JEFFERIES GROUP INC /DE/
Form 10-Q
May 07, 2010

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

FORM 10-Q

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

For the quarterly period ended March 31, 2010

OR

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

For the transition period from __________ to

Commission file number 1-14947

JEFFERIES GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	95-4719745
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
520 Madison Avenue, 10th Floor, New York, New York	10022
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: (212) 284-2550

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

Indicate the number of shares outstanding of the registrant s class of common stock, as of the latest practicable date. 171,690,186 shares as of the close of business April 28, 2010.

JEFFERIES GROUP, INC. AND SUBSIDIARIES
INDEX TO QUARTERLY REPORT ON FORM 10-Q
MARCH 31, 2010

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
JEFFERIES GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (UNAUDITED)
(Dollars in thousands, except per share amounts)

	March 31, 2010 (1)	December 31, 2009
ASSETS		
Cash and cash equivalents (including $138,429 from VIEs)	$ 1,028,903	$ 1,853,167
Cash and securities segregated and on deposit for regulatory purposes or deposited with clearing and depository organizations	1,328,194	1,089,803
Financial instruments owned, at fair value, including securities pledged to creditors of $9,060,962 and $5,623,345 in 2010 and 2009, respectively:		
Corporate equity securities (including $101,690 from VIEs)	1,854,113	1,500,042
Corporate debt securities (including $615,562 from VIEs)	3,355,418	2,421,704
Government, federal agency and other sovereign obligations	3,509,456	1,762,643
Mortgage- and asset-backed securities (including $31,624 from VIEs)	3,584,910	3,079,865
Loans and other receivables (including $368,302 from VIEs)	481,899	591,208
Derivatives (including $2,172 from VIEs)	38,952	62,117
Investments, at fair value (including $15,294 from VIEs)	70,854	70,156
Total financial instruments owned, at fair value (including $1,134,644 from VIEs)	12,895,602	9,487,735
Investments in managed funds	121,180	115,774
Other investments	206,059	193,628
Securities borrowed	8,246,352	8,237,998
Securities purchased under agreements to resell	4,625,081	3,515,247
Securities received as collateral	34,727	68,494
Receivables:		
Brokers, dealers and clearing organizations (including $317,494 from VIEs)	2,071,042	1,504,480
Customers (including $114 from VIEs)	1,198,288	1,020,480
Fees, interest and other	126,336	108,749
Premises and equipment	137,472	140,132
Goodwill	364,135	364,795
Other assets (including $107 from VIEs)	529,104	488,789
Total assets (including $1,590,788 from VIEs)	$ 32,912,475	$ 28,189,271

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (UNAUDITED) CONTINUED
(Dollars in thousands, except per share amounts)

	March 31, 2010 (1)	December 31, 2009
LIABILITIES AND STOCKHOLDERS EQUITY		
Financial instruments sold, not yet purchased, at fair value:		
Corporate equity securities (including $37,416 from VIEs)	$ 1,780,182	$ 1,360,528
Corporate debt securities (including $458,230 from VIEs)	2,518,190	1,909,781
Government, federal agency and other sovereign obligations	2,636,956	1,735,861
Mortgage- and asset-backed securities	12,060	21,474
Loans (including $321,311 from VIEs)	353,063	363,080
Derivatives (including $561 from VIEs)	23,673	18,427
Total financial instruments sold, not yet purchaed, at fair value (including $817,518 from VIEs)	7,324,124	5,409,151
Securities loaned	3,414,947	3,592,836
Securities sold under agreements to repurchase	10,504,523	8,239,117
Obligation to return securities received as collateral	34,727	68,494
Payables:		
Brokers, dealers and clearing organizations (including $250,346 from VIEs)	1,834,629	889,687
Customers	3,381,557	3,246,485
Accrued expenses and other liabilities (including $2,255 from VIEs)	597,245	941,210
	27,091,752	22,386,980
Long-term debt	2,730,379	2,729,117
Mandatorily redeemable convertible preferred stock	125,000	125,000
Mandatorily redeemable preferred interest of consolidated subsidiaries (including $320,058 from VIEs)	320,058	318,047
Total liabilities (including $1,390,177 from VIEs)	30,267,189	25,559,144
STOCKHOLDERS EQUITY		
Common stock, $.0001 par value. Authorized 500,000,000 shares; issued 196,536,929 shares in 2010 and 187,855,347 shares in 2009	20	19
Additional paid-in capital	2,067,144	2,036,087
Retained earnings	757,126	698,488
Less:		
Treasury stock, at cost, 24,691,756 shares in 2010 and 22,217,793 shares in 2009	(447,600)	(384,379)
Accumulated other comprehensive loss:		
Currency translation adjustments	(52,487)	(34,369)
Additional minimum pension liability	(7,257)	(7,257)
Total accumulated other comprehensive loss	(59,744)	(41,626)
Total common stockholders equity	2,316,946	2,308,589
Noncontrolling interests	328,340	321,538

Total stockholders equity	2,645,286	2,630,127
Total liabilities and stockholders equity	$ 32,912,475	$ 28,189,271

(1) Upon adoption of accounting changes described in ASC 810 effective January 1, 2010, we are required to separately identify the amounts included in our assets and liabilities that are attributed to consolidated variable interest entities (VIEs). We have chosen to present these amounts parenthetically in the financial statement line item for assets and liabilities at March 31, 2010. No comparative separate identification has been provided for assets and liabilities of consolidated VIEs at December 31, 2009.

See accompanying unaudited notes to consolidated financial statements.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS (Unaudited)
(In thousands, except per share amounts)

	Three Months Ended March 31, 2010	March 31, 2009
Revenues:		
Commissions	$ 134,438	$ 131,820
Principal transactions	152,546	122,376
Investment banking	198,337	37,086
Asset management fees and investment income (loss) from managed funds	6,599	(37)
Interest	150,020	102,087
Other	16,679	12,572
Total revenues	658,619	405,904
Interest expense	75,377	63,947
Net revenues	583,242	341,957
Interest on mandatorily redeemable preferred interest of consolidated subsidiaries	2,048	(5,303)
Net revenues, less mandatorily redeemable preferred interest	581,194	347,260
Non-interest expenses:		
Compensation and benefits	319,801	213,381
Floor brokerage and clearing fees	30,730	13,702
Technology and communications	40,210	30,785
Occupancy and equipment rental	19,706	16,296
Business development	13,361	9,445
Professional services	14,423	10,220
Other	17,413	4,249
Total non-interest expenses	455,644	298,078
Earnings before income taxes	125,550	49,182
Income tax expense	47,541	16,756
Net earnings	78,009	32,426
Net earnings (loss) to noncontrolling interests	3,943	(5,911)
Net earnings to common shareholders	$ 74,066	$ 38,337
Earnings per common share:		
Basic	$ 0.36	$ 0.19
Diluted	$ 0.36	$ 0.19

Weighted average common shares:		
Basic	198,507	203,310
Diluted	202,630	203,326

See accompanying unaudited notes to consolidated financial statements.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY
(Unaudited)
(Dollars in thousands, except per share amounts)

	Three Months Ended March 31, 2010	Year Ended December 31, 2009
Common stock, par value $0.0001 per share		
Balance, beginning of period	$ 19	$ 17
Issued	1	2
Balance, end of period	20	19
Additional paid-in capital		
Balance, beginning of period	2,036,087	1,870,120
Benefit plan share activity (1)	885	16,499
Share-based expense, net of forfeitures and clawbacks	9,244	125,127
Proceeds from exercise of stock options	56	69
Contingent consideration	419	(2,710)
Tax benefit (deficiency) for issuance of share-based awards	17,982	(14,606)
Equity component of convertible debt issuance, net of tax		41,588
Dividend equivalents on share-based plans	2,471	
Balance, end of period	2,067,144	2,036,087
Retained earnings		
Balance, beginning of period	698,488	418,445
Net earnings to common shareholders	74,066	280,043
Dividends	(15,428)	
Balance, end of period	757,126	698,488
Treasury stock, at cost		
Balance, beginning of period	(384,379)	(115,190)
Purchases	(63,220)	(263,794)
Returns / forfeitures	(1)	(8,105)
Issued		2,710
Balance, end of period	(447,600)	(384,379)
Accumulated other comprehensive (loss) income		
Balance, beginning of period	(41,626)	(52,121)
Currency adjustment	(18,118)	9,306

Pension adjustment, net of tax				1,189
Balance, end of period		(59,744)		(41,626)
Total common stockholders equity		2,316,946		2,308,589
Noncontrolling interests				
Balance, beginning of period		321,538		287,805
Net earnings to noncontrolling interests		3,943		36,537
Contributions		46		2,860
Distributions		(245)		(5,664)
Adoption of accounting changes to ASC 810		3,058		
Balance, end of period		328,340		321,538
Total stockholders equity	$	2,645,286	$	2,630,127

(1) Includes grants related to the Incentive Plan, Deferred Compensation Plan and Directors Plan.

