

JEFFERIES GROUP INC /DE/

Form 10-Q

June 30, 2011

Table of Contents

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

FORM 10-Q

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

For the quarterly period ended May 31, 2011

OR

**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 No

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

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. 202,150,582 shares as of the close of business on June 22, 2011.

**JEFFERIES GROUP, INC. AND SUBSIDIARIES
INDEX TO QUARTERLY REPORT ON FORM 10-Q
MAY 31, 2011**

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	
<u>Consolidated Statements of Financial Condition (unaudited)</u> <u>May 31, 2011 and November 30, 2010</u>	3
<u>Consolidated Statements of Earnings (unaudited)</u> <u>Three and Six Months Ended May 31, 2011 and Three and Five Months Ended May 31, 2010</u>	5
<u>Consolidated Statements of Changes in Stockholders' Equity (unaudited)</u> <u>Six Months Ended May 31, 2011 and Year Ended November 30, 2010</u>	6
<u>Consolidated Statements of Comprehensive Income (unaudited)</u> <u>Three and Six Months Ended May 31, 2011 and Three and Five Months Ended May 31, 2010</u>	7
<u>Consolidated Statements of Cash Flows (unaudited)</u> <u>Six Months Ended May 31, 2011 and Five Months Ended May 31, 2010</u>	8
<u>Notes to Consolidated Financial Statements (unaudited)</u>	10
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	59
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	84
<u>Item 4. Controls and Procedures</u>	86
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	86
<u>Item 1A. Risk Factors</u>	86
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	87
<u>Item 6. Exhibits</u>	88
<u>Signature</u>	89
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32</u>	
<u>EX-101 INSTANCE DOCUMENT</u>	
<u>EX-101 SCHEMA DOCUMENT</u>	
<u>EX-101 CALCULATION LINKBASE DOCUMENT</u>	
<u>EX-101 LABELS LINKBASE DOCUMENT</u>	
<u>EX-101 PRESENTATION LINKBASE DOCUMENT</u>	
<u>EX-101 DEFINITION LINKBASE DOCUMENT</u>	

Table of Contents

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)

	May 31, 2011	November 30, 2010
ASSETS		
Cash and cash equivalents (including \$219,335 in 2011 and \$202,565 in 2010, from VIEs)	\$ 2,498,737	\$ 2,188,998
Cash and securities segregated and on deposit for regulatory purposes or deposited with clearing and depository organizations	1,219,917	1,636,755
Financial instruments owned, at fair value, including securities pledged of \$14,712,257 and \$12,338,728 in 2011 and 2010, respectively:		
Corporate equity securities (including \$181,027 in 2011 and \$120,606 in 2010 from VIEs)	1,713,425	1,565,793
Corporate debt securities (including \$350,507 in 2011 and \$462,462 in 2010 from VIEs)	4,433,196	3,630,616
Government, federal agency and other sovereign obligations	5,617,698	5,191,973
Mortgage- and asset-backed securities (including \$42,821 in 2011 and \$43,355 in 2010 from VIEs)	5,187,115	4,921,565
Loans and other receivables (including \$480,918 in 2011 and \$362,465 in 2010 from VIEs)	608,993	434,573
Derivatives (including \$13,879 in 2011 and \$7,579 in 2010 from VIEs)	136,384	119,268
Investments, at fair value (including \$2,762 in 2011 and \$15,612 in 2010 from VIEs)	71,033	77,784
Total financial instruments owned, at fair value (including \$1,071,914 in 2011 and \$1,012,079 in 2010 from VIEs)	17,767,844	15,941,572
Investments in managed funds	125,303	131,585
Other investments	429,020	220,323
Securities borrowed	8,258,188	8,152,678
Securities purchased under agreements to resell	3,326,200	3,252,322
Securities received as collateral	51,984	48,616
Receivables:		
Brokers, dealers and clearing organizations (including \$177,889 in 2011 and \$195,485 in 2010 from VIEs)	3,879,969	2,550,234
Customers	1,805,715	1,328,365
Fees, interest and other (including \$6,925 in 2011 and \$127 in 2010 from VIEs)	287,655	165,603
Premises and equipment	150,500	142,729
Goodwill	367,131	364,964
Other assets (including \$241 in 2011 and \$370 in 2010 from VIEs)	798,371	601,799
Total assets (including \$1,476,304 in 2011 and \$1,410,626 in 2010 from VIEs)	\$ 40,966,534	\$ 36,726,543

Continued on next page.

Table of Contents

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

	May 31, 2011	November 30, 2010
LIABILITIES AND STOCKHOLDERS EQUITY		
Financial instruments sold, not yet purchased, at fair value:		
Corporate equity securities (including \$0 in 2011 and \$2,708 in 2010 from VIEs)	\$ 1,803,991	\$ 1,638,372
Corporate debt securities (including \$272,876 in 2011 and \$443,100 in 2010 from VIEs)	2,287,160	2,375,925
Government, federal agency and other sovereign obligations	7,056,721	4,735,288
Mortgage- and asset-backed securities	38,235	129,384
Loans (including \$162,285 in 2011 and \$150,100 in 2010 from VIEs)	165,750	171,278
Derivatives (including \$0 in 2011 and \$136 in 2010 from VIEs)	111,406	59,552
Total financial instruments sold, not yet purchased, at fair value (including \$435,161 in 2011 and \$596,044 in 2010 from VIEs)	11,463,263	9,109,799
Securities loaned	3,202,149	3,108,977
Securities sold under agreements to repurchase	9,159,727	10,684,056
Obligation to return securities received as collateral	51,984	48,616
Payables:		
Brokers, dealers and clearing organizations (including \$174,175 in 2011 and \$157,134 in 2010 from VIEs)	3,294,826	1,885,357
Customers	4,062,631	3,716,357
Accrued expenses and other liabilities (including \$125,936 in 2011 and \$94,402 in 2010 from VIEs)	1,203,575	1,142,850
Long-term debt	4,579,215	3,778,681
Mandatorily redeemable convertible preferred stock	125,000	125,000
Mandatorily redeemable preferred interest of consolidated subsidiaries (including \$327,790 in 2011 and \$315,885 in 2010 from VIEs)	327,790	315,885
Total liabilities (including \$1,063,062 in 2011 and \$1,163,465 in 2010 from VIEs)	37,470,160	33,915,578
STOCKHOLDERS EQUITY		
Common stock, \$.0001 par value. Authorized 500,000,000 shares; issued 212,148,852 shares in 2011 and 200,301,656 shares in 2010	21	20
Additional paid-in capital	2,399,782	2,218,123
Retained earnings	986,283	850,654
Less:		
Treasury stock, at cost, 9,994,438 shares in 2011 and 28,607,510 shares in 2010	(193,024)	(539,530)
Accumulated other comprehensive loss:		
Currency translation adjustments	(19,362)	(42,859)
Additional minimum pension liability	(8,419)	(8,419)
Total accumulated other comprehensive loss	(27,781)	(51,278)

Total common stockholders' equity	3,165,281	2,477,989
Noncontrolling interests	331,093	332,976
Total stockholders' equity	3,496,374	2,810,965
Total liabilities and stockholders' equity	\$ 40,966,534	\$ 36,726,543

See accompanying unaudited notes to consolidated financial statements.

Page 4 of 89

Table of Contents

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

	Three Months Ended		Six Months Ended	Five Months Ended
	May 31, 2011	May 31, 2010	May 31, 2011	May 31, 2010
Revenues:				
Commissions	\$ 129,291	\$ 146,001	\$ 249,212	\$ 228,956
Principal transactions	175,316	153,986	465,468	246,642
Investment banking	328,421	255,958	567,480	352,257
Asset management fees and investment income from managed funds	10,547	13,929	34,415	11,018
Interest	304,425	243,183	577,641	386,168
Other	22,117	18,983	42,578	27,363
Total revenues	970,117	832,040	1,936,794	1,252,404
Interest expense	242,952	164,504	451,246	257,234
Net revenues	727,165	667,536	1,485,548	995,170
Interest on mandatorily redeemable preferred interest of consolidated subsidiaries	4,415	2,018	20,854	2,513
Net revenues, less mandatorily redeemable preferred interest	722,750	665,518	1,464,694	992,657
Non-interest expenses:				
Compensation and benefits	431,936	384,311	874,828	568,407
Floor brokerage and clearing fees	31,384	35,509	59,517	54,089
Technology and communications	49,850	41,932	93,525	68,054
Occupancy and equipment rental	20,437	19,056	38,416	31,016
Business development	22,457	15,216	42,395	24,985
Professional services	16,099	11,284	29,375	21,694
Other	20,103	14,530	33,223	27,818
Total non-interest expenses	592,266	521,838	1,171,279	796,063
Earnings before income taxes	130,484	143,680	293,415	196,594
Income tax expense	45,784	56,189	106,670	76,403
Net earnings	84,700	87,491	186,745	120,191
Net earnings to noncontrolling interests	4,084	3,665	18,788	3,994
Net earnings to common shareholders	\$ 80,616	\$ 83,826	\$ 167,957	\$ 116,197

Earnings per common share:

Edgar Filing: JEFFERIES GROUP INC /DE/ - Form 10-Q

Basic	\$ 0.36	\$ 0.41	\$ 0.78	\$ 0.57
Diluted	\$ 0.36	\$ 0.41	\$ 0.78	\$ 0.57

Weighted average common shares:

Basic	210,751	196,944	205,054	197,759
Diluted	214,870	201,064	209,172	201,881

See accompanying unaudited notes to consolidated financial statements.

