEASE LOSS ACCRUAL

The Writedown of assets and lease loss accrual, net during 2008, 2007 and 2006 was \$1.2 million, (\$2.5 million), and \$8.5 million, respectively. The charge in 2008 was primarily related to the Company's decision to discontinue the use of the Direct Trading Institutional trade name, offset by a benefit related to an adjustment of a previously recognized lease loss with respect to the Company's 545 Washington Boulevard property in Jersey City, N.J.

The benefit in 2007 was primarily related to an adjustment of previously recognized lease losses with respect to the Company's 545 Washington Boulevard property in Jersey City, N.J. During 2007, the Company entered into two sub-lease agreements for a portion of the premises for which it had previously recorded a lease loss accrual. The lease loss accrual was adjusted based on the difference between the actual terms of the sub-leases and the assumptions previously used in the calculation of the lease loss accrual.

The charges in 2006 primarily related to costs associated with excess real estate capacity at the Company's 545 Washington Boulevard facility in Jersey City, N.J.

NOTE 14

DISCONTINUED OPERATIONS AND REGULATORY CHARGES AND RELATED MATTERS

The Company completed the sale of its Derivative Markets business to Citigroup in December 2004. In accordance with SFAS 144, the results of the Derivative Markets operating segment, the revenues and expenses associated with these businesses as well as all costs associated with the sale transaction have been included in Loss from discontinued operations, net of tax on the Consolidated Statements of Operations for all periods presented.

In 2006, the Company received a request from the staff of the SEC for voluntary production of certain documentation related to options activities of its former Derivative Markets operating segment which, prior to its sale by the Company in December 2004, was primarily operated through Knight Financial Products LLC. The Company believes this request is part of a broader review by the staff of the SEC regarding certain trading practices in the options industry during the period from 1999 to 2005. The Company responded to this request and is cooperating with the staff of the SEC and certain regional exchanges to resolve this matter. During 2007, the Company recorded a pre-tax charge of \$2.1 million (\$1.4 million, net of tax) relating to this matter. The charge of \$1.4 million has been reported in Loss from discontinued operations, net of tax on the Consolidated Statements of Operations. There were no further updates on this matter in 2008.

NOTE 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 income tax returns.

The provision for income taxes from continuing operations consists of (in millions):

	2008	2007	2006
Current:			
U.S. federal	\$ 94.8	\$ 73.4	\$106.6
U.S. state and local	25.3	13.1	7.9
Non U.S.	3.2	4.4	7.4
	123.3	90.9	121.9
Deferred:			
U.S. federal	4.4	(12.5)	(27.0)
U.S. state and local	2.5	(0.7)	3.2
Non U.S.	0.0	(0.1)	0.1
	6.9	(13.3)	(23.7)
Provision for income taxes	\$130.2	\$ 77.6	\$ 98.2

The preceding table does not reflect the tax effects of unrealized gains on available for sale securities, which was recorded directly in Stockholders' equity. Stockholders' equity decreased by \$7.1 million in 2005, as a result of the tax effects of unrealized gains on available for sale securities and increased by \$7.1 million in 2006 as such securities were sold. These tax effects are reported in the Consolidated Statements of Changes in Stockholders' Equity as a component of Accumulated other comprehensive income, net of tax.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table reconciles income tax expense from continuing operations at the U.S. federal statutory rate to the Company's Income tax expense (in millions):

	2008	2007	2006
U.S. federal income tax expense at statutory rate	\$110.0	\$70.4	\$89.8
U.S. state and local income tax expense (benefit), net of U.S. federal income tax effect	18.1	8.1	7.2
Non U.S.	1.0	0.6	–
Nondeductible charges	3.3	0.6	0.5
Other, net	(2.2)	(2.1)	0.7
Income tax expense	\$130.2	\$77.6	\$98.2

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. Significant components of the Company's deferred tax assets and liabilities at December 31, 2008 and 2007 are as follows (in millions):