See accompanying unaudited notes to consolidated financial statements.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)
(Dollars in thousands)

	Three Months Ended	
	March 31, 2010	March 31, 2009
Net earnings to common shareholders	$ 74,066	$ 38,337
Other comprehensive income (loss):		
Currency translation adjustments	(18,118)	(3,495)
Total other comprehensive loss (1)	(18,118)	(3,495)
Comprehensive income	$ 55,948	$ 34,842

(1) Total other comprehensive loss, net of tax, is attributable to Jefferies Group. No other comprehensive loss is attributable to noncontrolling interests.

See accompanying unaudited notes to consolidated financial statements.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(Dollars in thousands)

	Three Months Ended	
	March 31, 2010	March 31, 2009
Cash flows from operating activities:		
Net earnings	$ 78,009	$ 32,426
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization	7,859	7,148
Gain on repurchase of long-term debt		(5,946)
Fees related to assigned management agreements	(920)	
Interest on mandatorily redeemable preferred interests of consolidated subsidiaries	2,048	(5,303)
Accruals related to various benefit plans, stock issuances, net of forfeitures	10,129	7,169
(Increase) decrease in cash and securities segregated and on deposit for regulatory purposes or deposited with clearing and depository organizations	(238,408)	65,956
(Increase) decrease in receivables:		
Brokers, dealers and clearing organizations	(595,687)	53,474
Customers	(192,481)	(57,969)
Fees, interest and other	(18,812)	21,590
(Increase) decrease in securities borrowed	(57,434)	1,494,964
Increase in financial instruments owned	(3,454,521)	(1,549,463)
Increase in other investments	(12,635)	(4,890)
(Increase) decrease in investments in managed funds	(5,406)	7,629
Increase in securities purchased under agreements to resell	(1,121,664)	(1,767,452)
(Increase) decrease in other assets	(52,113)	6,092
Increase in payables:		
Brokers, dealers and clearing organizations	968,300	69,930
Customers	135,803	252,122
Decrease in securities loaned	(134,453)	(62,162)
Increase in financial instruments sold, not yet purchased	1,977,040	1,236,556
Increase (decrease) in securities sold under agreements to repurchase	2,272,072	(135,675)
Decrease in accrued expenses and other liabilities	(318,262)	(288,797)
Net cash used in operating activities	(751,536)	(622,601)
Cash flows from investing activities:		
Purchase of premises and equipment	(4,474)	(5,516)
Business acquisition		(38,760)
Cash received from contingent consideration	656	
Cash paid for contingent consideration	(6,997)	(8,163)
Net cash used in investing activities	(10,815)	(52,439)

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS CONTINUED (Unaudited)
(Dollars in thousands)

	Three Months Ended	
	March 31, 2010	March 31, 2009
Cash flows from financing activities:		
Excess tax benefits from the issuance of share-based awards	$ 18,475	$ 4,299
Net (payments on) proceeds from:		
Repurchase of long-term debt		(9,515)
Mandatorily redeemable preferred interest of consolidated subsidiaries	(37)	
Noncontrolling interest	(199)	
Repurchase of common stock	(63,220)	(75,549)
Dividends	(12,957)	
Exercise of stock options, not including tax benefits	56	69
Net cash used in financing activities	(57,882)	(80,696)
Effect of foreign currency translation on cash and cash equivalents	(4,031)	433
Net decrease in cash and cash equivalents	(824,264)	(755,303)
Cash and cash equivalents at beginning of period	1,853,167	1,294,329
Cash and cash equivalents at end of period	$ 1,028,903	$ 539,026
Supplemental disclosures of cash flow information:		
Cash paid (received) during the period for:		
Interest	$ 84,941	$ 73,524
Income taxes	59,791	(1,061)
Acquisitions:		
Fair value of assets acquired, including goodwill		53,104
Liabilities assumed		(14,344)
Cash paid for acquisition		38,760

See accompanying unaudited notes to consolidated financial statements.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(Unaudited)

Note 1. Organization and Summary of Significant Accounting Policies

Organization

The accompanying unaudited consolidated financial statements include the accounts of Jefferies Group, Inc. and all its subsidiaries (together, we or us), including Jefferies & Company, Inc. (Jefferies), Jefferies Execution Services, Inc., (Jefferies Execution), Jefferies International Limited, Jefferies Asset Management, LLC, Jefferies Financial Products, LLC and all other entities in which we have a controlling financial interest or are the primary beneficiary, including Jefferies High Yield Holdings, LLC (JHYH), Jefferies Special Opportunities Partners, LLC (JSOP) and Jefferies Employees Special Opportunities Partners, LLC (JESOP). The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S generally accepted accounting principles for complete financial statements. All adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. These unaudited consolidated financial statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2009.

On April 19, 2010, our Board of Directors approved a change to our fiscal year end from a calendar year basis to a fiscal year ending on November 30. Our 2010 second and third quarters will be the three months ended May 31 and August 31, respectively, and our fiscal year end will consist of the eleven month transition period beginning January 1, 2010 through November 30, 2010. Operating results for the three months ended March 31, 2010 are not necessarily indicative of the results that may be expected for the eleven-month period ending November 30, 2010.

Reclassifications

Prior to October 1, 2009, commissions and commission equivalents earned on certain over-the-counter equity securities trades were reported within Principal transactions revenue. As of October 1, 2009, these revenues are included within Commission revenue on the Consolidated Statements of Earnings. Previously presented financial statements have been adjusted to change these revenues from Principal transactions revenue to Commissions revenue. The impact of these changes is to increase Commissions revenue for the three months ended March 31, 2009 by $29.9 million from $101.9 million to $131.8 million and conversely to decrease Principal transactions by $29.9 million from $152.3 million to $122.4 million for transactions during the three months ended March 31, 2009 previously presented in our Quarterly Report on Form 10-Q, as filed on May 8, 2009. There was no impact on Total revenues, Net revenues, Net earnings or Earnings per share for the three months ended March 31, 2009 due to these changes.

Summary of Significant Accounting Policies

Principles of Consolidation

Our policy is to consolidate all entities in which we own more than 50% of the outstanding voting stock and have control. In addition, we consolidate entities which lack characteristics of an operating entity or business for which we are the primary beneficiary. The primary beneficiary is the party who has the power to direct the activities of a variable interest entity that most significantly impact the entity s economic performance and who has an obligation to absorb losses of the entity or a right to receive benefits from the entity that could potentially be significant to the entity. In situations where we have significant influence but not control of an entity that does not qualify as a variable interest entity, we apply the equity method of accounting or fair value accounting. We also have formed nonconsolidated investment vehicles with third-party investors that are typically organized as partnerships or limited liability companies. We act as general partner or managing member for these investment vehicles and have generally provided the third-party investors with termination or kick-out rights.

All material intercompany accounts and transactions are eliminated in consolidation.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(Unaudited)

Revenue Recognition

Commissions. All customer securities transactions are reported on the Consolidated Statements of Financial Condition on a settlement date basis with related income reported on a trade-date basis. Under clearing agreements, we clear trades for unaffiliated correspondent brokers and retain a portion of commissions as a fee for our services. Correspondent clearing revenues are included in other revenue. We permit institutional customers to allocate a portion of their gross commissions to pay for research products and other services provided by third parties. The amounts allocated for those purposes are commonly referred to as soft dollar arrangements. Soft dollar expenses amounted to $8.8 million and $7.1 million for the three months ended March 31, 2010 and 2009, respectively. We account for the cost of these arrangements on an accrual basis. As we are not the primary obligor for these arrangements, expenses relating to soft dollars are netted against commission revenues.

Principal Transactions. Financial instruments owned, securities pledged and Financial instruments sold, but not yet purchased (all of which are recorded on a trade-date basis) are carried at fair value with unrealized gains and losses reflected in principal transactions in the Consolidated Statements of Earnings on a trade date basis, except for unrealized gains and losses on financial instruments held by consolidated asset management entities, which are presented in Asset management fees and investment income (loss) from managed funds.

Investment Banking. Underwriting revenues and fees from mergers and acquisitions, restructuring and other investment banking advisory assignments or engagements are recorded when the services related to the underlying transactions are completed under the terms of the assignment or engagement. Expenses associated with such assignments are deferred until reimbursed by the client, the related revenue is recognized or the engagement is otherwise concluded. Expenses are recorded net of client reimbursements. Revenues are presented net of related unreimbursed expenses. Unreimbursed expenses with no related revenues are included in business development in the Consolidated Statements of Earnings.

Asset Management Fees and Investment Income (Loss) From Managed Funds. Asset management fees and investment income (loss) from managed funds include revenues we earn from management, administrative and performance fees from funds managed by us, revenues from management and performance fees we earn from third-party managed funds and investment income (loss) from our investments in these funds. We earn fees in connection with management and investment advisory services performed for various funds and managed accounts. These fees are based on the value of assets under management and may include performance fees based upon the performance of the funds. Management and administrative fees are generally recognized over the period that the related service is provided based upon the beginning or ending net asset value of the relevant period. Generally, performance fees are earned when the return on assets under management exceeds certain benchmark returns, high-water marks or other performance targets. Performance fees are accrued on a monthly basis and are not subject to adjustment once the measurement period ends (annually) and performance fees have been realized.