Page 5 of 89

Table of Contents

JEFFERIES GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY
(Unaudited)

(Dollars in thousands, except per share amounts)

	Six Months Ended May 31, 2011	Eleven Months Ended November 30, 2010
Common stock, par value \$0.0001 per share		
Balance, beginning of period	\$ 20	\$ 19
Issued	1	1
Balance, end of period	21	20
Additional paid-in capital		
Balance, beginning of period	2,218,123	2,036,087
Benefit plan share activity (1)	12,512	19,230
Share-based expense, net of forfeitures and clawbacks	34,353	149,799
Proceeds from exercise of stock options	51	108
Acquisitions and contingent consideration	419	419
Tax benefit for issuance of share-based awards	32,434	2,965
Dividend equivalents on share-based plans	4,167	9,515
Issuance of treasury stock	97,723	
Balance, end of period	2,399,782	2,218,123
Retained earnings		
Balance, beginning of period	850,654	688,039
Net earnings to common shareholders	167,957	223,666
Dividends	(32,328)	(61,051)
Balance, end of period	986,283	850,654
Treasury stock, at cost		
Balance, beginning of period	(539,530)	(384,379)
Purchases	(41,567)	(140,071)
Returns / forfeitures	(9,049)	(15,080)
Issued	397,122	
Balance, end of period	(193,024)	(539,530)
Accumulated other comprehensive (loss) income		
Balance, beginning of period	(51,278)	(41,626)
Currency adjustment	23,497	(8,490)

Pension adjustment, net of tax		(1,162)
Balance, end of period	(27,781)	(51,278)
Total common stockholders equity	3,165,281	2,477,989
Noncontrolling interests		
Balance, beginning of period	332,976	321,538
Net earnings to noncontrolling interests	18,788	16,601
Contributions	1,213	12,433
Distributions	(21,884)	(15,177)
Deconsolidation of asset management entity		(5,477)
Adoption of accounting changes to ASC 810		3,058
Balance, end of period	331,093	332,976
Total stockholders equity	\$ 3,496,374	\$ 2,810,965

(1) Includes grants related to the Incentive Plan, Deferred Compensation Plan and Directors Plan.
See accompanying unaudited notes to consolidated financial statements.

Table of Contents

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

	Three Months Ended		Six Months Ended	Five Months Ended
	May 31, 2011	May 31, 2010	May 31, 2011	May 31, 2010
Net earnings to common shareholders	\$ 80,616	\$ 83,826	\$ 167,957	\$ 116,197
Other comprehensive income:				
Currency translation adjustments	8,985	16,600	23,497	30,983
Total other comprehensive income (1)	8,985	16,600	23,497	30,983
Comprehensive income	\$ 89,601	\$ 100,426	\$ 191,454	\$ 147,180

(1) Total other comprehensive income, net of tax, is attributable to common shareholders. No other comprehensive income is attributable to noncontrolling interests.

See accompanying unaudited notes to consolidated financial statements.

Page 7 of 89

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

	Six Months Ended May 31, 2011	Five Months Ended May 31, 2010
Cash flows from operating activities:		
Net earnings	\$ 186,745	\$ 120,191
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization	25,209	14,720
Fees related to assigned management agreements	(1,736)	(1,587)
Interest on mandatorily redeemable preferred interests of consolidated subsidiaries	20,854	2,513
Accruals related to various benefit plans and stock issuances, net of estimated forfeitures	37,817	18,011
Decrease (increase) in cash and securities segregated and on deposit for regulatory purposes or deposited with clearing and depository organizations	417,049	(323,250)
Increase in receivables:		
Brokers, dealers and clearing organizations	(1,274,030)	(741,789)
Customers	(473,600)	(552,492)
Fees, interest and other	(119,575)	(50,866)
Increase in securities borrowed	(58,616)	(289,095)
Increase in financial instruments owned	(1,645,394)	(4,329,765)
Increase in other investments	(209,105)	(29,762)
Decrease (increase) in investments in managed funds	6,282	(7,823)
(Increase) decrease in securities purchased under agreements to resell	(46,590)	302,795
Increase in other assets	(182,534)	(184,498)
Increase in payables:		
Brokers, dealers and clearing organizations	1,386,872	443,574
Customers	344,807	114,208
Increase in securities loaned	54,510	572,189
Increase in financial instruments sold, not yet purchased	2,183,385	2,474,499
(Decrease) increase in securities sold under agreements to repurchase	(1,565,229)	1,737,028
Increase in accrued expenses and other liabilities	15,487	23,298
Net cash used in operating activities	(897,392)	(687,901)
Cash flows from investing activities:		
Net payments on premises and equipment	(27,568)	(10,136)
Cash received from contingent consideration	1,752	925
Cash paid for contingent consideration		(6,997)

Net cash used in investing activities	(25,816)	(16,208)
---------------------------------------	----------	----------

Continued on next page.

Page 8 of 89

Table of Contents

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

	Six Months Ended May 31, 2011	Five Months Ended May 31, 2010
Cash flows from financing activities:		
Excess tax benefits from the issuance of share-based awards	\$ 34,010	\$ 1,994
Gross proceeds from short-term borrowings	1,257,000	1,497,000
Gross payments on short-term borrowings	(1,257,000)	(1,497,000)
Net proceeds from (payments on):		
Issuance of common shares	494,845	
Issuance of senior notes, net of issuance costs	794,587	
Mandatorily redeemable preferred interest of consolidated subsidiaries	(8,949)	(17,066)
Noncontrolling interest	(20,671)	(14,408)
Repurchase of common stock	(41,567)	(103,336)
Dividends	(28,161)	(12,957)
Exercise of stock options, not including tax benefits	51	108
Net cash provided by (used in) financing activities	1,224,145	(145,665)
Effect of foreign currency translation on cash and cash equivalents	8,802	(9,109)
Net increase (decrease) in cash and cash equivalents	309,739	(858,883)
Cash and cash equivalents at beginning of period	2,188,998	1,853,167
Cash and cash equivalents at end of period	\$ 2,498,737	\$ 994,284
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	\$ 363,397	\$ 237,138
Income taxes, net	129,984	84,090

See accompanying unaudited notes to consolidated financial statements.

Page 9 of 89

Table of Contents

JEFFERIES GROUP, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Index

	Page
Note 1. Organization and Basis of Presentation	11
Note 2. Summary of Significant Accounting Policies	13
Note 3. Cash, Cash Equivalents and Short-Term Investments	19
Note 4. Financial Instruments	20
Note 5. Derivative Financial Instruments	32
Note 6. Collateralized Transactions	36
Note 7. Securitization Activities and Variable Interest Entities	36
Note 8. Jefferies Finance LLC	42
Note 9. Acquisitions	43
Note 10. Short-Term Borrowings	45
Note 11. Long-Term Debt	45
Note 12. Mandatorily Redeemable Convertible Preferred Stock	46
Note 13 Noncontrolling Interest and Mandatorily Redeemable Preferred Interests of Consolidated Subsidiaries	46
Note 14. Benefit Plans	47
Note 15. Compensation Plans	47
Note 16. Earnings Per Share	52
Note 17. Income Taxes	53
Note 18. Commitments, Contingencies and Guarantees	53
Note 19. Net Capital Requirements	56
Note 20. Segment Reporting	56
Note 21. Related Party Transactions	58

Page 10 of 89

Table of Contents

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

Note 1. Organization and Basis of Presentation

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 Hong Kong 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).

We operate in two business segments, Capital Markets and Asset Management. Capital Markets includes our securities trading (including the results of our indirectly partially-owned subsidiary, Jefferies High Yield Trading, LLC) and investment banking activities, which provides the research, sales, trading and origination effort for various equity, fixed income and advisory products and services. Asset Management provides investment management services to various private investment funds, separate accounts and mutual funds.

