JEFFERIES & COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF FINANCIAL CONDITION
AS OF
MAY 31, 2012

(UNAUDITED)

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JEFFERIES & COMPANY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF FINANCIAL CONDITION (UNAUDITED)
AS OF MAY 31, 2012
(Dollars in thousands, except per share amounts)

ASSETS	
Cash and cash equivalents	$ 1,479,969
Cash and securities segregated and on deposit for regulatory purposes or deposited with clearing and depository organizations	1,043,515
Financial instruments owned, at fair value, including securities pledged of $8,414,181	8,572,377
Securities borrowed	5,282,667
Securities purchased under agreements to resell	2,289,151
Receivables:	
Brokers, dealers, and clearing organizations	684,266
Customers	629,757
Fees, interest, and other	139,454
Due from affiliates	21,323
Premises and equipment, net	118,475
Goodwill	254,398
Deferred taxes	251,888
Other assets	209,455
Total assets	$ 20,976,695
LIABILITIES AND STOCKHOLDER'S EQUITY	
LIABILITIES:	
Short-term borrowing	$ 150,000
Financial instruments sold, not yet purchased, at fair value	3,549,715
Securities loaned	2,467,357
Securities sold under agreements to repurchase	7,728,356
Payables:	
Brokers, dealers and clearing organizations	574,176
Customers	2,572,863
Due to Parent and affiliates	489,340
Accrued expenses and other liabilities	428,121
	17,959,928
Subordinated liabilities	1,250,000
STOCKHOLDER'S EQUITY:	
Class A Common Stock of $0.10 par value; authorized, issued, and outstanding 11,000 shares	1
Additional paid-in capital	1,123,387
Accumulated other comprehensive loss	(451)
Retained earnings	643,830
Total stockholder's equity	1,766,767
Total liabilities and stockholder's equity	$ 20,976,695

See notes to Consolidated Statement of Financial Condition.

1. ORGANIZATION AND BASIS OF PRESENTATION

Organization and Business — The accompanying Consolidated Statement of Financial Condition includes the accounts of Jefferies & Company, Inc. (the "Company") and its wholly owned subsidiary, Jefferies Insurance Holdings LLC, and all other entities in which it has a controlling financial interest. The Company is registered as a broker-dealer under the Securities Exchange Act of 1934 (the "Act") and is a wholly owned subsidiary of Jefferies Group, Inc. (the "Parent"). The Company operates and is managed as a single business segment, that of an institutional securities broker-dealer, which provides several types of financial services, including sales, trading, financing and market making activities in equity, high yield, corporate bond, mortgage- and asset-backed, municipal, government and agency, convertible and international securities, as well as fundamental research and prime brokerage services. The Company also provides investment banking services including securities underwriting and distribution and financial advisory services, including advice on mergers and acquisitions, recapitalizations and restructurings.

The Company is registered with the Securities and Exchange Commission ("SEC") as a broker-dealer and is also registered as a futures commission merchant with the Commodity Futures Trading Commission ("CFTC").

Basis of Presentation — The accompanying Consolidated Statement of Financial Condition has been prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP"). These principles require management to make estimates and assumptions that may affect the amounts reported on the Consolidated Statement of Financial Condition and accompanying notes. The most significant of these estimates and assumptions relate to fair value measurements, goodwill, 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 — The Company's policy is to consolidate all entities in which it owns more than 50% of the outstanding voting stock and have control. In addition, the Company consolidates entities which lack characteristics of an operating entity or business for which it is 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 the Company has significant influence but not control of an entity that does not qualify as a variable interest entity, it applies the equity method of accounting. See Note 8, Variable Interest Entities for further discussion on variable interest entities.

All material intercompany accounts and transactions have been eliminated in consolidation.

Subsequent Events — Management has evaluated events and transactions that occurred subsequent to May 31, 2012 through the date this Consolidated Statement of Financial Condition was issued, and determined there were no events or transactions during such period that would require recognition or disclosure in this statement.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash Equivalents — Cash equivalents consist of 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 Act and segregation rules of the CFTC, the Company is required to segregate cash or qualified securities 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 included in this caption.

Foreign Currency Translation — Assets and liabilities of its foreign subsidiary having non-U.S. dollar functional currencies are translated at exchange rates at the end of the period.

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 the Company's trading activities and include both cash and derivative products. Fair value is defined as the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price).

Fair Value Hierarchy — In determining fair value, the Company maximizes the use of observable inputs and minimizes 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 the assumptions that market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The Company applies a hierarchy to categorize its fair value measurements broken down into three levels based on the transparency of inputs to the valuation of an asset or liability as follows:

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

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, the financial instrument is valued at the point within the bid-ask range that meets the Company's best estimate of fair value.

The Company uses prices and inputs that are current as of the measurement date. 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 of financial instruments may include the use of valuation models and other techniques. Adjustments to valuations derived from valuation models may be made when, in management's judgment, either the size of the position in the financial instrument in a non-active market, other features of the financial instrument such as its complexity, the market in which the financial instrument is traded or, risk uncertainties about market conditions require that an adjustment be made to the value derived from the models. Adjustments from the price derived from a valuation model reflect management's judgment that other participants in the market for the financial instrument being measured at fair value would also consider in valuing that same financial instrument. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment.