Interest Revenue and Expense. We recognize contractual interest on financial instruments owned and financial instruments sold, but not yet purchased, on an accrual basis as a component of interest revenue and expense. Interest flows on derivative trading transactions and dividends are included as part of the fair valuation of these contracts in principal transactions in the Consolidated Statements of Earnings and are not recognized as a component of interest revenue or expense. We account for our short-term, long-term borrowings and our mandatorily redeemable convertible preferred stock on an accrual basis with related interest recorded as interest expense. In addition, we recognize interest revenue related to our securities borrowed and securities purchased under agreements to resell activities and interest expense related to our securities loaned and securities sold under agreements to repurchase activities on an accrual basis.

Cash Equivalents

Cash equivalents include highly liquid investments not held for resale with original maturities of three months or less.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(Unaudited)

Cash and Securities Segregated and on Deposit for Regulatory Purposes or Deposited With Clearing and Depository Organizations

In accordance with Rule 15c3-3 of the Securities Exchange Act of 1934, Jefferies as a broker-dealer carrying client accounts, is subject to requirements related to maintaining cash or qualified securities in a segregated reserve account for the exclusive benefit of its clients. In addition, certain financial instruments used for initial and variation margin purposes with clearing and depository organizations are recorded in this caption.

Foreign Currency Translation

Assets and liabilities of foreign subsidiaries having non-U.S. dollar functional currencies are translated at exchange rates at the end of a period. Revenues and expenses are translated at average exchange rates during the period. The gains or losses resulting from translating foreign currency financial statements into U.S. dollars, net of hedging gains or losses and taxes, if any, are included in Other comprehensive income. Gains or losses resulting from foreign currency transactions are included in principal transactions in the Consolidated Statements of Earnings.

Financial Instruments

Financial instruments owned and Financial instruments sold, not yet purchased are recorded at fair value, either as required by accounting pronouncements or through the fair value option election. These instruments primarily represent our trading activities and include both cash and derivative products. Gains and losses are recognized in Principal transactions in our Consolidated Statements of Earnings. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price).

Fair Value Hierarchy

In determining fair value, we maximize the use of observable inputs and minimize the use of unobservable inputs by requiring that the observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs reflect our assumptions that market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. We apply a hierarchy to categorize our fair value measurements broken down into three levels based on the transparency of inputs as follows:

Level 1: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

Level 2: Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these financial instruments include cash instruments for which quoted prices are available but traded less frequently, derivative instruments whose fair value have been derived using a model where inputs to the model are directly observable in the market, or can be derived principally from or corroborated by observable market data, and instruments that are fair valued using other financial instruments, the parameters of which can be directly observed.

Level 3: Instruments that have little to no pricing observability as of the reported date. These financial instruments are measured using management s best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

The availability of observable inputs can vary and is affected by a wide variety of factors, including, for example, the type of financial instrument and market conditions. To the extent that valuation is based on models or input that are

JEFFERIES GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(Unaudited)

less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised in determining fair value is greatest for instruments categorized in Level 3.

We use prices and inputs that are current as of the measurement date. As the observability of prices and inputs may change for a financial instrument from period to period, this condition may cause a transfer of an instrument among the fair value hierarchy levels. Transfers among the levels are recognized at the beginning of each period.

Valuation Process for Financial Instruments

Financial instruments are valued at quoted market prices, if available. Certain financial instruments have bid and ask prices that can be observed in the marketplace. For financial instruments whose inputs are based on bid-ask prices, we allow for mid-market pricing and adjust to the point within the bid-ask range that meets our best estimate of fair value. For offsetting positions in the same financial instrument, the same price within the bid-ask spread is used to measure both the long and short positions.

For financial instruments that do not have readily determinable fair values using quoted market prices, the determination of fair value is based upon consideration of available information, including types of financial instruments, current financial information, restrictions on dispositions, fair values of underlying financial instruments and quotations for similar instruments. The valuation process for financial instruments may include the use of valuation models and other techniques. Adjustments to valuations (such as counterparty, credit, concentration or liquidity) derived from valuation models may be made when, in management s judgment, either the size of the position in the financial instrument in a nonactive market or other features of the financial instrument such as its complexity, or the market in which the financial instrument is traded require that an adjustment be made to the value derived from the models. An adjustment may be made if a financial instrument is subject to sales restrictions that would result in a price less than the quoted market price. Adjustments from the price derived from a valuation model reflect management s judgment that other participants in the market for the financial instrument being measured at fair value would also consider in valuing that same financial instrument and are adjusted for assumptions about risk uncertainties and market conditions. Results from valuation models and valuation techniques in one period may not be indicative of future period fair value measurements.

See Note 3, Financial Instruments, for a description of valuation techniques applied to the classes of financial instruments at fair value.

Investments in Managed Funds

Investments in managed funds include our investments in funds managed by us and our investments in third-party managed funds in which we are entitled to a portion of the management and/or performance fees. Investments in nonconsolidated managed funds are accounted for on the equity method or fair value. Gains or losses on our investments in managed funds are included in Asset management fees and investment income (loss) from managed funds in the Consolidated Statements of Earnings.

Other Investments

Other investments includes investments entered into where we exercise significant influence over operating and capital decisions in private equity and other operating entities in connection with our capital market activities and loans issued in connection with such activities. Other investments are accounted for on the equity method or at cost, as appropriate.

JEFFERIES GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(Unaudited)

Receivable from and Payable to Customers

Receivable from and payable to customers includes amounts receivable and payable on cash and margin transactions. Securities owned by customers and held as collateral for these receivables are not reflected in the accompanying consolidated financial statements. Receivable from officers and directors represents balances arising from their individual security transactions. These transactions are subject to the same regulations as customer transactions and are provided on substantially the same terms.

Securities Borrowed and Securities Loaned

Securities borrowed and securities loaned are carried at cost and accounted for as collateralized financing transactions. In connection with both trading and brokerage activities, we borrow securities to cover short sales and to complete transactions in which customers have failed to deliver securities by the required settlement date, and lend securities to other brokers and dealers for similar purposes. We have an active securities borrowed and lending matched book business in which we borrow securities from one party and lend them to another party. When we borrow securities, we generally provide cash to the lender as collateral, which is reflected in our Consolidated Statements of Financial Condition as Securities borrowed. We earn interest revenues on this cash collateral. Similarly, when we lend securities to another party, that party provides cash to us as collateral, which is reflected in our Consolidated Statements of Financial Condition as Securities loaned. We pay interest expense on the cash collateral received from the party borrowing the securities. A substantial portion of our interest revenues and interest expenses results from this matched book activity. The initial collateral advanced or received approximates or is greater than the fair value of the securities borrowed or loaned. We monitor the fair value of the securities borrowed and loaned on a daily basis and request additional collateral or return excess collateral, as appropriate.

Securities Purchased Under Agreements to Resell and Securities Sold Under Agreements to Repurchase

Securities purchased under agreements to resell and Securities sold under agreements to repurchase (collectively repos) are accounted for as collateralized financing transactions and are recorded at their contracted repurchase amount. We earn net interest revenues from this activity which is reflected in our Consolidated Statements of Earnings. We monitor the fair value of the underlying securities daily versus the related receivable or payable balances. Should the fair value of the underlying securities decline or increase, additional collateral is requested or excess collateral is returned, as appropriate. We carry repos on a net basis by counterparty when appropriate.

Premises and Equipment

Premises and equipment are depreciated using the straight-line method over the estimated useful lives of the related assets (generally three to ten years). Leasehold improvements are amortized using the straight-line method over the term of the related leases or the estimated useful lives of the assets, whichever is shorter.

Goodwill

At least annually, and more frequently if warranted, we assess whether goodwill has been impaired by comparing the estimated fair value, calculated based on earnings and book value multiples, of each reporting unit with its estimated net book value, by estimating the amount of stockholders equity required to support each reporting unit. Periodically estimating the fair value of a reporting unit requires significant judgment and often involves the use of significant estimates and assumptions. These estimates and assumptions could have a significant effect on whether or not an impairment charge is recorded and the magnitude of such a charge. We completed our annual assessment of goodwill as of September 30, 2009 and no impairment was identified.

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Income Taxes

We file a consolidated U.S. federal income tax return, which includes all of our qualifying subsidiaries. We also are subject to income tax in various states and municipalities and those foreign jurisdictions in which we operate. Amounts provided for income taxes are based on income reported for financial statement purposes and do not necessarily represent amounts currently payable. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and for tax loss carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income taxes are provided for temporary differences in reporting certain items, principally, share-based compensation, deferred compensation, unrealized gains and losses on investments and tax amortization on intangible assets. The realization of deferred tax assets is assessed and a valuation allowance is recorded to the extent that it is more likely than not that any portion of the deferred tax asset will not be realized.

The tax benefit related to dividends and dividend equivalents paid on nonvested share based payment awards and outstanding equity options is recognized as an increase to additional paid in capital. These amounts are included in tax benefits for issuance of share-based awards on the Consolidated Statement of Changes in Stockholders Equity.