Change in Year End

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. As such, the current period represents the three and six months ended May 31, 2011 and has been reported on the basis of the new fiscal year. Our prior year period consisted of the three and five months ended May 31, 2010 and is reported on the basis of the previous calendar year cycle.

Basis of Presentation

The accompanying unaudited Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) 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 GAAP for complete financial statements. All adjustments (consisting of normal recurring accruals) considered necessary for fair presentation have been included. These unaudited consolidated financial statements should be read in conjunction with our Transition Report on Form 10-K for the eleven months ended November 30, 2010.

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 GAAP. The most significant of these estimates and assumptions relate to fair value measurements, compensation and benefits, legal reserves and the realizability of deferred tax assets. Although these and other estimates and assumptions are based on the best available information, actual results could be materially different from these estimates.

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.

Table of Contents

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

Intercompany accounts and transactions are eliminated in consolidation.

Immaterial Restatements

As indicated in our Transition Report on Form 10-K for the eleven months ended November 30, 2010 (hereafter in this Note referred to as adjustments), we made correcting adjustments to our financial statements for the three and five months ended May 31, 2010 relating to the netting of interest income and interest expense, differences with our former clearing bank, and certain other immaterial adjustments. We do not believe that these adjustments are material to our financial statements for these periods. For additional information on these adjustments, see Note 1, Organization and Basis of Presentation, and Note 23, Selected Quarterly Financial Data (Unaudited), of the Consolidated Financial Statements of our Transition Report on Form 10-K for the eleven months ended November 30, 2010.

The following table sets forth the effects of the adjustments on Net earnings, on an after tax basis, for the three and five months ended May 31, 2010 (in thousands):

Decrease in Net earnings to common shareholders

	Three Months Ended May 31, 2010	Five Months Ended May 31, 2010
Previously reported Net earnings to common shareholders	\$ 84,832	\$ 118,539
Netting of interest revenues and expense		
Differences with clearing bank	(766)	(1,680)
Other items (1)	(240)	(662)
Total adjustments	(1,006)	(2,342)
Adjusted Net earnings to common shareholders	\$ 83,826	\$ 116,197

(1) Other items Includes the effect of certain other immaterial adjustments.

The following table sets forth the effects of the adjustments on major caption items within our Consolidated Statement of Earnings for the three and five months ended May 31, 2010 (in thousands, except per share amounts):

Page 12 of 89

Table of Contents

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

	Three Months Ended May 31, 2010		Five Months Ended May 31, 2010	
	As		As Previously	
	Previously Reported	Adjusted	Reported	Adjusted
Principal transactions	\$ 155,581	\$ 153,986	\$ 249,755	\$ 246,642
Interest	150,187	243,183	250,065	386,168
Total revenues	740,640	832,040	1,119,414	1,252,404
Interest expense	71,110	164,504	120,042	257,234
Net revenues	669,530	667,536	999,372	995,170
Net revenues, less mandatorily redeemable preferred interest	667,512	665,518	996,859	992,657
Floor brokerage and clearing fees	35,849	35,509	54,458	54,089
Total non-interest expenses	522,179	521,838	796,433	796,063
Earnings before income taxes	145,333	143,680	200,426	196,594
Income tax expense	56,836	56,189	77,893	76,403
Net earnings	88,497	87,491	122,533	120,191
Net earnings to common shareholders	84,832	83,826	118,539	116,197
Earnings per common share:				
Basic	\$ 0.42	\$ 0.41	\$ 0.58	\$ 0.57
Diluted	\$ 0.41	\$ 0.41	\$ 0.58	\$ 0.57

These adjustments affected certain line items within cash flows from operating activities on the Consolidated Statement of Cash Flows for the five months ended May 31, 2010, with no net effect on net cash used in operating activities. In addition, supplemental disclosures for cash paid for interest were also adjusted.

Note 2. Summary of Significant Accounting Policies**Revenue Recognition Policies**

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. 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 \$11.9 million and \$11.3 million for the three months ended May 31, 2011 and 2010, respectively, and \$22.4 million and \$17.1 million for the six months ended May 31, 2011 and five months ended May 31, 2010, 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 and Financial instruments sold, but not yet purchased (all of which are recorded on a trade-date basis) are carried at fair value with gains and losses reflected in Principal transactions in the Consolidated Statements of Earnings on a trade date basis.

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. Out-of-pocket expenses are recorded net of client reimbursements. Revenues are presented net of related out-of-pocket unreimbursed expenses. Unreimbursed out-of-pocket expenses with no related revenues are included in Business development and Professional services expenses in the Consolidated Statements of Earnings.

Table of Contents

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

Asset Management Fees and Investment Income From Managed Funds. Asset management fees and investment income 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 related-party managed funds and investment income 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 assets under management or an agreed upon notional amount 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. 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 (generally annual periods) 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, including money market funds, not held for resale with original maturities of three months or less.

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).

Table of Contents

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

Fair Value Hierarchy

In determining fair value, we maximize the use of observable inputs and minimize the use of unobservable inputs by requiring that 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 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

Table of Contents

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

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 4, 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 related-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 from managed funds in the Consolidated Statements of Earnings.

Other Investments

Other investments includes investments and loans 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. Revenues on Other investments are included in Other income in the Consolidated Statement of Earnings.

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 included within this financial statement line item 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 the amounts of cash collateral advanced and received in connection with the transactions 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. 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 and incur interest 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

Table of Contents

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

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 of each reporting unit with its estimated net book value. 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 June 1, 2011 and no impairment was identified. (Refer to Note 9, Acquisitions, for further details on our annual assessment of goodwill.)

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

In the normal course of business, we have been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with our activities as a global securities and investment banking firm. We are also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding our businesses, certain of which may result in judgments, settlements, fines, penalties or other injunctions.

We recognize a liability for a contingency in Accrued expenses and other liabilities 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. The determination of the outcome and loss estimates requires significant judgment on the part of management.

Table of Contents

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

In many instances, it is not possible to determine whether any loss is probable or even possible or to estimate the amount of any loss or the size of any range of loss. We believe that, in the aggregate, the pending legal actions or proceedings should not have a material adverse effect on our consolidated results of operations, cash flows or financial condition. In addition, we believe that any amount that could be reasonably estimated of potential loss or range of potential loss in excess of what has been provided in the consolidated financial statements is not material.

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 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 available to common shareholders represent net earnings 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 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.

Securitization Activities

We engage in securitization activities related to commercial mortgage loans and mortgage-backed and other asset-backed securities. Such transfers of financial assets are generally 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.

When a transfer of assets does not meet the criteria of a sale, that transfer is treated as a secured borrowing. We continue to recognize the assets of a secured borrowing in Financial instruments owned and recognize the associated financing in Other liabilities in the Consolidated Statements of Financial Condition.

New Accounting Developments

Fair Value Measurements and Disclosures. In May 2011, the Financial Accounting Standards Board (FASB) issued accounting updates to ASC 820, Fair Value Measurements Topic Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs, which provide clarifying guidance on how to

Table of Contents

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

measure fair value and additional disclosure requirements. The amendments prohibit the use of blockage factors at all levels of the fair value hierarchy and provide guidance on measuring financial instruments that are managed on a net portfolio basis. Additional disclosure requirements include transfers between Levels 1 and 2; and for Level 3 fair value measurements, a description of our valuation processes and additional information about unobservable inputs impacting Level 3 measurements. The updates are effective March 1, 2012 and will be applied prospectively. We are currently evaluating the impact, if any, that these updates will have on our financial condition, results of operations or cash flows.

Reconsideration of Effective Control for Repurchase Agreements. In April 2011, the FASB issued accounting guidance that removes the requirement to consider whether sufficient collateral is held when determining whether to account for repurchase agreements and other agreements that both entitle and obligate the transferor to repurchase or redeem financial assets before their maturity as sales or as secured financings. The guidance is effective prospectively for transactions beginning on January 1, 2012. We do not believe that the adoption of this guidance will have an impact on our financial condition, results of operations or cash flows.

Note 3. 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 May 31, 2011 and November 30, 2010 (in thousands):

	May 31, 2011	November 30, 2010
Cash and cash equivalents:		
Cash in banks	\$ 373,429	\$ 325,227
Money market investments	2,125,308	1,863,771
Total cash and cash equivalents	\$ 2,498,737	\$ 2,188,998
Cash and securities segregated (1)	\$ 1,219,917	\$ 1,636,755

- (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.