	2008	2007
Deferred tax assets:		
Employee compensation and benefit plans	\$ 45.6	\$ 48.0
Fixed assets and other amortizable assets	3.5	3.0
Reserves	6.1	10.3
Valuation of investments	5.5	1.8
Net operating loss carryforwards	41.3	40.7
Less: Valuation allowance on net operating loss carryforwards	(41.3)	(40.1)
Total Deferred tax assets	60.7	63.7
Deferred tax liabilities		
Fixed assets and other amortizable assets	19.2	14.0
Valuation of investments	8.3	2.7
Total deferred tax liabilities	27.5	16.7
Net deferred tax assets	\$ 33.2	\$ 47.0

At December 31, 2008, the Company had U.S. federal net operating loss carryforwards, resulting from acquisitions, of \$35.0 million. The Company recorded a related deferred tax asset of \$12.3 million as of December 31, 2008, and an offsetting valuation allowance as these net operating loss carryforwards are considered more likely than not to expire unutilized. These carryforwards are subject to annual limitations on utilization and will begin to expire in 2019.

At December 31, 2008, the Company had state net operating loss carryforwards of \$97.8 million of which \$33.5 million resulted from acquisitions. The Company recorded a related deferred tax asset of \$5.6 million as of December 31, 2008, and an offsetting valuation allowance as these net operating

loss carryforwards are considered more likely than not to expire unutilized. Certain of these carryforwards are subject to annual limitations on utilization and will begin to expire in 2011.

At December 31, 2008, the Company had U.K. net operating loss carryforwards of \$78.0 million. The Company recorded a related deferred tax asset of \$23.4 million as of December 31, 2008, and an offsetting valuation allowance as these net operating loss carryforwards are considered more likely than not to remain unutilized. These net operating losses may be carried forward indefinitely.

Effective January 1, 2007, the Company adopted FIN 48. The Company recognized no material adjustment in the liability for unrecognized income tax benefits as a result of the implementation of FIN 48. At the adoption date of January 1, 2007 and at December 31, 2008, the Company had \$0.9 million of unrecognized tax benefits, all of which would impact the Company's effective tax rate if recognized.

As of December 31, 2008, the Company is subject to U.S. federal income tax examinations for the tax years 2005 and 2007, and to non-U.S. income tax examinations for the tax years 2002 through 2007. In addition, the Company is subject to state and local income tax examinations in various jurisdictions for the tax years 2000 through 2007. 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 from continuing operations before income taxes and minority interest. Penalties are recorded in Other expenses, interest paid is recorded as Interest expense and interest received is recorded in Interest, net on the Consolidated Statements of Operations.

NOTE 16

EARNINGS PER SHARE

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations for 2008, 2007 and 2006 (in millions, except per share data):

For the years ended December 31,	2008		2007		2006	
	Numerator/ Net Income	Denominator/ Shares	Numerator/ Net Income	Denominator/ Shares	Numerator/ Net Income	Denominator/ Shares
Income and shares used in basic calculations	\$177.9	88.4	\$122.2	97.1	\$158.3	101.4
Effect of dilutive stock based awards	–	3.4	–	3.7	–	4.8
Income and shares used in diluted calculations	\$177.9	91.8	\$122.2	100.8	\$158.3	106.2
Basic earnings per share		\$2.01		\$1.26		\$1.56
Diluted earnings per share		\$1.94		\$1.21		\$1.49

The above calculations exclude options that could potentially dilute EPS in the future but were antidilutive for the periods presented. The number of such options excluded was approximately 1.4 million, 1.1 million and 0.5 million in 2008, 2007 and 2006, respectively.

NOTE 17

COMPREHENSIVE INCOME

Comprehensive income includes net income and changes in equity except those resulting from investments by, or distributions to, stockholders. Comprehensive income is as follows (in millions):

For the years ended December 31,	2008	2007	2006
Net income	\$177.9	\$122.2	\$158.3
Other comprehensive income, net of tax:			
Realization of gains on sales of investment securities held as available-for-sale	–	–	(10.3)
Total comprehensive income, net of tax	\$177.9	\$122.2	\$148.0

Other comprehensive income, net of tax, represents net unrealized gains on the Company's strategic investment in the ISE at December 31, 2005 and the subsequent realization of such gains in 2006.