Legal Reserves

We recognize a liability for a contingency when it is probable that a liability has been incurred and when the amount of loss can be reasonably estimated. When a range of probable loss can be estimated, we accrue the most likely amount of such loss, and if such amount is not determinable, then we accrue the minimum of the range of probable loss.

We record reserves related to legal proceedings in accrued expenses and other liabilities to the extent such losses are probable and can be estimated. The determination of these reserve amounts requires significant judgment on the part of management. We consider many factors including, but not limited to: the amount of the claim; the basis and validity of the claim; previous results in similar cases; and legal precedents and case law. Each legal proceeding is reviewed with counsel in each accounting period and the reserve is adjusted as deemed appropriate by management.

Share-Based Compensation

Share-based awards are measured based on the grant-date fair value of the award and recognized over the period from the service inception date through the date the employee is no longer required to provide service to earn the award. Expected forfeitures are included in determining share-based compensation expense.

Earnings per Common Share

Basic earnings per share (EPS) is computed by dividing net earnings (loss) available to common shareholders by the weighted average number of common shares outstanding and certain other shares committed to be, but not yet issued. Net earnings (loss) available to common shareholders represent net earnings (loss) to common shareholders reduced by the allocation of earnings to participating securities. Losses are not allocated to participating securities. Common shares outstanding and certain other shares committed to be, but not yet issued, include restricted stock and restricted stock units for which no future service is required. Diluted EPS is computed by dividing net earnings available to common shareholders plus dividends on dilutive mandatorily redeemable convertible preferred stock by the weighted average number of common shares outstanding and certain other shares committed to be, but not yet issued, plus all dilutive common stock equivalents outstanding during the period.

Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and, therefore, are included in the earnings allocation in computing earnings per share under the two-class method of earning per share. We grant restricted stock and restricted stock

JEFFERIES GROUP, INC. AND SUBSIDIARIES
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units as part of our share-based compensation that contain nonforfeitable rights to dividends and dividend equivalents, respectively, and therefore, prior to the requisite service being rendered for the right to retain the award, restricted stock and restricted stock units meet the definition of a participating security. As such, we calculate Basic and Diluted earnings per share under the two-class method. All prior-period earnings per share data presented have been adjusted to include participating securities in the earnings per share computation using the two-class method.

Securitization Activities

We engage in securitization activities related to mortgage-backed securities. Such transfers of financial assets are accounted for as sales when we have relinquished control over the transferred assets. The gain or loss on sale of such financial assets depends, in part, on the previous carrying amount of the assets involved in the transfer allocated between the assets sold and the retained interests, if any, based upon their respective fair values at the date of sale. We may retain interests in the securitized financial assets as one or more tranches of the securitization. These retained interests are included within Financial instruments owned in the Consolidated Statement of Financial Condition at fair value. Any changes in the fair value of such retained interests are recognized within Principal transactions revenues in the Consolidated Statement of Earnings.

Accounting Developments

The following is a summary of Accounting Standards Codification (ASC) Topics that have impacted or will impact our disclosures and/or accounting policies for financial statements issued for interim and annual periods:

Consolidation

We have adopted accounting changes described in ASC Topic 810, Consolidation, as of January 1, 2010, which require that the party who has the power to direct the activities of a variable interest entity that most significantly impact the entity s economic performance and who has an obligation to absorb losses of the entity or a right to receive benefits from the entity that could potentially be significant to the entity consolidate the variable interest entity. The changes to ASC 810, effective as of January 1, 2010, eliminate the quantitative approach previously applied to assessing the consolidation of a variable interest entity and require ongoing reassessments for consolidation. Upon adoption of these accounting changes on January 1, 2010, we consolidated certain CLOs and other investment vehicles. We applied the fair value option as our transition method to consolidate these entities. The following table presents the effect of the consolidation of these entities on our assets, liabilities and stockholders equity on January 1, 2010 (in thousands):

Cash and cash equivalents	$ 66,254
Financial instruments owned, at fair value:	
Corporate debt securities	30,393
Loans and other receivables	1,523,566
Investments, at fair value	2,990
Total financial instruments owned, at fair value	1,556,949
Investments in managed funds	(7,273)
Receivable from customers	(13,317)
Receivable from fees, interest and other	4,265
Total assets	$ 1,606,878
Accrued expenses and other liabilities	$ 2,886
Long-term debt	1,600,934

Total liabilities	1,603,820
Noncontrolling interests	3,058
Total stockholders equity	3,058
Total liabilities and stockholders equity	$ 1,606,878

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Subsequently, we sold and assigned our management agreements for the CLOs to a third party; thus we no longer have the power to direct the most significant activities of the CLOs. Upon the assignment of the management agreements in the first quarter of 2010, we deconsolidated the CLOs and accounted for our remaining interests in the CLOs at fair value.

Transfers and Servicing

We adopted further accounting changes described in ASC Topic 860, Transfers and Servicing, as of January 1, 2010, which eliminate the concept of a qualifying special purpose entity, require that a transferor consider all arrangements made contemporaneously with, or in contemplation of, a transfer of assets when determining whether derecognition of a financial asset is appropriate, clarify the requirement that a transferred financial asset be legally isolated from the transferor and any of its consolidated affiliates, stipulate that constraints on a transferee s ability to freely pledge or exchange transferred assets causes the transfer to fail sale accounting, and define participating interests and provides guidance on derecognizing participating interests. The adoption did not have an effect on our financial condition, results of operations or cash flows.

Use of Estimates

We have made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with U.S. generally accepted accounting principles. The most important of these estimates and assumptions relate to fair value measurements and compensation and benefits. Although these and other estimates and assumptions are based on the best available information, actual results could be materially different from these estimates. Current economic conditions increased the risks and complexity of the judgments in these estimates.

Note 2. Cash, Cash Equivalents and Short-Term Investments

We generally invest our excess cash in money market funds and other short-term investments. Cash equivalents include highly liquid investments not held for resale with original maturities of three months or less. The following are financial instruments that are cash and cash equivalents that are deemed by us to be generally readily convertible into cash as of March 31, 2010 and December 31, 2009 (in thousands of dollars):

	March 31, 2010	December 31, 2009
Cash and cash equivalents:		
Cash in banks	$ 203,818	$ 196,189
Money market investments	825,085	1,656,978
Total cash and cash equivalents	1,028,903	1,853,167
Cash and securities segregated (1)	1,328,194	1,089,803
	$ 2,357,097	$ 2,942,970

(1) Consists of deposits at exchanges and clearing organizations, as well as deposits in accordance with

Rule 15c3-3 of the Securities Exchange Act of 1934, which subjects Jefferies, as a broker dealer carrying client accounts, to requirements related to maintaining cash or qualified securities in a segregated reserve account for the exclusive benefit of its clients.

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Note 3. Financial Instruments

The following is a summary of our financial assets and liabilities that are accounted for at fair value on a recurring basis as of March 31, 2010 and December 31, 2009 by level within the fair value hierarchy (in thousands):

	As of March 31, 2010				
	Level 1	Level 2	Level 3	Counterparty and Cash Collateral Netting	Total
Assets:					
Financial instruments owned:					
Corporate equity securities	$ 1,761,958	$ 55,089	$ 37,066	$	$ 1,854,113
Corporate debt securities	8,193	3,224,253	109,464		3,341,910
Collateralized debt obligations		3	13,505		13,508
U.S. government and federal agency securities	1,508,637	442,967			1,951,604
U.S. issued municipal securities		239,969	425		240,394
Foreign government issued securities	661,845	655,613			1,317,458
Residential mortgage-backed securities		3,196,723	166,536		3,363,259
Commercial mortgage-backed securities		98,762	14,966		113,728
Other asset-backed securities		107,813	110		107,923
Loans and other receivables		245,669	236,230		481,899
Derivatives	139,540	81,659		(182,247)	38,952
Investments at fair value		685	70,169		70,854
Total financial instruments owned	$ 4,080,173	$ 8,349,205	648,471	$ (182,247)	$ 12,895,602
Investments in Managed Funds			8,378		
Level 3 assets for which the firm does not bear economic exposure (1)			(214,743)		
Level 3 assets for which the firm bears economic exposure			$ 442,106		
Liabilities:					
Financial instruments sold, not yet purchased:					
Corporate equity securities	$ 1,757,459	$ 22,685	$ 38	$	$ 1,780,182
Corporate debt securities		2,517,966	224		2,518,190
	1,296,376	160			1,296,536

U.S. government and federal agency securities					
U.S. issued municipal securities		10			10
Foreign government issued securities	729,373	611,037			1,340,410
Residential mortgage-backed securities		11,199			11,199
Commercial mortgage-backed securities		861			861
Loans		176,766	176,297		353,063
Derivatives	129,273	108,366	1,517	(215,483)	23,673
Total financial instruments sold, not yet purchased	$ 3,912,481	$ 3,449,050	$ 178,076	$ (215,483)	$ 7,324,124

(1) Consists of Level 3 assets which are attributable to third party and employee noncontrolling interests in certain consolidated entities.