Table of Contents

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

Note 4. 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 May 31, 2011 and November 30, 2010 by level within the fair value hierarchy (in thousands):

	As of May 31, 2011				
	Level 1 (3)	Level 2 (3)	Level 3	Counterparty and Cash Collateral Netting (2)	Total
Assets:					
Financial instruments owned:					
Corporate equity securities	\$ 1,529,938	\$ 165,257	\$ 18,230	\$	\$ 1,713,425
Corporate debt securities	17,270	4,376,238	39,688		4,433,196
Collateralized debt obligations		94,366	84,046		178,412
U.S. government and federal agency securities	1,721,513	270,233			1,991,746
Municipal securities		497,145	858		498,003
Sovereign obligations	2,036,048	1,091,901			3,127,949
Residential mortgage-backed securities		4,066,322	206,721		4,273,043
Commercial mortgage-backed securities		580,571	33,516		614,087
Other asset-backed securities		112,221	9,352		121,573
Loans and other receivables		347,937	261,056		608,993
Derivatives	234,656	277,979	102	(376,353)	136,384
Investments at fair value		25	71,008		71,033
Total financial instruments owned	\$ 5,539,425	\$ 11,880,195	724,577	\$ (376,353)	\$ 17,767,844
Level 3 assets for which the firm does not bear economic exposure (1)			(192,001)		
Level 3 assets for which the firm bears economic exposure			\$ 532,576		
Liabilities:					
Financial instruments sold, not yet purchased:					
Corporate equity securities	\$ 1,668,580	\$ 135,373	\$ 38	\$	\$ 1,803,991
Corporate debt securities	9,358	2,277,802			2,287,160
U.S. government and federal agency securities	3,893,234	2,598			3,895,832
Municipal securities		551			551
Sovereign obligations	2,046,285	1,114,053			3,160,338

Residential mortgage-backed securities		38,149			38,149
Other asset-backed securities		86			86
Loans		159,352	6,398		165,750
Derivatives	229,944	333,752	2,841	(455,131)	111,406
Total financial instruments sold, not yet purchased	\$ 7,847,401	\$ 4,061,716	\$ 9,277	\$ (455,131)	\$ 11,463,263

- (1) Consists of Level 3 assets which are either financed by nonrecourse secured financings or attributable to third party or employee noncontrolling interests in certain consolidated entities.
- (2) Represents counterparty and cash collateral netting across the levels of the fair value hierarchy for positions with the same counterparty.
- (3) There were no significant transfers between Level 1 and Level 2 for the three-months and six-months ended May 31, 2011.

Table of Contents

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

As of November 30, 2010

	Level 1	Level 2	Level 3	Counterparty and Cash Collateral Netting (2)	Total
Assets:					
Financial instruments owned:					
Corporate equity securities	\$ 1,453,744	\$ 89,430	\$ 22,619	\$	\$ 1,565,793
Corporate debt securities	25	3,557,183	73,408		3,630,616
Collateralized debt obligations		27,863	31,121		58,984
U.S. government and federal agency securities	2,322,204	210,422			2,532,626
Municipal securities		477,462	472		477,934
Sovereign obligations	1,600,762	580,651			2,181,413
Residential mortgage-backed securities		3,912,708	132,359		4,045,067
Commercial mortgage-backed securities		524,614	6,004		530,618
Other asset-backed securities		286,329	567		286,896
Loans and other receivables		206,977	227,596		434,573
Derivatives	279,811	176,069		(336,612)	119,268
Investments at fair value			77,784		77,784
Total financial instruments owned	\$ 5,656,546	\$ 10,049,708	571,930	\$ (336,612)	\$ 15,941,572
Level 3 assets for which the firm does not bear economic exposure (1)			(204,139)		
Level 3 assets for which the firm bears economic exposure			\$ 367,791		
Liabilities:					
Financial instruments sold, not yet purchased:					
Corporate equity securities	\$ 1,554,489	\$ 83,845	\$ 38	\$	\$ 1,638,372
Corporate debt securities		2,375,925			2,375,925
U.S. government and federal agency securities	1,688,684	51,604			1,740,288
Municipal securities		170			170
Sovereign obligations	2,180,667	814,163			2,994,830
Residential mortgage-backed securities		127,547			127,547
Commercial mortgage-backed securities		1,837			1,837

Loans		124,050	47,228		171,278
Derivatives	241,860	240,866	2,346	(425,520)	59,552
Total financial instruments sold, not yet purchased	\$ 5,665,700	\$ 3,820,007	\$ 49,612	\$ (425,520)	\$ 9,109,799

- (1) Consists of Level 3 assets which are either financed by nonrecourse secured financings or attributable to third party or employee noncontrolling interests in certain consolidated entities.
- (2) Represents counterparty and cash collateral netting across the levels of the fair value hierarchy for positions with the same counterparty.

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

Table of Contents

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

that are not registered broker-dealers because they are risk managed by us on a fair value basis. We have elected to apply the fair value option to certain secured financings that arise in connection with our securitization activities. At May 31, 2011 and November 30, 2010, \$104.8 million and \$85.7 million, respectively, in secured financings, are included within Other liabilities on the Consolidated Statement of Financial Position, are accounted for at fair value and are classified as Level 3 liabilities. 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 – 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: Non-exchange traded 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

Page 22 of 89

Table of Contents

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

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.

Collateralized Debt Obligations

Collateralized debt obligations measured using prices observed for recently executed market transactions are classified within Level 2 of the fair value hierarchy. When measured based on valuations received from third party brokers, collateralized debt obligations are classified within Level 3 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. Non-callable 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.

Sovereign Obligations

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

Table of Contents

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

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 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.

Project Loans: Valuation of project loans are based on bench marks of prices for recently executed transactions of related realized collateralized securities and are classified within Level 3 of the fair value hierarchy.

Escrow and Trade Claim Receivables: Escrow and trade claim receivables are categorized within Level 3 of the fair value hierarchy where fair value is estimated based on reference to market prices and implied yields of debt securities of the same or similar issuers. Escrow and trade claim receivables are categorized within Level 2 where fair value is based on recent trade activity in the same security.

Table of Contents

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

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.

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 and single-name credit default swaps. 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. The following tables provide further information about our investments in entities that have the characteristics of an investment company at May 31, 2011 and November 30, 2010 (in thousands):

	Fair Value (f)	May 31, 2011	
		Unfunded Commitments	Redemption Frequency (if currently eligible)
Equity Long/Short Hedge Funds (a)	\$ 18,283	\$	Quarterly, Semiannually
High Yield Hedge Funds(b)	1,064		
Fund of Funds(c)	942	129	Annually
Private Equity Funds(d)	23,726	6,303	
Other Investments(e)			At Will
Total(g)	\$ 44,015	\$ 6,432	

Table of Contents

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

	Fair Value (f)	November 30, 2010	
		Unfunded Commitments	Redemption Frequency (if currently eligible) Quarterly, Semiannually Annually At Will
Equity Long/Short Hedge Funds ^(a)	\$ 19,865	\$	
High Yield Hedge Funds ^(b)	1,561		
Fund of Funds ^(c)	2,622	131	Annually
Private Equity Funds ^(d)	26,567	6,792	
Other Investments ^(e)	287		At Will
Total ^(g)	\$ 50,902	\$ 6,923	

- (a) This category includes investments in hedge funds that invest in both long and short equity securities in domestic and international markets in both public and private sectors. At May 31, 2011 and November 30, 2010, investments representing approximately 97% and 67%, respectively, of the fair value in this category are redeemable with 60 – 90 days prior written notice. At November 30, 2010, investments representing approximately 30% of fair value cannot be redeemed until the lock-up period expired on December 31, 2010. At May 31, 2011 and November 30, 2010, investments representing approximately 3% 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 May 31, 2011 and November 30, 2010, an investment representing less than 1% of fair value 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.
- (b) This category includes investments in funds that invest in domestic and international public high yield debt, private high yield investments, senior bank loans, public leveraged equities, distressed debt, and private equity investments. There are no redemption provisions and distributions are received through the liquidation of the underlying assets of the funds. At May 31, 2011 and November 30, 2010, these investments are currently in liquidation and we are unable to estimate when the underlying assets will be fully liquidated.
- (c) This category includes investments in fund of funds that invest in various private equity funds. At May 31, 2011 and November 30, 2010, approximately 99% and 41%, respectively, of the fair value of investments in this category is managed by us and has no redemption provisions. Distributions are received through the liquidation of the underlying assets of the fund of funds, which are estimated to be liquidated in one to three years. At May 31, 2011 we requested redemption for investments representing approximately 1% of fair value at May 31, 2011, however we are unable to estimate when these funds will be returned. At November 30, 2010, investments representing approximately 59% of the fair value were approved for redemption and the funds' net asset values were received in the first quarter of 2011.
- (d) At May 31, 2011 and November 30, 2010, investments representing approximately 81% and 74% respectively, include investments in private equity funds that invest in the equity of various private companies in the energy, technology, internet service and telecommunication service industries including acquired or restructured

companies. These investments cannot be redeemed; distributions are received through the liquidation of the underlying assets of the funds and are expected to liquidate in one to ten years. Investments in this category at May 31, 2011 and November 30, 2010, representing approximately 19% and 26%, respectively, are investments in closed-ended funds that invest in Croatian and Vietnamese companies.