NOTE 18

SIGNIFICANT CLIENTS AND INVESTORS

The Company considers significant clients to be those clients who account for 10% or more of the total U.S. equity dollar value traded by the Company during the period. No client accounted for more than 10% of the total U.S. equity dollar value traded during 2008 and 2007. One client accounted for approximately 10.9% of the Company's U.S. equity dollar value traded during 2006.

The Company considers significant investors to be those investors who account for 10% or more of assets under management in the Deephaven Funds. Two investors each accounted for more than 10% of the Deephaven Funds' asset under management as of December 31, 2008. One investor accounted for more than 10% of the Deephaven Funds' asset under management as of December 31, 2007.

NOTE 19

DEEPHAVEN TRANSACTION

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

Effective January 1, 2007, the Deephaven Managers were also granted an option (the "Option"), exercisable after January 1, 2008 and until December 31, 2012, and conditioned on meeting certain requirements, to obtain a 49% interest in Deephaven Holdings, to which the Company's interests in Deephaven would be contributed in exchange for the termination of their new employment agreements and associated profit-sharing bonuses. The agreement also provided that in

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

the event of a change of control of the Company prior to December 31, 2012, the Deephaven Managers would have the option (the "Change of Control Option"), in exchange for the termination of their 2006 Employment Agreements and associated profit-sharing bonuses, to obtain a 51% interest in Deephaven Holdings or, if the Option had already been exercised, to increase their 49% interest resulting from the exercise of the Option by an additional 2%. Following any exercise of the Option or Change of Control Option by the Deephaven Managers, pre-tax earnings prior to profit sharing would be allocated between Knight and the Deephaven Managers in the same manner as under the 2006 Employment Agreements.

Exercise of Option by Deephaven Managers

On January 10, 2008, Deephaven Managing Partners, LLC ("Deephaven Partners"), an entity owned and controlled by the Deephaven Managers, provided notice to the Company that it was exercising the Option.

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

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

Minority interest expense of \$6.2 million in 2008 represents the accrual for the one-time 2008 minimum distribution to the Deephaven Managers pursuant to the New LLC Agreement.

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

See Footnote 20 "Commitments and Contingent Liabilities" for a discussion of the closing of the Deephaven Event Fund. Also, see Footnote 25 "Subsequent Events" for discussion of the Company's plan to exit from the Asset Management business.

NOTE 20

COMMITMENTS AND CONTINGENT LIABILITIES

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. The results of these matters cannot be predicted with certainty, and the Company cannot estimate a possible range of loss for these matters at this time. 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 described in Footnote 2 "Significant Accounting Policies," if a Deephaven fund which has a six-month performance period incurs losses in the performance period ended December 31, the Company may make the determination, at its sole discretion, to return all or a portion of incentive allocation fees collected for the prior six-month performance period ending June 30 of that year.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Based upon market conditions and industry practice, in August 2007, the Company, at its sole discretion, made the determination that if a Deephaven fund with a six-month performance period incurred losses in the performance period ending December 31, 2007, Deephaven would return all or a portion of the incentive allocation fees collected from investors in that fund for the six-month performance period ended June 30, 2007. Of the \$68.4 million of incentive allocation fees recorded for the six-month period ended June 30, 2007, Deephaven repaid approximately \$19.0 million in the fourth quarter of 2007.

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 \$11.9 million, \$9.1 million and \$8.6 million in 2008, 2007 and 2006, respectively, and is included in Occupancy and equipment rentals on the Consolidated Statements of Operations. The Company has sublet a portion of its excess office space to third parties.