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	As of December 31, 2009				
	Level 1	Level 2	Level 3	Counterparty and Cash Collateral Netting	Total
Assets:					
Financial instruments owned:					
Corporate equity securities	$ 1,419,019	$ 37,981	$ 43,042	$	$ 1,500,042
Corporate debt securities		2,295,486	116,648		2,412,134
Collateralized debt obligations			9,570		9,570
U.S. government and federal agency securities	821,323	367,642			1,188,965
U.S. issued municipal securities		127,346	420		127,766
Foreign government issued securities	71,199	374,517	196		445,912
Residential mortgage-backed securities		2,578,796	136,496		2,715,292
Commercial mortgage-backed securities		307,068	3,215		310,283
Other asset-backed securities		54,180	110		54,290
Loans and other receivables		84,666	506,542		591,208
Derivatives	219,067	102,357	1,909	(261,216)	62,117
Investments at fair value		4,592	65,564		70,156
Total financial instruments owned	$ 2,530,608	$ 6,334,631	883,712	$ (261,216)	$ 9,487,735
Level 3 assets for which the firm does not bear economic exposure (1)			(379,153)		
Level 3 assets for which the firm bears economic exposure			$ 504,559		
Liabilities:					
Financial instruments sold, not yet purchased:					
Corporate equity securities	$ 1,350,125	$ 10,403	$	$	$ 1,360,528
Corporate debt securities		1,909,781			1,909,781
U.S. government and federal agency securities	1,350,155	1,911			1,352,066
U.S. issued municipal securities		10			10
Foreign government issued securities	150,684	233,101			383,785
		21,474			21,474

Residential mortgage-backed securities					
Loans		10,660	352,420		363,080
Derivatives	225,203	100,731	4,926	(312,433)	18,427
Total financial instruments sold, not yet purchased	$ 3,076,167	$ 2,288,071	$ 357,346	$ (312,433)	$ 5,409,151

(1) Consists of Level 3 assets which are attributable to third party and employee noncontrolling interests in certain consolidated entities.

We elected to apply the fair value option to loans and loan commitments made in connection with our investment banking and sales and trading activities and certain investments held by subsidiaries that are not registered broker-dealers. Loans and investments at fair value are included in Financial instruments owned and loan commitments are included in Financial instruments sold, not yet purchased derivatives on the Consolidated Statements of Financial Condition. The fair value option was elected for loans and loan commitments and investments held by subsidiaries that are not registered broker-dealers because they are risk managed by us on a fair value basis. Cash and cash equivalents, the cash component of cash and securities segregated and on deposit for regulatory purposes or deposited with clearing and depository organizations, receivables brokers, dealers and clearing organizations, receivables customers, receivables fees, interest and other, payables brokers, dealers and clearing organizations and payables

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customers, are not accounted for at fair value; however, the recorded amounts approximate fair value due to their liquid or short-term nature.

The following is a description of the valuation basis, including valuation techniques and inputs, used in measuring our financial assets and liabilities that are accounted for at fair value on a recurring basis:

Corporate Equity Securities

Exchange Traded Equity Securities: Exchange-traded equity securities are measured based on quoted exchange prices, which are generally obtained from pricing services, and are categorized as Level 1 in the fair value hierarchy.

Non-exchange Traded Equity Securities: Non-exchange traded equity securities are measured primarily using broker quotations, pricing service data from external providers and prices observed for recently executed market transactions and are categorized within Level 2 of the fair value hierarchy. Where such information is not available, non-exchange traded equity securities are categorized as Level 3 financial instruments and measured using valuation techniques involving quoted prices of or market data for comparable companies, similar company ratios and multiples (e.g., price/EBITDA, price/book value), discounted cash flow analyses and transaction prices observed for subsequent financing or capital issuance by the company. When using pricing data of comparable companies, judgment must be applied to adjust the pricing data to account for differences between the measured security and the comparable security (e.g., issuer market capitalization, yield, dividend rate, geographical concentration).

Equity warrants: Equity warrants are generally classified within Level 3 of the fair value hierarchy and are measured using the Black-Scholes model with key inputs impacting the valuation including the underlying security price, implied volatility, dividend yield, interest rate curve, strike price and maturity date.

Corporate Debt Securities

Corporate Bonds: Corporate bonds are measured primarily using broker quotations and pricing service data from external providers, where available, prices observed for recently executed market transactions of comparable size, and bond spreads or credit default swap spreads of the issuer adjusted for basis differences between the swap curve and the bond curve. Corporate bonds measured using these valuation methods are categorized within Level 2 of the fair value hierarchy. If broker quotes, pricing data or spread data is not available, alternative valuation techniques are used including cash flow models incorporating interest rate curves, single name or index credit default swap curves for comparable issuers and recovery rate assumptions. Corporate bonds measured using alternative valuation techniques are classified within Level 3 of the fair value hierarchy and comprise a limited portion of our corporate bonds.

High Yield Corporate and Convertible Bonds: A significant portion of our high yield corporate and convertible bonds are classified within Level 2 of the fair value hierarchy and are measured primarily using broker quotations and pricing service data from external providers, where available, and prices observed for recently executed market transactions of comparable size. Where pricing data is less observable, valuations are classified in Level 3 and are based on pending transactions involving the issuer or comparable issuers, prices implied from an issuer s subsequent financings or recapitalizations, models incorporating financial ratios and projected cash flows of the issuer and market prices for comparable issuers.

Auction Rate Securities: Auction rate securities (ARS) included within corporate debt securities include ARS backed by pools of student loans and auction rate preferred securities issued by closed end mutual funds. ARS are measured using market data provided by external service providers, as available. The fair value of ARS is also determined by benchmarking to independent market data and adjusting for projected cash flows, level of seniority in the capital structure, leverage, liquidity and credit rating, as appropriate. ARS are classified within Level 3 of the fair value hierarchy based on our assessment of the transparency of the external market data received.

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Collateralized Debt Obligations

Collateralized debt obligations are measured based on valuations received from third party brokers and classified within Level 3 of the fair value hierarchy due to the unobservable nature of the pricing inputs underlying the broker valuations.

U.S. Government and Federal Agency Securities

U.S. Treasury Securities: U.S. Treasury securities are measured based on quoted market prices and categorized in Level 1 of the fair value hierarchy.

U.S. Agency Issued Debt Securities: Callable and non callable U.S. agency issued debt securities are measured primarily based on quoted market prices obtained from external pricing services. Noncallable U.S. agency securities are generally classified within Level 1 of the fair value hierarchy and callable U.S. agency securities are classified within Level 2.

Municipal Securities

Municipal securities are measured based on quoted prices obtained from external data providers and generally classified within Level 2 of the fair value hierarchy.

Foreign Government Issued Securities

G-7 Government and non-G-7 Government Bonds: G-7 government and non-G-7 government bonds are measured based on quoted market prices obtained from external pricing services. G-7 government bonds are categorized within Level 1 of the fair value hierarchy and non-G-7 government bonds are categorized within Level 2.

Emerging Market Sovereign Debt Securities: Valuations are primarily based on market price quotations from external data providers, where available, or recently executed independent transactions of comparable size. To the extent market price quotations are not available or recent transactions have not been observed, valuation techniques incorporating foreign currency curves, interest rate yield curves and country spreads for bonds of similar issuers, seniority and maturity are used to determine fair value. Emerging market sovereign debt securities are generally classified within Level 2 of the fair value hierarchy.

Residential Mortgage-Backed Securities

Agency Residential Mortgage-Backed Securities: Agency residential mortgage-backed securities include mortgage pass-through securities (fixed and adjustable rate), collateralized mortgage obligations, interest-only and principal-only securities and to-be-announced securities and are generally measured using market price quotations from external data providers and categorized within Level 2 of the fair value hierarchy.

Agency Residential Inverse Interest-Only Securities (Agency Inverse IOs): The fair value of agency inverse IOs is estimated using expected future cash flow techniques that incorporate prepayment models and other prepayment assumptions to amortize the underlying mortgage loan collateral. We use prices observed for recently executed transactions to develop market-clearing spread and yield curve assumptions. Valuation inputs with regard to underlying collateral incorporate weighted average coupon, loan-to-value, credit scores, geographic location, maximum and average loan size, originator, servicer, and weighted average loan age. Agency inverse IOs are categorized within Level 2 of the fair value hierarchy. We also use vendor data in developing assumptions, as appropriate.

Non-Agency Residential Mortgage-Backed Securities: Fair values are determined primarily using discounted cash flow methodologies and securities are categorized within Level 2 or Level 3 of the fair value hierarchy based on the observability of the pricing inputs used. Performance attributes of the underlying mortgage loans are evaluated to estimate pricing inputs, such as prepayment rates, default rates and the severity of credit losses. Attributes of the underlying mortgage loans that affect the pricing inputs include, but are not limited to, weighted

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average coupon; average and maximum loan size; loan-to-value; credit scores; documentation type; geographic location; weighted average loan age; originator; servicer; historical prepayment, default and loss severity experience of the mortgage loan pool; and delinquency rate. Yield curves used in the discounted cash flow models are based on observed market prices for comparable securities and published interest rate data to estimate market yields.