- (e) At November 30, 2010, this category included investments in closed-ended funds that invested in Vietnamese equity and debt instruments.
- (f) Fair value has been estimated using the net asset value derived from each of the funds' partner capital statements.
- (g) Investments at fair value, in the Consolidated Statements of Financial Condition at May 31, 2011 and November 30, 2010 include \$27.0 million and \$26.9 million, respectively, of direct investments which are not investment companies and therefore are not part of this disclosure table.

Table of Contents

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

At May 31, 2011 and November 30, 2010, our Financial instruments owned and Financial instruments sold, not yet purchased are measured using different valuation basis as follows:

	May 31, 2011		November 30, 2010	
	Financial Instruments Owned	Financial Instruments Sold, Not Yet Purchased	Financial Instruments Owned	Financial Instruments Sold, Not Yet Purchased
Exchange closing prices	9%	14%	9%	17%
Recently observed transaction prices	1%	2%	5%	2%
Data providers/pricing services	78%	81%	65%	60%
Broker quotes	2%	1%	12%	19%
Valuation techniques	10%	2%	9%	2%
	100%	100%	100%	100%

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.

Table of Contents

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

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 May 31, 2011 (in thousands):

	Three Months Ended May 31, 2011						Change in unrealized gains/ (losses) relating to instruments still held at May 31, 2011 (1)
	Balance, February 28, 2011	Total gains/ losses (realized and unrealized) (1)	Purchases, sales, settlements, and issuances, net	Transfers into Level 3	Transfers out of Level 3	Balance, May 31, 2011	
Assets:							
Financial instruments owned:							
Corporate equity securities	\$ 33,281	\$ (489)	\$ 2,392	\$	\$(16,954)	\$ 18,230	\$ (864)
Corporate debt securities	74,984	690	(35,257)	1,681	(2,410)	39,688	(135)
Collateralized debt obligations	102,946	9,943	(25,237)	5,154	(8,760)	84,046	4,875
U.S. issued municipal securities	799	59				858	59
Residential mortgage-backed securities	97,109	(2,783)	(787)	113,366	(184)	206,721	(6,303)
Commercial mortgage-backed securities	6,301	5,013	5,532	22,971	(6,301)	33,516	5,013
Other asset-backed securities	11,452	(118)	(4,675)	5,871	(3,178)	9,352	75
Loans and other receivables	217,751	5,052	47,210	1,896	(10,853)	261,056	3,904
Investments at fair value	67,834	7,727	(4,534)		(19)	71,008	7,740
Liabilities:							
Financial instruments sold, not yet purchased:							
Corporate equity securities	\$ 38	\$	\$	\$	\$	\$ 38	\$
Net derivatives (2)	4,957	(2,218)				2,739	(2,118)
Loans	17,776	(21)	(11,357)			6,398	

- (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.

Analysis of Level 3 Assets and Liabilities for the Three Months Ended May 31, 2011

During the three months ended May 31, 2011, transfers of assets of \$150.9 million from Level 2 to Level 3 are primarily attributed to:

Non-agency residential mortgage-backed securities, commercial mortgage-backed securities, other asset-backed securities and collateralized debt obligations due to a tightening in the historical trading period used for corroborating market data and a greater scrutiny of vendor prices.

During the three months ended May 31, 2011, transfers of assets of \$48.7 million from Level 3 to Level 2 are primarily attributed to:

Corporate equity securities and Loans and other receivables, for which market transactions were announced or market data on comparable securities used as a benchmark became more observable;

Collateralized debt obligations due to corroborating vendor prices to actual transactions; and

Commercial mortgage-backed securities, for which market trades were observed in the period for either identical or similar securities.

During the three months ended May 31, 2011 there were no transfers of liabilities from Level 2 to Level 3 or from Level 3 to Level 2.

Table of Contents

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

Net gains on Level 3 assets were \$25.1 million and net gains on Level 3 liabilities were \$2.2 million for the three months ended May 31, 2011. Net gains on Level 3 assets were primarily due to increased valuations of various investments at fair value, collateralized debt obligations, and commercial mortgage-backed securities, and sales of certain collateralized debt obligations and residential mortgage-backed securities; offset by decreased valuations of residential mortgage-backed securities.

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 May 31, 2010 (in thousands):

	Balance, February 28, 2010	Three Months Ended May 31, 2010			Balance, May 31, 2010	Change in unrealized gains/ (losses) relating to instruments still held at May 31, 2010 (1)
		Total gains/ losses (realized and unrealized) (1)	Purchases, sales, settlements, and issuances, net	Transfers into Level 3		
Assets:						
Financial instruments owned:						
Corporate equity securities	\$ 35,314	\$(15,909)	\$ 3,138	\$111	\$ (736)	\$ (15,853)
Corporate debt securities	123,083	2,590	(5,373)	263	(20,288)	1,205
Collateralized debt obligations	12,860	453				332
U.S. issued municipal securities	420	16				436
Residential mortgage-backed securities	170,689	(2,168)	643	718	(21,049)	(5,852)
Commercial mortgage-backed securities	730	(249)	391	858	(730)	(249)
Other asset-backed securities	110	(30)	289			(30)
Loans and other receivables	300,557	8,466	9,930		(173,772)	4,640
Investments at fair value	65,780	5,405	1,359	7	(254)	4,638
Investments in managed funds	\$ 8,630	\$ 14	\$	\$	\$	\$ 8,644
						\$ 14

Liabilities:

Financial
instruments sold, not
yet purchased:

Corporate equity securities	\$	38	\$		\$		\$	38	\$
Corporate debt securities			(935)	15,300			14,365	(935)	
Net derivatives (2)		1,663	(392)				1,271	(392)	
Loans		283,396		32,829		(247,983)	68,242		

(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.

Analysis of Level 3 Assets and Liabilities for the Three Months Ended May 31, 2010

During the three months ended May 31, 2010, we had transfers of assets of \$2.0 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. Transfers of assets from Level 3 to Level 2 during the three months ended May 31, 2010 were \$216.8 million and are 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; residential mortgage-backed securities, for which market trades were observed in the period for either identical or similar securities; and corporate debt securities, for which market transactions were announced or market data on comparable securities used as a valuation benchmark became more transparent.

Table of Contents

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

Transfers of liabilities from Level 2 to Level 3 were \$-0- and transfers of liabilities from Level 3 to Level 2 were \$248.0 million for the three months ended May 31, 2010. Transfers of liabilities from Level 3 to Level 2 during the three months ended May 31, 2010 are primarily due to transfers of 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 losses on Level 3 assets were \$1.4 million and net gains on Level 3 liabilities were \$1.3 million for the three months ended May 31, 2010. Net losses on Level 3 assets were attributed to corporate equity securities due to market volatility impacting the valuation of equity warrants and declines in commodity prices underlying certain equity valuations, partially offset by net gains on loans and investments.

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 six months ended May 31, 2011 (in thousands):

	Six Months Ended May 31, 2011						Change in unrealized gains/ (losses) relating to instruments still held at May 31, 2011 (1)
	Balance, November 30, 2010	Total gains/ losses (realized and unrealized) (1)	Purchases, sales, settlements, and issuances, net	Transfers into Level 3	Transfers out of Level 3	Balance, May 31, 2011	
Assets:							
Financial instruments owned:							
Corporate equity securities	\$ 22,619	\$ 1,667	\$ 1,948	\$	\$(8,004)	\$ 18,230	\$ 323
Corporate debt securities	73,408	2,690	(35,991)	101	(520)	39,688	796
Collateralized debt obligations	31,121	10,401	38,854	3,680	(10)	84,046	10,085
U.S. issued municipal securities	472	78	308			858	78
Residential mortgage-backed securities	132,359	9,976	(7,506)	72,012	(120)	206,721	(11,103)
Commercial mortgage-backed securities	6,004	6,906	16,052	4,554		33,516	5,464
Other asset-backed securities	567	780	6,422	2,150	(567)	9,352	780
Loans and other receivables	227,596	9,531	23,108	1,284	(463)	261,056	6,723
Investments at fair value	77,784	7,833	(11,529)		(3,080)	71,008	8,351

Liabilities:

Financial

instruments sold, not
yet purchased:

Corporate equity

securities	\$	38	\$		\$		\$		\$	38	\$	
Net derivatives (2)		2,346		393						2,739		492
Loans		47,228				(40,830)				6,398		

(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.