The Company leases certain computer and other equipment under noncancelable operating leases and has entered into guaranteed employment contracts with certain of its employees. As of December 31, 2008, 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 millions):

Lease & Contract Obligations

	Gross Lease Obligations	Sublease Income	Net Lease Obligations	Other Obligations
Year ending December 31, 2009	\$ 16.8	\$1.0	\$ 15.8	\$ 6.3
Year ending December 31, 2010	17.1	0.9	16.1	2.9
Year ending December 31, 2011	17.4	0.9	16.4	0.8
Year ending December 31, 2012	17.4	1.0	16.4	0.8
Year ending December 31, 2013	15.6	1.1	14.6	—
Thereafter through October 31, 2021	102.8	4.9	97.9	—
	\$187.1	\$9.9	\$177.2	\$10.6

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. As of December 31, 2008, the Company has provided a letter of credit for \$4.1 million, collateralized by U.S. Treasury Bills, as a guarantee for one of the Company's lease obligations.

Closing of Deephaven Event Fund

On January 31, 2008, Deephaven announced that it had concluded that it is in the best interests of investors in the Deephaven Event Fund LLC and the Deephaven Event Fund Ltd. (collectively, the "Event Fund") that the Event Fund return investors' capital. As a result, redemptions in the Event Fund were suspended with immediate effect and Deephaven began an orderly process to reduce trading positions to cash and return investors' capital as promptly as reasonably practicable. As of February 1, 2008, and through the period of time Deephaven is returning investors' capital, no management or incentive allocation fee will be charged to investors in the Event Fund.

NOTE 21

NET CAPITAL REQUIREMENTS

The Company's U.S. registered broker-dealers are subject to the SEC's Uniform Net Capital Rule, which requires the maintenance of minimum net capital. As of December 31, 2008, all of the Company's broker-dealer subsidiaries were in compliance with their capital adequacy requirements. The following table

sets forth the net capital levels and requirements for the following significant U.S. registered broker-dealer subsidiaries at December 31, 2008 as filed in their respective regulatory filings (in millions):

Entity	Net Capital	Net Capital Requirement	Excess Net Capital
KEM	\$125.5	\$9.5	\$115.9
KCM	157.2	1.2	155.9
Knight Direct	20.6	0.9	19.6
Knight Libertas	7.9	0.7	7.2

In addition, the Company's foreign registered broker-dealers are subject to certain financial resource requirements of the FSA and SFC. The following table sets forth the financial resource requirement for the following significant foreign regulated broker-dealer at December 31, 2008 (in millions):

Entity	Financial Resources	Resource Requirement	Excess Financial Resources
KEMIL	\$34.7	\$13.7	\$21.0

NOTE 22

FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK AND CONCENTRATIONS OF CREDIT RISK

As a market-maker of equities, the majority of the Company's securities transactions are conducted as principal or riskless principal with broker-dealer and institutional counterparties primarily located in the United States. The Company clears the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

majority of its securities transactions through clearing brokers. Foreign transactions are settled pursuant to a global custody and clearing agreement with a major U.S. bank. Substantially all of the Company's credit exposures are concentrated with its clearing brokers and the bank (the "clearing agents"). These clearing agents may re-hypothecate certain securities held on behalf of the Company. Additionally, pursuant to the terms of the agreements between the Company and the clearing agents, the clearing agents have the right to charge the Company for all losses that result from a counterparty's failure to fulfill its contractual obligations. The Company has the ability to pursue collection from or performance with regard to this right. The Company's policy is to monitor the credit standing of the clearing agents and all counterparties with which it conducts business.

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

Securities sold, not yet purchased 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.

During the normal course of business, the Company may enter into certain 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. As of December 31, 2008, the Company was a party to futures contracts having a notional value of \$51.1 million and a fair value of \$124,000, which is recorded in Receivable from brokers and dealers on the Consolidated Statements of Financial Condition, net of cash collateral, with realized and unrealized gains and losses recognized in Net trading revenue on the Consolidated Statements of Operations.

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

NOTE 23

ACQUISITIONS

EdgeTrade

On January 14, 2008, the Company completed the acquisition of EdgeTrade for \$58.2 million comprised of \$28.2 million in cash and approximately 2.3 million shares of unregistered Knight common stock valued at \$30.0 million. Goodwill and intangible assets recognized upon the closing of the transaction amounted to \$69.0 million. None of the goodwill is expected to be deductible for tax purposes.