Commercial Mortgage-Backed Securities

Agency Commercial Mortgage-Backed Securities: GNMA project loan bonds and FNMA DUS mortgage-backed securities are generally measured by using prices observed for recently executed market transactions to estimate market-clearing spread levels for purposes of estimating fair value. GNMA project loan bonds and FNMA DUS mortgage-backed securities are categorized within Level 2 of the fair value hierarchy.

Non-Agency Commercial Mortgage-Backed Securities: Non-agency commercial mortgage-backed securities are measured using pricing data obtained from third party services and prices observed for recently executed market transactions and are categorized within Level 2 and Level 3 of the fair value hierarchy.

Other Asset-Backed Securities

Other asset-backed securities include, but are not limited to, securities backed by auto loans, credit card receivables and student loans and are categorized within Level 2 of the fair value hierarchy. Valuations are determined using pricing data obtained from third party services and prices observed for recently executed market transactions.

Loans and Other Receivables

Corporate Loans: Corporate loans categorized within Level 2 of the fair value hierarchy are measured based on market price quotations from external data providers where sufficient observability exists as to the extent of market transaction data supporting the pricing data. Corporate loans categorized within Level 3 are measured based on market price quotations that are considered to be less transparent, market prices for debt securities of the same creditor, and estimates of future cash flow incorporating assumptions regarding creditor default and recovery rates and consideration of the issuer s capital structure.

Participation Certificates in GNMA Project and Construction Loans: Valuations of participation certificates in GNMA project and construction loans are based on observed market prices of recently executed purchases of similar loans which are then used to derive a market implied spread. The market implied spread is used as the primary input in estimating the fair value of loans at the measurement date. The loan participation certificates are categorized within Level 2 of the fair value hierarchy given the observability and volume of recently executed transactions.

Escrow and Trade Claim Receivables: Escrow and trade claim receivables are categorized within Level 3 of the fair value hierarchy with fair value estimated based on reference to market prices and implied yields of debt securities of the same or similar issuers.

Derivatives

Listed Derivative Contracts: Listed derivative contracts are measured based on quoted exchange prices, which are generally obtained from pricing services, and are categorized as Level 1 in the fair value hierarchy.

OTC Derivative Contracts: OTC derivative contracts are generally valued using models, whose inputs reflect assumptions that we believe market participants would use in valuing the derivative in a current period transaction. Inputs to valuation models are appropriately calibrated to market data. For many OTC derivative contracts, the valuation models do not involve material subjectivity as the methodologies do not entail significant judgment and the inputs to valuation models do not involve a high degree of subjectivity as the valuation model inputs are readily observable or can be derived from actively quoted markets. OTC derivative contracts are primarily categorized in Level 2 of the fair value hierarchy given the observability of the inputs to the valuation models.

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OTC options include OTC equity and commodity options measured using Black-Scholes models with key inputs impacting the valuation including the underlying security or commodity price, implied volatility, dividend yield, interest rate curve, strike price and maturity date. Discounted cash flow models are utilized to measure certain OTC derivative contracts including the valuations of our interest rate swaps, which incorporate observable inputs related to interest rate curves, and valuations of our foreign exchange forwards and swaps, which incorporate observable inputs related to foreign currency spot rates and forward curves. Credit defaults swaps include both index and single-name credit default swaps. External prices are available as inputs in measuring index credit default swaps. For single-name credit default swaps, fair value is determined based on valuation statements provided by the counterparty. For commodity and equity total return swaps, market prices are observable for the underlying asset and used as the basis for measuring the fair value of the derivative contracts. Total return swaps executed on other underlyings are measured based on valuations received from third parties.

Investments at Fair Value

Investments at fair value include primarily investments in hedge funds, fund of funds and private equity funds, which are measured based on the net asset value of the funds provided by the fund managers and categorized within Level 3 of the fair value hierarchy. Additionally, investments at fair value include direct equity investments in private companies, which are measured using valuation techniques involving quoted prices of or market data for comparable companies, similar company ratios and multiples (e.g., price/EBITDA, price/book value), discounted cash flow analyses and transaction prices observed for subsequent financing or capital issuance by the company. Direct equity investments in private companies are categorized within Level 3 of the fair value hierarchy.

Investments in Managed Funds

Investments in managed funds that are accounted for at fair value consist of interests in collateralized loan obligations, are measured based on valuations received from third parties and are categorized in Level 3 of the fair value hierarchy.

At March 31, 2010 and December 31, 2009, our Financial instruments owned and Financial instruments sold, not yet purchased are measured using different valuation bases as follows:

Valuation Basis at March 31, 2010	Financial Instruments Owned	Financial Instruments Sold, Not Yet Purchased
Exchange closing prices	14%	24%
Recently observed transaction prices	12%	2%
Data providers/pricing services	60%	58%
Broker quotes	11%	15%
Valuation techniques	3%	1%
	100%	100%

Valuation Basis at December 31, 2009	Financial Instruments Owned	Financial Instruments Sold, Not Yet Purchased
Exchange closing prices	15%	25%
Recently observed transaction prices	2%	2%
Data providers/pricing services	55%	48%
Broker quotes	12%	23%

Valuation techniques	16%	2%
	100%	100%

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Pricing information obtained from external data providers may incorporate a range of market quotes from dealers, recent market transactions and benchmarking model derived prices to quoted market prices and trade data for comparable securities. External pricing data is subject to evaluation for reasonableness using a variety of means including comparisons of prices to those of similar product types, quality and maturities, consideration of the narrowness or wideness of the range of prices obtained, knowledge of recent market transactions and an assessment of the similarity in prices to comparable dealer offerings in a recent time period.

The following is a summary of changes in fair value of our financial assets and liabilities that have been classified as Level 3 for the three months ended March 31, 2010 and 2009 (in thousands):

	Three Months Ended March 31, 2010						
	Balance, December 31, 2009	Total gains/ losses (realized and unrealized) (1)	Purchases, sales, settlements, and issuances	Transfers into Level 3	Transfers out of Level 3	Balance, March 31, 2010	Change in unrealized gains/ (losses) relating to instruments still held at March 31, 2010 (1)
Assets:							
Financial instruments owned:							
Corporate equity securities	$ 43,042	$ (6,605)	$ 3,361	$ 71	$ (2,803)	$ 37,066	$ (6,378)
Corporate debt securities	116,648	(1,318)	(5,163)	50	(753)	109,464	937
Collateralized debt obligations	9,570	3,935				13,505	3,935
U.S. issued municipal securities	420	5				425	5
Foreign government issued securities	196				(196)		
Residential mortgage-backed securities	136,496	5,345	23,248	5,397	(3,950)	166,536	392
Commercial mortgage-backed securities	3,215	(226)	12,450	858	(1,331)	14,966	(303)
Other asset-backed securities	110					110	
Loans and other receivables	506,542	6,735	(44,488)		(232,559)	236,230	4,025
Investments at fair value	65,564	282	38	4,285		70,169	(313)

Investments in managed funds	$	$ 1,106	$ 7,272	$	$	$ 8,378	$ 1,106
Liabilities:							
Financial instruments sold, not yet purchased:							
Corporate equity securities	$	$	$	$ 38	$	$ 38	$
Corporate debt securities		(6)	230			224	(5)
Net derivatives (2)	6,835	(3,409)			(1,909)	1,517	(3,409)
Loans	352,420		(48,282)		(127,841)	176,297	

(1) Realized and unrealized gains/(losses) are reported in Principal transactions in the Consolidated Statements of Earnings.

(2) Net Derivatives represent Financial instruments owned derivatives and Financial instruments sold, not yet purchased derivatives.

During the three months ended March 31, 2010, we had transfers of assets of $10.7 million from Level 2 to Level 3, which are primarily attributed to transfers of non-agency mortgage-backed securities for which no recent trade activity was observed for purposes of determining observable inputs. Additionally, transfers of assets from Level 2 to Level 3 are attributed to certain investments at fair value, which have little to no transparency as to trade activity. Transfers of assets from Level 3 to Level 2 during the three months ended March 31, 2010 were $241.6 million primarily attributed to corporate loans, for which we obtained additional market pricing data from third party sources during the quarter that provided additional transparency into the valuation process for these assets.

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Transfers of liabilities from Level 2 to Level 3 were $0.04 million and transfers of liabilities from Level 3 to Level 2 were $129.8 million for the three months ended March 31, 2010. Transfers of liabilities from Level 3 to Level 2 during the three months ended March 31, 2010 are primarily due to transfers of short corporate loans, for which we obtained additional market pricing data from third party sources during the quarter that provided additional transparency into the valuation process for these liabilities.

Net gains on Level 3 assets, excluding investments in managed funds, were $8.2 million and net gains on Level 3 liabilities were $3.4 million for the three months ended March 31, 2010.