Analysis of Level 3 Assets and Liabilities for the Six Months Ended May 31, 2011

During the six months ended May 31, 2011, transfers of assets of \$83.8 million from Level 2 to Level 3 are primarily attributed to:

Non-agency residential mortgage-backed securities, commercial asset backed securities, collateralized debt obligations, and other asset-backed securities due to a tightening in the historical trading period used for corroborating market data and a greater scrutiny of vendor prices.

During the six months ended May 31, 2011, transfers of assets of \$12.8 million from Level 3 to Level 2 are primarily attributed to:

Table of Contents

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

Corporate equity securities, for which market transactions were announced or market data on comparable securities used as a benchmark became more observable.

During the six months ended May 31, 2011 there were no transfers of liabilities from Level 2 to Level 3 or from Level 3 to Level 2.

Net gains on Level 3 assets were \$49.9 million and net losses on Level 3 liabilities were \$0.4 million for the six months ended May 31, 2011. Net gains on Level 3 assets were primarily due to increased valuations of various collateralized debt obligations, investments at fair value, loans and other receivables, and commercial-mortgage backed securities, and sales of certain residential mortgage-backed securities, offset by decreased valuations of certain residential mortgage-backed securities.

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 five months ended May 31, 2010 (in thousands):

	Balance, December 31, 2009	Five Months Ended May 31, 2010			Balance, May 31, 2010	Change in unrealized gains/ (losses) relating to instruments still held at May 31, 2010 (1)
		Total gains/ losses (realized and unrealized) (1)	Purchases, sales, and issuances, net	settlements, and Transfers into Level 3		
Assets:						
Financial instruments owned:						
Corporate equity securities	\$ 43,042	\$(21,841)	\$ 2,984	\$ 681	\$ (2,948)	\$ (21,610)
Corporate debt securities	116,648	(159)	(3,632)	110	(12,692)	1,788
Collateralized debt obligations	9,570	3,743				3,743
U.S. issued municipal securities	420	16				436
Sovereign obligations	196				(196)	
Residential mortgage-backed securities	136,496	8,971	15,801	6,223	(18,658)	(207)
Commercial mortgage-backed securities	3,215	(237)	(901)	858	(1,935)	(248)
Other asset-backed securities	110	(30)	289		369	(30)
	506,542	9,142	9,504		(380,007)	145,181

Loans and other receivables							
Investments at fair value	65,564	5,511	(1,190)	2,412		72,297	4,620
Investments in managed funds	\$	\$ 1,372	\$	\$7,272	\$	\$ 8,644	\$ 1,372
Liabilities:							
Financial instruments sold, not yet purchased:							
Corporate equity securities	\$	\$	\$	\$ 38	\$	\$ 38	\$
Corporate debt securities		(935)	15,300			14,365	(935)
Net derivatives (2)	6,835	(3,655)			(1,909)	1,271	(3,655)
Loans	352,420		44,566		(328,744)	68,242	

(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.

Analysis of Level 3 Assets and Liabilities for the Five Months Ended May 31, 2010

During the five months ended May 31, 2010, we had transfers of assets of \$17.6 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

Table of Contents

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

are attributed to certain investments at fair value and investments in managed funds, which have little to no transparency as to trade activity. Transfers of assets from Level 3 to Level 2 during the five months ended May 31, 2010 were \$416.4 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; residential mortgage-backed securities, for which market trades were observed in the period for either identical or similar securities; and corporate debt securities, for which market transactions were announced or market data on comparable securities used as a benchmark became more observable.

Transfers of liabilities from Level 2 to Level 3 were \$0.04 million and transfers of liabilities from Level 3 to Level 2 were \$330.7 million for the five months ended May 31, 2010. Transfers of liabilities from Level 3 to Level 2 during the three and five months ended May 31, 2010 are primarily due to transfers of 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 were \$6.5 million and net gains on Level 3 liabilities were \$4.6 million for the five months ended May 31, 2010. Net gains on Level 3 assets were attributed to corporate equity securities due to market volatility impacting the valuation of equity warrants and declines in commodity prices underlying certain equity valuations, partially offset by net gains on loans and investments.

Level 3 cash instruments are frequently hedged with instruments classified within Level 1 and Level 2, and accordingly, gains and 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.

Note 5. 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 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 realized and unrealized gains and losses are 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. (See Notes 4 and 18 for additional disclosures about derivative instruments.)

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, we may enter into master netting agreements and collateral arrangements with counterparties. These agreements provide

Table of Contents

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

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 a highly rated European bank (the Bank), which allow JFP customers that require a counterparty with a high credit rating for commodity index transactions to transact with the Bank. The Bank simultaneously enters into offsetting transactions with JFP and receives a fee from JFP for providing credit support.

The following table presents the fair value and related number of derivative contracts at May 31, 2011 and November 30, 2010 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 (dollars in thousands):

	May 31, 2011			
	Assets		Liabilities	
	Fair Value	Number of Contracts	Fair Value	Number of Contracts
Interest rate contracts	\$ 162,992	36,437	\$ 191,396	52,526
Foreign exchange contracts	11,626	352	22,037	1,356
Equity contracts	233,196	1,254,861	227,385	1,190,042
Commodity contracts	11,547	60,783	90,881	23,514
Credit contracts	93,376	43	34,838	39
Total	512,737	1,352,476	566,537	1,267,477
Counterparty/cash-collateral netting	(376,353)		(455,131)	
Total per Consolidated Statement of Financial Condition	\$ 136,384		\$ 111,406	

	November 30, 2010			
	Assets		Liabilities	
	Fair Value	Number of Contracts	Fair Value	Number of Contracts
Interest rate contracts	\$ 77,295	41,166	\$ 126,281	43,243
Foreign exchange contracts	20,263	1,165	17,004	290
Equity contracts	275,760	1,166,365	249,229	1,133,464
Commodity contracts	62,727	103,562	76,911	35,071
Credit contracts	19,835	18	15,647	15
Total	455,880	1,312,276	485,072	1,212,083
Counterparty/cash-collateral netting	(336,612)		(425,520)	
Total per Consolidated Statement of Financial Condition	\$ 119,268		\$ 59,552	

The following table presents unrealized and realized gains and losses on derivative contracts for the three months ended May 31, 2011 and 2010, respectively, and the six and five months ended May 31, 2011 and 2010, respectively (in thousands):

Page 33 of 89

Table of Contents

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

	Three Months Ended		Six Months Ended	Five Months Ended
	May 31, 2011	May 31, 2010	May 31, 2011	May 31, 2010
	Gain (Loss)	Gain (Loss)	Gain (Loss)	Gain (Loss)
Interest rate contracts	\$ (94,037)	\$ (11,293)	\$ (87,229)	\$ (36,759)
Foreign exchange contracts	(3,156)	2,457	(8,182)	816
Equity contracts	(42,953)	(22,067)	(103,870)	(47,268)
Commodity contracts	12,060	7,469	32,591	3,732
Credit contracts	8,182	(27,614)	5,742	(50,762)
Total	\$ (119,904)	\$ (51,048)	\$ (160,948)	\$ (130,241)

The following tables set forth the remaining contract maturity of the fair value of OTC derivative assets and liabilities as of May 31, 2011 (in thousands):

	OTC derivative assets (1) (2) (4)				
			Greater Than	Cross-Maturity	
	0 12 Months	1 5 Years	5 Years	Netting (3)	Total
Commodity swaps	\$ 1,336	\$	\$	\$	\$ 1,336
Commodity options	68				68
Equity options	10,922				10,922
Credit default swaps		20,401	62,396	(14,883)	67,914
Total return swaps	444	914			1,358
Foreign currency forwards and swaps	9,195	99			9,294
Fixed income forwards	16,580				16,580
Interest rate swaps and caps	3,231	21,303	43,849	(5,408)	62,975
Total	\$ 41,776	\$ 42,717	\$ 106,245	\$ (20,291)	170,447
Cross product counterparty netting					(9,057)
Total OTC derivative assets included in Financial instruments owned					\$ 161,390

(1) At May 31, 2011, we held exchange traded derivative assets and other credit enhancements of \$17.1 million.

(2)

OTC derivative assets in the table above are gross of collateral received. OTC derivative assets are recorded net of collateral received on the Consolidated Statements of Financial Condition. At May 31, 2011, cash collateral received was \$42.1 million.

- (3) Amounts represent the netting of receivable balances with payable balances within product category for the same counterparty across maturity categories.
- (4) Derivative fair values include counterparty netting within product category.