In August 2008, the business of EdgeTrade, an agency-only trade execution and algorithmic software firm that allows buy- and sell-side clients to more effectively source liquidity and manage the trading process as well as maintain anonymity, reduce market impact and lower transaction costs, merged into Knight Direct. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed (in millions):

Agreed purchase price	\$ 59.5
Adjustment for working capital	(2.0)
Adjusted purchase price	57.5
Acquisition costs	0.7
Purchase of business	<u>\$ 58.2</u>
Cash	\$ 1.0
Goodwill	51.7
Intangible assets	17.3
Other assets	3.9
Accrued expenses and other liabilities	(15.7)
Purchase of business	<u>\$ 58.2</u>

Knight Libertas

On July 11, 2008, the Company acquired Libertas Holdings LLC and its subsidiaries, a boutique institutional fixed income brokerage firm, for \$50.3 million in cash and approximately 1.5 million shares of unregistered Knight common stock valued at \$25.0 million. The terms of the agreement include a potential earn-out of up to \$75.0 million of unregistered Knight common stock based on the future performance of Knight Libertas during the three-year period following the closing of the transaction. Goodwill and intangible assets recognized upon the closing of the transaction amounted to \$73.8 million. The majority of goodwill is expected to be deductible for tax purposes.

Knight Libertas is a riskless principal fixed income broker-dealer specializing in high-yield and high-grade corporate bonds, distressed debt, asset- and mortgage-backed securities, convertible bonds and syndicated loans. Knight Libertas provides clients with proprietary research reports on companies and target sectors. Upon acquisition, Libertas Holdings LLC was renamed Knight Libertas Holdings LLC and its U.S. broker-dealer subsidiary was renamed Knight Libertas LLC (together with its affiliates, "Knight Libertas"). The following table summarizes the estimated fair values of the assets acquired and liabilities assumed (in millions):

Agreed purchase price	\$75.2
Adjustment for working capital	(0.7)
Adjusted purchase price	74.5
Acquisition costs	0.8
Purchase of business	<u>\$75.3</u>
Cash	\$ 1.3
Goodwill	47.6
Intangible assets	26.2
Other assets	5.5
Accrued expenses and other liabilities	(5.3)
Purchase of business	<u>\$75.3</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 24

BUSINESS SEGMENTS

The Company currently has three operating segments, Global Markets, Asset Management and Corporate. The Global Markets segment provides market access and trade execution services in nearly every U.S. equity security and a large number of international securities, fixed income, foreign exchange, futures and options. The Asset Management segment consists of the Company's 51% ownership interest in Deephaven Holdings, which owns Deephaven, the investment manager and sponsor of the Deephaven Funds. The Corporate segment includes all

corporate investment income earned on strategic investments, the Company's corporate investment as a limited partner or non-managing member in the Deephaven Funds and corporate overhead expenses. Corporate overhead expenses primarily consist of compensation for certain senior executives and other individuals employed at the corporate holding company, legal and other professional expenses relating to corporate matters, directors' fees, investor and public relations expenses and directors' and officers' insurance.

The Company's revenues, income (loss) from continuing operations before income taxes and minority interest ("Pre-tax earnings") and total assets by segment are summarized below (in millions):

	Global Markets	Asset Management	Corporate	Consolidated Total
For the year ended December 31, 2008:				
Revenues	\$ 998.5	\$ 33.3	\$ 1.1	\$1,032.9
Pre-tax earnings ⁽¹⁾	357.5	(19.4)	(23.8)	314.3
Total assets	1,867.9	73.6	73.1	2,014.6
For the year ended December 31, 2007:				
Revenues	\$ 739.9	\$118.2	\$ 27.1	\$ 885.2
Pre-tax earnings	180.4	16.5	4.3	201.2
Total assets	1,435.6	170.8	149.5	1,755.8
For the year ended December 31, 2006:				
Revenues	\$ 657.6	\$214.9	\$ 66.9	\$ 939.5
Pre-tax earnings	150.3	74.8	31.4	256.5
Total assets	1,672.8	199.1	156.3	2,028.2

Totals may not add due to roundings.