	Three Months Ended March 31, 2009				
	Non-derivative instruments Assets	Non-derivative instruments Liabilities	Derivative instruments Assets	Derivative instruments Liabilities	Investments
Balance, December 31, 2008	$ 394,316	$ 3,515	$	$ 8,197	$ 75,059
Total gains/ (losses) (realized and unrealized) (1)	(39,296)	390	3,087	(4,324)	(6,474)
Purchases, sales, settlements, and issuances	134,968	58,516			2,757
Transfers into Level 3	25,528				6
Transfers out of Level 3	(12,550)	(3,515)			
Balance, March 31, 2009	$ 502,966	$ 58,906	$ 3,087	$ 3,873	$ 71,348
Change in unrealized gains/ (losses) relating to instruments still held at March 31, 2009 (1)	$ (37,511)	$ (390)	$ 3,087	$ 4,324	$ (7,013)

(1) Realized and unrealized gains/ (losses) are reported in principal transactions in the Consolidated Statements of Earnings.

During the three months ended March 31, 2009, we had transfers of assets of $25.5 million from Level 2 to Level 3 and transfers of $12.6 million from Level 3 to Level 2. During the three months ended March 31, 2009, we had transfers of liabilities of $3.5 million from Level 3 to Level 2. Net gains on Level 3 derivative assets and derivative liabilities were $3.1 million and $4.3 million, respectively, for the three months ended March 31, 2009 and net losses on Level 3 non-derivative assets were $39.3 million.

Level 3 cash instruments are frequently hedged with instruments classified within Level 1 and Level 2, and accordingly, gains or losses that have been reported in Level 3 are frequently offset by gains or losses attributable to instruments classified within Level 1 or Level 2 or by gains or losses on derivative contracts classified in Level 3 of the fair value hierarchy.

The following tables provide further information about our investments in entities that have the characteristics of an investment company at March 31, 2010 and December 31, 2009 (in thousands):

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	March 31, 2010		
	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)
Equity Long/Short Hedge Funds [a] [i]	$ 18,567	$	Quarterly, Semiannually
Equity Long/Short Hedge Funds International [b] [i]	32		
High Yield Hedge Funds [c] [i]	996		
High Yield Hedge Funds International [d] [i]	771		
Fund of Funds [e] [i]	3,529	163	Annually, GP Consent Required
Private Equity Funds [f] [i]	12,039	3,118	
Private Equity Funds International [g]	7,703	4,616	
Other Investments [h]	4,543		At Will
Total [j]	$ 48,181	$ 7,897	

	December 31, 2009		
	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)
Equity Long/Short Hedge Funds [a] [i]	$ 16,210	$	Quarterly, Semiannually
Equity Long/Short Hedge Funds International [b] [i]	71		
High Yield Hedge Funds [c] [i]	1,022		
High Yield Hedge Funds International [d] [i]	1,114		
Fund of Funds [e] [i]	6,497	166	Annually, GP Consent Required
Private Equity Funds [f] [i]	10,407	3,150	
Private Equity Funds International [g]	6,979	5,081	
Other Investments [h]	5,113		At Will
Total [j]	$ 47,413	$ 8,397	

(a) This category includes investments in hedge funds that invest in both long and short equity securities in both domestic and international markets. These hedge funds may invest in securities in both public and private sectors. Investments representing approximately 2% of fair value cannot be redeemed as they are in liquidation and distributions will be received through the liquidation of the underlying assets of the funds. We are unable to estimate when the underlying assets will be liquidated. At March 31, 2010 and December 31, 2009, investments representing approximately 28% and 31%, respectively, of fair value cannot be redeemed until the lock-up period expires on December 31, 2010. At March 31, 2010 and December 31, 2009, investments representing approximately 70% and 67%, respectively, of the fair value in this category are redeemable with 60 90 days prior written notice.

(b) This category includes an investment in a hedge fund that invests in foreign technology equity securities, which has no redemption provisions. Distributions are received through the liquidation of the underlying assets of the fund, which is estimated to be within one to two years.

(c) This category includes investments in funds that invest in U.S. public high yield debt, private high yield investments, senior bank loans, public leveraged equities, distressed debt, private equity investments and emerging markets debt.

There are no redemption provisions and distributions are received through the liquidation of the underlying assets of the funds. These funds are currently in liquidation; however, we are unable to estimate when the underlying assets will be fully liquidated.

(d) This category includes an investment in a hedge fund that invests in Russian fixed income instruments.

(e) This category includes investments in funds of funds that invest in various private equity funds. At March 31, 2010 and December 31, 2009, approximately 76% and 40%, respectively, of the fair value of the investments is managed by Jefferies and has no redemption provisions. Distributions are received

through the
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funds, which are estimated to be liquidated in one to three years. At March 31, 2010 and December 31, 2009, investments representing approximately 16% and 60%, respectively, of the fair value of the investments in this category were approved for redemption and the funds’ net asset values were received in April and in the first quarter of 2010, respectively. Investments representing approximately 8% at March 31, 2010 of the fair value of the investments in this category have been redeemed and the remaining funds are expected to be received within the year.

(g) This category includes investments in private equity funds that invest in the equity of various U.S. private companies in the energy, technology, internet service and telecommunication service industries including acquired or restructured companies. These investments can never be redeemed; distributions are received through the liquidation of the underlying assets of the funds. At March 31, 2010 and December 31, 2009, investments representing approximately 95% and 94%, respectively, of fair value are expected to liquidate in one to eleven years. At March 31, 2010 and December 31, 2009, an investment representing approximately 5% and 6%, respectively, of the total fair value in this category is currently in liquidation; however, we are unable to estimate when the underlying assets will be fully liquidated.

(h) This category includes investments in private equity funds that invest in the equity of foreign private companies. At March 31, 2010 and December 31, 2009, investments representing approximately 76% and 74%, respectively, of fair value are Israeli private equity funds that invest in service companies. The fair values of these investments have been estimated using the net asset value derived from each of the funds partner capital statements. These investments can never be redeemed; distributions are received through the liquidation of the underlying assets of the fund, which are estimated to be liquidated in two to five years. At March 31, 2010 and December 31, 2009 the fair value of investments representing approximately 24% and 26%, respectively, of the fair value are private equity funds that invest in Croatian and Vietnamese companies.

(i) At March 31, 2010 and December 31, 2009 investments representing approximately 78% and 67%, respectively, of the fair value of investments are held on behalf of a Jefferies deferred compensation plan measured at net asset value. At March 31, 2010 and December 31, 2009 investments representing approximately 22% and 33%, respectively, of fair value are closed-ended funds that invest in Vietnamese equity and debt instruments.

(j) Fair value has been estimated using the net asset value derived from each of the funds partner capital statements.

(k) Investments at fair value, in the Consolidated Statements of Financial Condition at March 31, 2010 and December 31, 2009 include $22.7 million of direct investments which are not investment companies and therefore are not part of this disclosure table.

Note 4. Derivative Financial Instruments

Off-Balance Sheet Risk

We have contractual commitments arising in the ordinary course of business for securities loaned or purchased under agreements to resell, repurchase agreements, future purchases and sales of foreign currencies, securities transactions on a when-issued basis and underwriting. Each of these financial instruments and activities contains varying degrees of off-balance sheet risk whereby the fair values of the securities underlying the financial instruments may be in excess of, or less than, the contract amount. The settlement of these transactions is not expected to have a material effect upon our consolidated financial statements.

Derivative Financial Instruments

Our derivative activities are recorded at fair value in the Consolidated Statements of Financial Condition, with realized and unrealized gains and losses recognized in principal transactions in the Consolidated Statements of Earnings on a trade date basis and as a component of cash flows from operating activities in the Consolidated Statements of Cash Flows. Acting in a trading capacity, we may enter into derivative transactions to satisfy the needs of our clients and to manage our own exposure to market and credit risks resulting from our trading activities. Derivatives are subject to various risks similar to other financial instruments, including market, credit and operational risk. In addition, we may be exposed to legal risks related to derivative activities. The risks of derivatives should not be viewed in isolation, but rather should be considered on an aggregate basis along with our other trading-related activities. We manage the risks associated with derivatives on an aggregate basis along with the risks associated with proprietary trading as part of our firmwide risk management policies. In connection with our derivative activities,

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may enter into master netting agreements and collateral arrangements with counterparties. These agreements provide us with the ability to offset a counterparty s rights and obligations, request additional collateral when necessary or liquidate the collateral in the event of counterparty default.

A portion of our derivative activities is performed by Jefferies Financial Products, LLC (JFP), a market maker in commodity index products and a trader in commodity futures and options. JFP maintains credit intermediation facilities with highly rated European banks (the Banks), which allow JFP customers that require a counterparty with a high credit rating for commodity index transactions to transact with the Banks. The Banks simultaneously enter into offsetting transactions with JFP and receive a fee from JFP for providing credit support. In certain cases, JFP is responsible to the Banks for the performance of JFP s customers.

The fair value of derivative assets and derivative liabilities are presented on the Consolidated Statements on Financial Condition in Financial Instruments Owned Derivatives and Financial Instruments Sold, Not Yet Purchased Derivatives net of cash paid or received under credit support agreements and on a net counterparty basis when a legal right to offset exists under a master netting agreement. Net unrealized and realized gains and losses on derivative contracts are recognized within principal transactions revenue in our Consolidated Statements of Earnings. (See Notes 3 and 16 for additional disclosures about derivative instruments.)