Page 34 of 89

Table of Contents

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

	OTC derivative liabilities (1) (2) (4)					
			Greater Than	Cross-Maturity		
	0 12 Months	1 5 Years	5 Years	Netting (3)	Total	
Commodity swaps	\$ 82,290	\$	\$	\$	\$ 82,290	
Commodity options	952				952	
Equity options	759	2,309			3,068	
Credit default swaps	2,219	16,959	5,562	(14,883)	9,857	
Total return swaps		247			247	
Foreign currency forwards and swaps	19,680	45			19,725	
Interest rate swaps and caps	6,753	52,494	63,348	(5,408)	117,187	
Total	\$ 112,653	\$ 72,054	\$ 68,910	\$ (20,291)	233,326	
Cross product counterparty netting						(9,057)
Total OTC derivative liabilities included in Financial instruments sold, not yet purchased						\$ 224,269

(1) At May 31, 2011, we held exchange traded derivative liabilities and other credit enhancements of \$8.0 million.

(2) OTC derivative liabilities in the table above are gross of collateral pledged. OTC derivative liabilities are recorded net of collateral pledged on the Consolidated Statements of Financial Condition. At May 31, 2011, cash collateral pledged was \$120.9 million.

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

(4) Derivative fair values include counterparty netting within product category.

At May 31, 2011, 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	\$ 125,819
B to BBB	2,012
Unrated	33,559
Total	\$ 161,390

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 May 31, 2011 and November 30, 2010, is \$115.2 million and \$51.8 million, respectively, for which we have posted collateral of \$110.2 million and \$44.9 million, respectively, in the normal course of business. If the credit-risk-related contingent features underlying these agreements were triggered on May 31, 2011 and November 30, 2010, we would have been required to post an additional \$8.2 million and \$6.5 million, respectively, of collateral to our counterparties.

Table of Contents

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

Note 6. Collateralized Transactions

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. Counterparties generally have the right to sell or repledge the collateral. Pledged securities that can be sold or repledged by the counterparty are included within Financial instruments owned and noted as Securities pledged on our Consolidated Statements of Financial Condition.

We receive securities in connection with resale agreements, securities borrowings and customer margin loans. In many instances, we are permitted by contract or custom to rehypothecate securities received as collateral. At May 31, 2011 and November 30, 2010, the approximate fair value of securities received related to resale agreements, securities borrowings and customer margin loans that may be sold or repledged by us was approximately \$24.9 billion and \$22.3 billion, respectively. At May 31, 2011 and November 30, 2010, a substantial portion of the securities received by us had been sold or repledged.

We also receive securities as collateral in connection with derivative transactions and in connection with certain securities for securities transactions in which we are the lender of securities. 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 May 31, 2011 and November 30, 2010, \$52.0 million and \$48.6 million, respectively, were reported as Securities received as collateral and as Obligation to return securities received as collateral.

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, treat these as noncash transactions and do 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 on our Consolidated Statements of Financial Condition.

Note 7. Securitization Activities and Variable Interest Entities***Securitization Activities***

We engage in securitization activities related to mortgage loans and mortgage-backed and other asset-backed securities. In our securitization activities, we use special purpose entities (SPEs). Our securitization vehicles generally meet the criteria of variable interest entities; however we do not consolidate our securitization vehicles as we do not meet the characteristics of the primary beneficiary for these vehicles. See Variable Interest Entities in this footnote for further discussion on variable interest entities and our determination of the primary beneficiary.

We derecognize financial assets transferred in securitizations when we have relinquished control over such assets. If we have not relinquished control over transferred assets, the financial assets continue to be recognized in Financial instruments owned and a corresponding secured borrowing is recognized in Other liabilities. Transferred assets are carried at fair value prior to securitization, with unrealized gains and losses reflected in Principal transactions in the Consolidated Statements of Earnings. We act as placement or structuring agent in connection with the beneficial interests issued by securitization vehicles. Net revenues are recognized in connection with these activities.

Our continuing involvement in securitization vehicles to which we have transferred assets is limited to holding beneficial interests in these vehicles (i.e., securities issued by these vehicles), which are included within Financial instruments owned on the Consolidated Statements of Financial Condition, and servicing rights over certain transferred assets (i.e., project loans), which are included within Other assets on the Consolidated Statements of Financial Condition. We apply fair value accounting to the securities and the servicing rights are amortized over the period of the estimated net servicing income. We have not provided financial or other support to these securitization vehicles during the six months ended May 31, 2011 and five months ended May 31, 2010. We have no explicit or

Table of Contents

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

implicit arrangements to provide additional financial support to these securitization vehicles and have no liabilities related to these securitization vehicles at May 31, 2011 and November 30, 2010. Although not obligated, we may make a market in the securities issued by these securitization vehicles. In these market-making transactions, we buy these securities from and sell these securities to investors. Securities purchased through these market-making activities are not considered to be continuing involvement in these vehicles, although the securities are included in Financial instruments owned Mortgage- and asset-backed securities.

During the three and six months ended May 31, 2011, we transferred assets of \$4,508.7 million and \$6,650.4 million, respectively, as part of our securitization activities in which we had continuing involvement, received cash proceeds of \$3,863.0 million and \$5,498.4 million, respectively, beneficial interests of \$671.9 million and \$1,189.7 million, respectively, and recognized Net revenues of \$19.8 million and \$28.1 million, respectively. During the three and five months ended May 31, 2010, we transferred assets of \$3,166.7 million and \$5,257.1 million, respectively, as part of our securitization activities in which we had continuing involvement, received cash proceeds of \$2,684.1 million and \$4,271.2 million, respectively, beneficial interests of \$500.7 million and \$1,036.9 million, respectively, servicing rights of \$0.1 million and \$0.1 million, respectively, and recognized Net revenues of \$32.8 million and \$51.4, million, respectively. These transfers were accounted for as sales of assets. Assets received in the form of securities issued in these transfers were initially categorized as Level 2 within the fair value hierarchy. For further information on fair value measurements and the fair value hierarchy, refer to Note 2, Summary of Significant Accounting Policies, and Note 4, Financial Instruments.

The following tables present the total information regarding securitization vehicles to which we, acting as transferor, have transferred assets and for which we received sale accounting treatment at May 31, 2011 and November 30, 2010 (in millions):

Securitization Type	Assets obtained as proceeds	As of May 31, 2011	
		Total Assets (4)	Assets Retained (1)(2)
Residential mortgage-backed securities	\$ 1,114.9 (3)	\$7,506.7	\$ 653.5 (1)(2)
Commercial mortgage-backed securities	74.8 (3)	2,087.2	29.9 (1)(2)

- (1) At May 31, 2011, the securities issued in these securitizations are comprised of government agency-backed securities.
- (2) A significant portion of these securities have been subsequently sold in secondary-market transactions to third parties. As of June 24, 2011, we continue to hold approximately \$509.3 million and \$27.8 million of these Residential mortgage-backed securities and Commercial mortgage-backed securities, respectively, in inventory.
- (3) Initial fair value of securities received on date of asset transfer that were issued by securitization vehicles.
- (4) Represents unpaid principal amount of assets in the securitization vehicles.

Securitization Type	Assets obtained as proceeds	As of November 30, 2010	
		Total Assets (6)	Assets Retained (1)(2)
Residential mortgage-backed securities	\$ 2,203.1 (3)	\$6,549.5	\$ 684.7 (1)(2)

Commercial mortgage-backed securities	105.7 (3)	2,005.4	40.4 (1)(2)
Project loans	0.1 (4)	107.8	0.1 (5)

- (1) At November 30, 2010, the securities issued in these securitizations are comprised of government agency-backed securities.
- (2) A significant portion of these securities have been subsequently sold in secondary-market transactions to third parties. As of June 24, 2011, we continue to hold approximately \$87.7 million and \$27.8 million of these Residential mortgage-backed securities and Commercial mortgage-backed securities, respectively, in inventory.
- (3) Initial fair value of securities received on date of asset transfer that were issued by securitization vehicles.
- (4) Initial fair value of servicing rights received on transferred project loans.
- (5) Represents amortized servicing rights on transferred project loans.
- (6) Represents unpaid principal amount of assets in the securitization vehicles.

Table of Contents

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

The following table presents cash flows received during the three and six months ended May 31, 2011 and three and five months ended May 31, 2010 related to securitization vehicles to which we have transferred assets and received sale accounting (in millions):

	Three Months Ended (1)		Six Months Ended	Five Months Ended
	May 31, 2011	May 31, 2010	May 31, 2011 (1)	May 31, 2010 (1)
Residential mortgage-backed securities	\$ 13.1	\$ 8.6	\$ 30.5	\$ 12.7
Commercial mortgage-backed securities		0.2	2.0	0.7

(1) Cash flows received on beneficial interests in securitization vehicles of project loans were de minimus for the three and six months ended May 31, 2011 and the three and five months ended May 31, 2010.

Variable Interest Entities

Variable interest entities (VIEs) are entities in which equity investors lack the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. VIEs are consolidated by 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.