⁽¹⁾ Asset Management excludes \$6.2 million in Minority interest expense relating to the one-time minimum distribution for the year ended December 31, 2008.

NOTE 25

SUBSEQUENT EVENTS

Deephaven Asset Sale

As disclosed in a Form 8-K furnished by the Company on January 27, 2009, Deephaven announced that it entered into an Asset Purchase Agreement ("Purchase Agreement") along with Stark & Roth, Inc. (together with its affiliates, "Stark"), Deephaven Partners, the Company and each of the Deephaven Managers, pursuant to which Deephaven has agreed to sell substantially all of its assets to Stark, and Stark will assume certain limited liabilities of Deephaven.

As consideration for the sale, Deephaven could receive: (i) a payment of up to \$7.3 million on the closing date of the transaction, (ii) deferred payments of up to an additional \$20.7 million to be paid between the closing date and 2011, and (iii) an additional payment in 2011 of up to \$16.7 million based upon the investment return of certain assets being managed by Stark over the two year period following the closing of the transaction.

Each of these payments (collectively the "Purchase Price") is subject to *pro rata* reduction to the extent that investors in the Deephaven Global Multi-Strategy Fund ("GMS Fund") representing less than \$1.4 billion in assets elect to have Stark continue to manage their investment on an on-going basis.

It is currently expected that this formula-based reduction to the three components of the Purchase Price may be significant. In addition, the Purchase Price is subject to certain offsets. The closing of the transaction is subject to customary conditions, including approval of the GMS Fund investors as further described in the January 27, 2009 Form 8-K.

On February 20, 2009, Deephaven committed to begin the process of a wind-down of their business in contemplation of the Stark transaction. On this date, Deephaven began reducing their workforce by 20 employees, representing approximately 15% of their total workforce. Additional workforce reductions are expected during the first half of 2009.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 26

CONDENSED FINANCIAL STATEMENTS OF KNIGHT CAPITAL GROUP, INC. (PARENT ONLY)

Presented below are the Condensed Statements of Financial Condition, Operations and Cash Flows for the Company on an unconsolidated basis.

STATEMENTS OF FINANCIAL CONDITION KNIGHT CAPITAL GROUP, INC. (PARENT ONLY)

December 31, (in thousands)	2008	2007
Assets		
Cash and cash equivalents	\$ 64,619	\$ 43,759
Securities owned, at fair value	6,721	6,400
Investments in subsidiaries, equity method	1,098,546	831,591
Fixed assets and leasehold improvements, at cost, less accumulated depreciation and amortization of \$349 in 2008 and \$132 in 2007	537	191
Investments in Deephaven sponsored funds	47,152	83,732
Receivable from Deephaven sponsored funds	–	85,000
Strategic investments	50,029	54,603
Other assets	60,956	29,209
Total assets	\$1,328,560	\$1,134,485
Liabilities and Stockholders' Equity		
Liabilities		
Accrued compensation expense	\$ 57,419	\$ 21,710
Accrued expenses and other liabilities	2,815	10,094
Payable to subsidiaries	75,897	123,276
Income taxes payable	25,071	24,027
Long term debt	140,000	70,000
Total liabilities	301,202	249,107
Total stockholders' equity	1,027,358	885,378
Total liabilities and stockholders' equity	\$1,328,560	\$1,134,485

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

STATEMENTS OF OPERATIONS KNIGHT CAPITAL GROUP, INC. (PARENT ONLY)