The following table presents the fair value and related notional amounts of derivative contracts at March 31, 2010 and December 31, 2009 categorized by predominant risk exposure. The fair value of assets/liabilities related to derivative contracts represents our receivable/payable for derivative financial instruments, gross of counterparty netting and cash collateral received and pledged (in thousands):

	March 31, 2010			
	Assets		Liabilities	
	Fair Value	Notional Amount	Fair Value	Notional Amount
Interest rate contracts	$ 17,817	$ 56,741,743	$ 31,786	$ 61,678,849
Foreign exchange contracts	25,210	747,978	28,296	631,551
Equity contracts	138,865	3,398,117	129,471	3,032,428
Commodity contracts	21,573	13,002,789	35,200	9,213,285
Credit contracts	17,734	378,761	14,403	345,000
Total	221,199	$ 74,269,388	239,156	$ 74,901,113
Counterparty/cash-collateral netting	(182,247)		(215,483)	
Total per Consolidated Statement of Financial Condition	$ 38,952		$ 23,673	

	December 31, 2009			
	Assets		Liabilities	
(in thousands)	Fair Value	Notional Amount	Fair Value	Notional Amount
Interest rate contracts	$ 27,415	$ 1,259,014	$ 24,068	$ 1,910,832
Foreign exchange contracts	2,637	291,812	7,470	281,246
Equity contracts	222,311	3,580,416	228,403	8,958,430
Commodity contracts	54,257	4,882,782	57,237	2,683,425

Credit contracts	16,713	217,441	13,682	135,000
Total	323,333	$ 10,231,465	330,860	$ 13,968,933
Counterparty/cash-collateral netting	(261,216)		(312,433)	
Total per Consolidated Statement of Financial Condition	$ 62,117		$ 18,427	

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The following table presents unrealized and realized gains and losses on derivative contracts for the three months ended March 31, 2010 and 2009:

	Three Months Ended	
	March 31, 2010	March 31, 2009
(in thousands)	Gain (Loss)	Gain (Loss)
Interest rate contracts	$ 21,257	$ (5,010)
Foreign exchange contracts	(871)	(1,121)
Equity contracts	(5,936)	(191,483)
Commodity contracts	(2,845)	(3,556)
Credit contracts	(19,048)	7,215
Total	$ (7,443)	$ (193,955)

The following tables set forth the remaining contract maturity of the fair value of OTC derivative assets and liabilities as of March 31, 2010 (in thousands):

	OTC derivative assets (1) (2) (4)				
	0 12 Months	1 5 Years	Greater Than 5 Years	Cross-Maturity Netting (3)	Total
Commodity options	$ 5,559	$ 6,252	$	$	$ 11,811
Total return swaps	3,053	2,032			5,085
Credit default swaps		1,008	12,290	(364)	12,934
Fx forwards and swaps	1,049				1,049
Interest rate swaps			660		660
Total	$ 9,661	$ 9,292	$ 12,950	$ (364)	$ 31,539

(1) At March 31, 2010, we held exchange traded derivative assets of $10.3 million.

(2) Option and swap contracts in the table above are gross of collateral received. Option

and swap contracts are recorded net of collateral received on the Consolidated Statement of Financial Condition. At March 31, 2010, collateral received was $2.9 million.

(3) Amounts represent the netting of receivable balances with payable balances for the same counterparty across maturity categories.

(4) Derivative fair values include counterparty netting.

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	OTC derivative liabilities (1) (2) (4)				
	0 - 12 Months	1 - 5 Years	Greater Than 5 Years	Cross-Maturity Netting (3)	Total
Commodity swaps	$ 16,909	$	$	$	$ 16,909
Commodity options	2,259	7,334			9,593
Total return swaps	120				120
Credit default swaps			11,443	(364)	11,079
Equity options		1,517			1,517
Fx forwards and swaps	5,516	243			5,759
Interest rate swaps	257	8,831	5,698		14,786
Total	$ 25,061	$ 17,925	$ 17,141	$ (364)	$ 59,763

(1) At March 31, 2010, we held no exchange traded derivative liabilities.

(2) Option and swap contracts in the table above are gross of collateral pledged. Option and swap contracts are recorded net of collateral pledged on the Consolidated Statement of Financial Condition. At March 31, 2010, collateral pledged was $36.1 million.

(3) Amounts represent the

netting of receivable balances with payable balances for the same counterparty across maturity categories.

(4) Derivative fair values include counterparty netting.

At March 31, 2010, the counterparty credit quality with respect to the fair value of our OTC derivatives assets was as follows (in thousands):

Counterparty credit quality:	
A or higher	$ 30,520
Unrated	1,019
Total	$ 31,539

Contingent Features

Certain of our derivative instruments contain provisions that require our debt to maintain an investment grade credit rating from each of the major credit rating agencies. If our debt were to fall below investment grade, it would be in violation of these provisions, and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on our derivative instruments in liability positions. The aggregate fair value of all derivative instruments with such credit-risk-related contingent features that are in a liability position at March 31, 2010 and 2009, is $20.7 million and $26.1 million, respectively, for which we have posted collateral of $19.6 million and $24.3 million, respectively, in the normal course of business. On March 31, 2010, if the credit-risk-related contingent features underlying these agreements were triggered, we would not be required to post additional collateral to our counterparties as we are over collateralized; if triggered on March 31, 2009, we would have been required to post an additional $0.7 million of collateral to our counterparties.

Note 5. Collateralized Transactions

We receive securities in connection with resale agreements and securities borrowings and generally provide cash to the resale counterparty or lender, respectively, as collateral. At March 31, 2010 and December 31, 2009, the approximate fair value of securities received by us that may be sold or repledged by us related to resale agreements and securities borrowings was $13.5 billion and $11.6 billion, respectively. At March 31, 2010 and December 31, 2009, a substantial portion of the securities received by us had been sold or repledged. Additionally, we receive securities as collateral in connection with customer margin loans.

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We engage in securities for securities transactions in which we are the borrower of securities and provide other securities as collateral rather than cash. As no cash is provided under these types of transactions, we, as borrower, should treat these as noncash transactions and should not recognize assets or liabilities on the Consolidated Statements of Financial Condition. The securities pledged as collateral under these transactions are included within the total amount of Financial instruments owned and noted as Securities pledged to creditors on our Consolidated Statement of Financial Condition. At December 31, 2009, certain securities for securities transactions of borrowed fixed income securities were recorded as an asset on our Consolidated Statement of Financial Condition within Securities borrowed and the fixed income securities pledged as collateral to the lender were recorded as a liability within Securities loaned on the Consolidated Statement of Financial Condition. The December 31, 2009 Consolidated Statement of Financial Condition has not been adjusted for this accounting treatment as the impact on the consolidated financial statements is not material. At March 31, 2010, we have appropriately not recognized these transactions on the Consolidated Statement of Financial Condition.

We pledge securities in connection with repurchase agreements, securities lending agreements and other secured arrangements, including clearing arrangements. The pledge of our securities is in connection with our mortgage-backed securities, corporate bond, government and agency securities and equities businesses. Securities pledged to creditors are included within Financial instruments owned on our Consolidated Statements of Financial Condition. Counterparties generally have the right to sell or repledge the collateral. The following is a summary of the carrying value of the major categories of securities pledged to creditors, including amounts pledged as collateral where we have borrowed securities, as of March 31, 2010 and December 31, 2009 (in thousands):

	March 31, 2010	December 31, 2009
Equity securities	$ 1,147,704	$ 658,959
Fixed income securities	7,913,258	4,964,386
	$ 9,060,962	$ 5,623,345

At March 31, 2010 and December 31, 2009, of the total securities pledged to creditors, $1.8 billion and $1.6 billion, respectively, were pledged to counterparties in connection with clearing arrangements utilized by us, which includes margin loans provided to us. Under the terms of our arrangements that allow us to offset our payables with other activity with the clearing counterparty, we had no liabilities outstanding on our Consolidated Statement of Financial Condition associated with these clearing arrangements at March 31, 2010 and December 31, 2009.

We also engage in securities for securities transactions in which we are the lender of securities and receive other securities as collateral rather than cash. In instances where we are permitted to sell or repledge these securities, we report the fair value of the collateral received and the related obligation to return the collateral in the Consolidated Statements of Financial Condition. At March 31, 2010 and December 31, 2009, $34.7 million and $68.5 million, respectively, were reported as Securities received as collateral and as Obligation to return securities received as collateral.

Note 6. Securitization Activities and Variable Interest Entities

Securitization Activities

We engage in securitization activities related to mortgage-backed and other asset-backed securities. In our securitization activities, we use special purpose entities (SPEs). Prior to January 1, 2010, we did not consolidate our securitization vehicles as they met the criteria of qualifying special purpose entities (QSPEs). QSPEs were not subject to consolidation prior to January 1, 2010. With the removal of the QSPE concept and the exception from applying the consolidation requirements for VIEs under the accounting changes to ASC Topic 860, Transfers and Servicing, and ASC Topic 810, Consolidations, effective January 1, 2010, our securitization vehicles generally meet

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