We initially determine whether we are the primary beneficiary of a VIE upon our initial involvement with the VIE. We reassess whether we are the primary beneficiary of a VIE on an ongoing basis rather than upon the occurrence of certain events. Our determination of whether we are the primary beneficiary of a VIE is based upon the facts and circumstances for each VIE and requires significant judgment. In determining whether we are the party with the power to direct the VIE's most significant activities, we first identify the activities of the VIE that most significantly impact its economic performance. Our considerations in determining the VIE's most significant activities primarily include, but are not limited to, the VIE's purpose and design and the risks passed through to investors. We then assess whether we have the power to direct those significant activities. Our considerations in determining whether we have the power to direct the VIE's most significant activities include, but are not limited to, voting interests of the VIE, management, service and/ or other agreements of the VIE, involvement in the VIE's initial design and the existence of explicit or implicit financial guarantees. In situations where we have determined that the power over the VIE's most significant activities is shared, we assess whether we are the party with the power over the majority of the significant activities. If we are the party with the power over the majority of the significant activities, we meet the "power" criteria of the primary beneficiary. If we do not have the power over a majority of the significant activities or we determine that decisions require consent of each sharing party, we do not meet the "power" criteria of the primary beneficiary. We assess our variable interests in a VIE both individually and in aggregate to determine whether we have an obligation to absorb losses of or a right to receive benefits from the VIE that could potentially be significant to the VIE. The determination of whether our variable interest is significant to the VIE requires significant judgment. In determining the significance of our variable interest, we consider the terms, characteristics and size of the variable interests, the design and characteristics of the VIE, our involvement in the VIE and our market-making activities related to the variable interests.

VIEs Where We Are The Primary Beneficiary

The following tables present information about the assets and liabilities of our consolidated VIEs which are presented within our Consolidated Statements of Financial Condition in the respective asset and liability categories, as of May 31, 2011 and November 30, 2010 (in millions). The assets and liabilities in the tables below are presented prior to consolidation and thus a portion of these assets and liabilities are eliminated in consolidation. We have aggregated

our consolidated VIEs based upon principal business activity.

Table of Contents

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

		May 31, 2011			November 30, 2010		
		Mortgage- and Asset-backed			Mortgage- and Asset-backed		
	High Yield	Securitizations	Other	High Yield	Securitizations	Other	
Cash	\$ 219.1	\$	\$ 0.2	\$ 202.6	\$	\$	
Financial instruments owned	956.6	107.0	8.3	889.8	101.4	21.0	
Securities borrowed	283.8			455.8			
Receivable from brokers and dealers	177.9			195.5			
Other	8.0	0.2		11.6	0.1		
	\$ 1,645.4	\$ 107.2	\$ 8.5	\$ 1,755.3	\$ 101.5	\$ 21.0	
Financial instruments sold, not yet purchased	\$ 448.4	\$	\$	\$ 602.6	\$	\$	
Payable to brokers and dealers	174.2			157.1			
Mandatorily redeemable interests (1)	1,047.9			1,047.9			
Promissory note (2)			4.4			4.4	
Secured financing (3)		107.0			101.4		
Other	25.7	0.2		36.3	0.1		
	\$ 648.3	\$ 107.2	\$ 4.4	\$ 1,843.9	\$ 101.5	\$ 4.4	

(1) After consolidation, which eliminates our interests and the interests of our consolidated subsidiaries, JSOP and JESOP, the carrying amount of the mandatorily redeemable financial interests pertaining to the above VIEs included within Mandatorily redeemable preferred interests of consolidated subsidiaries in the Consolidated Statements of Financial Condition was approximately \$327.8 million and \$315.9 million at May 31, 2011 and November 30, 2010, respectively.

(2) The promissory note represents an amount due to us and is eliminated in consolidation.

(3) Secured financing is included within Accrued expenses and other liabilities in the Consolidated Statements of Financial Condition. Approximately \$2.2 million and \$15.7 million of the secured financing represents an amount held by us in inventory and is eliminated in consolidation at May 31, 2011 and November 30, 2010, respectively.

High Yield. We conduct our high yield secondary market trading activities through Jefferies High Yield Trading, LLC (JHYT), Jefferies High Yield Finance, LLC (JHYF), and Jefferies Leveraged Credit Products, LLC (JLCP). JHYT is a registered broker-dealer engaged in the secondary sales and trading of high yield securities and special situation securities, including bank debt, post-reorganization equity, public and private equity, equity derivatives and other

financial instruments. JHYT makes markets in high yield and distressed securities and provides research coverage on these types of securities. JHYF is engaged in the trading of total return swaps. JLCP is engaged in the trading of bank debt, credit default swaps and trade claims. JHYT, JHYF and JLCP are wholly owned subsidiaries of JHYH.

We own voting and non-voting interests in JHYH and have entered into management, clearing, and other services agreements with JHYH. We and Leucadia National Corporation (Leucadia), a significant holder of our common stock, each have the right to nominate two of a total of four directors to JHYH's board of directors. Two funds managed by us, JSOP and JESOP, are also investors in JHYH. The arrangement term is through April 2013, with an option to extend. As a result of agreements entered into with Leucadia in April 2008, any request to Leucadia for additional capital investment in JHYH requires the unanimous consent of our Board of Directors, including the consent of any Leucadia designees to our board. We have determined that JHYH, JSOP and JESOP meet the definition of a variable interest entity. We are the primary beneficiary of JHYH, JSOP and JESOP and accordingly consolidate JHYH (and the assets, liabilities and results of operations of its wholly owned subsidiaries JHYT, JHYF and JLCP), JSOP and JESOP.

Table of Contents

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

At May 31, 2011 and November 30, 2010, the carrying amount of our variable interests was \$342.6 million and \$328.2 million, respectively, which consist of our debt, equity and partnership interests in JHYH, JSOP and JESOP, which are eliminated in consolidation. In addition, the secondary market trading activity conducted through JHYT, JHYF and JLCP is a significant component of our overall brokerage platform, and while not contractually obligated, could require us to provide additional financial support and/ or expose us to further losses of JHYH, JSOP and JESOP. The assets of these VIEs are available for the benefit of the mandatorily redeemable interest holders and equity holders. The creditors of these VIEs do not have recourse to our general credit.

There have been no changes in our conclusion to consolidate JHYH, JSOP and JESOP since formation.

Mortgage and asset-backed securitizations. We are the primary beneficiary of a mortgage-backed securitization vehicle to which we transferred a project loan and retained servicing rights over the loan as well as retained a portion of the beneficial interests (i.e., securities) issued by the securitization vehicle. Our variable interests in this vehicle consist of beneficial interests and a contractual servicing fee. The asset of this VIE consists of a project loan, which is available for the benefit of the vehicles beneficial interest holders. The creditors of this VIE do not have recourse to our general credit.

Other. We are the primary beneficiary of certain investment vehicles set up for the benefit of our employees or clients. We manage and invest alongside our employees or clients in these vehicles. The assets of these VIEs consist of private equity and debt securities, and are available for the benefit of the entities' debt and equity holders. Our variable interests in these vehicles consist of equity securities and promissory notes. The creditors of these VIEs do not have recourse to our general credit.

VIEs Where We Have a Variable Interest

We also hold variable interests in VIEs in which we are not the primary beneficiary and accordingly do not consolidate. We do not consolidate these VIEs as we do not have the power to direct the activities that most significantly impact their economic performance. Other than Jefferies Employees Partners IV, LLC, as discussed below, we have not provided financial or other support to these VIEs during the six months ended May 31, 2011 or eleven months ended November 30, 2010 and we have no explicit or implicit arrangements to provide additional financial support to these VIEs and have no liabilities related to these VIEs at May 31, 2011 and November 30, 2010. We have aggregated certain nonconsolidated VIEs based upon principal business activity. The following tables present the total assets of nonconsolidated VIEs in which we hold variable interests, our maximum exposure to loss from these nonconsolidated VIEs, and the carrying amount of our interests in these nonconsolidated VIEs at May 31, 2011 and November 30, 2010 (in millions):

		VIE Assets	May 31, 2011 Maximum exposure to loss in non- consolidated VIEs	Carrying Amount
Collateralized loan obligations		\$ 1,952.6	\$ 50.1(2)	\$ 50.1
Mortgage- and asset-backed vehicles	Non-agency (1)	98,223.9	1,043.1(2)	1,043.1
Mortgage- and asset-backed vehicles	Agency (1)	13,430.0	2,031.4(2)	2,031.4
Asset management vehicle		1,385.0	3.4(2)	3.4
Private equity vehicles		82.8	131.0	54.3
Total		\$ 115,074.3	\$ 3,259.0	\$ 3,182.3