For the years ended December 31, (in thousands)	2008	2007	2006
Revenues			
Corporate management fees	\$ 28,000	\$ 28,165	\$ 28,000
Investment income and other, net	(40,092)	22,631	14,975
Total revenues	(12,092)	50,796	42,975
Expenses			
Compensation expense	21,599	20,505	20,915
Professional fees	8,333	6,492	10,161
Business development	849	432	597
Interest expense	5,008	161	281
Other	5,010	3,815	3,785
Total expenses	40,799	31,405	35,739
(Loss) income before income taxes and equity in earnings of subsidiaries	(52,891)	19,391	7,236
Income tax (benefit) expense	(14,233)	5,062	444
(Loss) income before equity in earnings of subsidiaries	(38,658)	14,329	6,792
Equity in earnings of subsidiaries	216,569	107,911	151,554
Net income	\$177,911	\$122,240	\$158,346

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

STATEMENTS OF CASH FLOWS KNIGHT CAPITAL GROUP, INC. (PARENT ONLY)

For the years ended December 31,	2008	2007	2006
(in thousands)			
Cash flows from operating activities			
Net income	\$ 177,911	\$ 122,240	\$ 158,346
Adjustments to reconcile net income to net cash (used in) provided by operating activities			
Equity in earnings of subsidiaries	(216,569)	(107,911)	(151,554)
Depreciation and amortization	651	239	71
Stock-based compensation	5,310	4,539	3,998
Unrealized loss (gain) on investments in Deephaven sponsored funds	28,195	(17,786)	(12,669)
Realized (gain) on strategic investments	(1,547)	—	—
Unrealized loss (gain) on strategic investments	13,288	(688)	1,119
(Increase) decrease in operating assets			
Securities owned	(321)	(57)	2,013
Other assets	(32,185)	(7,314)	(3,790)
Increase (decrease) in operating liabilities			
Accrued compensation expense	35,709	396	8,406
Accrued expenses and other liabilities	(7,279)	6,921	568
Payable to subsidiaries	(18,200)	55,612	20,296
Income taxes payable	1,044	4,865	(5,746)
Net cash (used in) provided by operating activities	(13,993)	61,056	21,058
Cash flows from investing activities			
Purchases of fixed assets and leasehold improvements	(562)	(14)	(310)
Redemptions in Deephaven sponsored funds	93,385	35,000	19,575
Investment in Deephaven sponsored funds	—	—	(1,310)
Proceeds from sale of strategic investments	6,275	5,534	—
Purchases of strategic investments	(13,442)	(10,400)	(38,750)
Dividends received from subsidiaries	123,503	129,324	250,514
Capital contributions to subsidiaries	(122,554)	(21,252)	(235,735)
Net cash provided by (used in) investing activities	86,605	138,192	(6,016)
Cash flows from financing activities			
Stock options exercised	10,360	21,075	26,787
Income tax benefit on stock awards exercised	6,117	15,172	19,405
Proceeds from long term debt borrowing	70,000	70,000	—
Cost of common stock repurchased	(138,229)	(266,643)	(75,959)
Net cash used in financing activities	(51,752)	(160,396)	(29,767)
Increase (decrease) in cash and cash equivalents	20,860	38,852	(14,725)
Cash and cash equivalents at beginning of the year	43,759	4,907	19,632
Cash and cash equivalents at end of the year	\$ 64,619	\$ 43,759	\$ 4,907
Supplemental disclosure of cash flow information:			
Cash paid for interest	\$ 5,008	\$ 97	\$ 408
Cash paid for income taxes	\$ 112,749	\$ 66,826	\$ 102,747

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

NOTES TO CONDENSED FINANCIAL STATEMENTS KNIGHT CAPITAL GROUP, INC. (PARENT ONLY)

A. General

The condensed financial statements of Knight Capital Group, Inc. (parent only; the "Parent Company") should be read in conjunction with the Consolidated Financial Statements of the Company and the notes thereto.

B. Income Taxes

As stated in Footnote 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 income tax returns. As such, both federal and state income taxes attributable to subsidiaries are accrued at the subsidiary level and are therefore, included in Equity in earnings of subsidiaries on the Condensed Financial Statements. Income tax (benefit) expense included on the Parent Company's Condensed Statements of Operations represents only the income taxes attributable to the Parent Company.