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. 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 between the fair value hierarchy levels. Transfers between levels are recognized at the beginning of each period. The degree of judgment exercised in determining fair value is greatest for instruments categorized in Level 3.

Valuation Process for Financial Instruments

The Independent Price Verification ("IPV") Group, which is part of Finance, in partnership with Market Risk Management, is responsible for establishing the Company's valuation policies and procedures. The IPV Group and Market Risk Management, which are independent of the Company's business functions, play an important role and serve as a control function in determining that the Company's financial instruments are appropriately valued and that fair value measurements are reliable. This is particularly important where prices or valuations that require inputs are less observable. In the event that observable inputs are not available, the control processes are designed to assure that the valuation approach utilized is appropriate and consistently applied and that the assumptions are reasonable. The IPV Group reports to the Global Controller of the Parent and is subject to the oversight of the IPV Committee, which is comprised of the Parent's Chief Financial Officer, Global Controller, Global Head of Product Control, Chief Risk Officer, and Principal Accounting Officer, among other personnel. The Company's IPV policies and procedures are reviewed, at a minimum annually, and changes to the policies require the approval of the IPV Committee.

Price Testing Process. The business units are responsible for determining the fair value of the Company's financial instruments using approved valuation models and methodologies. In order to ensure that the business unit valuations represent a fair value exit price, the IPV Group tests and validates the fair value of the financial instrument inventory. In the testing process, the IPV Group obtains prices and valuation inputs from sources independent of the Company, consistently adheres to established procedures set forth in the Company's valuation policies for sourcing prices and valuation inputs and valuation methodologies. Sources used to validate fair value prices and inputs include, but are not limited to, exchange data, recently executed transactions, pricing data obtained from third party vendors, pricing and valuation services, broker quotes and observed comparable transactions.

To the extent discrepancies between the business unit valuations and the pricing or valuations resulting from the price testing process are identified, such discrepancies are investigated by the IPV Group and valuations are adjusted, as appropriate. The IPV Group maintains documentation of its testing, results, rationale and recommendations and prepares a monthly summary of its valuation results. This process also forms the basis for the Company's classification of fair values within the fair value hierarchy (i.e., Level 1, Level 2 or Level 3). The IPV Group utilizes the additional expertise of Market Risk Management personnel in valuing more complex financial instruments and financial instruments with less or limited pricing observability. The results of the valuation testing are reported to the IPV Committee on a monthly basis, which discusses the results and is charged with the final conclusions as to the financial instrument fair values in the Consolidated Statement of Financial Condition.

Judgment exercised in determining Level 3 fair value measurements is supplemented by daily analysis of profit and loss performed by the Finance control functions. Valuation techniques generally rely on recent transactions of suitably comparable financial instruments and use the observable inputs from those comparable transactions as a validation basis for Level 3 inputs. Level 3 fair value measurements are further validated through subsequent sales testing and market comparable sales, if such information is available. Level 3 fair value measurements require documentation of the valuation rationale applied, which is reviewed for consistency in application from period to period; and the documentation includes benchmarking the assumptions underlying the valuation rationale against relevant analytic data.

Third Party Pricing Information. Pricing information obtained from external data providers and pricing services may incorporate a range of market quotes from dealers, recent market transactions and benchmarking model derived prices to quoted market prices and trade data for comparable securities. External pricing data is subject to evaluation for reasonableness using a variety of means including comparisons of prices to those of similar product types, quality and maturities, consideration of the narrowness or wideness of the range of prices obtained, knowledge of recent market transactions and an assessment of the similarity in prices to comparable dealer offerings in a recent time period. The Company has a process whereby it challenges the appropriateness of pricing information obtained from data providers and pricing services in order to validate the data for consistency with the definition of a fair value exit price. The Company's process includes understanding and evaluating the service providers' valuation methodologies. For corporate, U.S. government and agency, and municipal debt securities (excluding auction rate securities), to the extent pricing services or broker quotes are utilized in its valuation process, the vendor services are collecting and aggregating observable market information as to recent trade activity and active bid-ask submissions. The composite pricing information received from the independent pricing service is not based on unobservable inputs or proprietary models. For mortgage- and other asset-backed securities and collateralized debt obligations, the Company's independent pricing service uses a matrix evaluation approach incorporating both observable yield curves and market yields on comparable securities as well as implied inputs from observed trades for comparable securities in order to determine prepayment speeds, cumulative default rates and loss severity. Further, the Company considers pricing data from multiple service providers as available as well as compares pricing data to prices observed for recent transactions, if any, in order to corroborate valuation inputs.

Model Review Process. Where a pricing model is to be used to determine fair value, the pricing model is reviewed for theoretical soundness and appropriateness by Market Risk Management, independent from the trading desks, and then approved to be used in the valuation process. Review and approval of a model for use includes benchmarking the model against relevant third party valuations, testing sample trades in the model, backtesting the results of the model against actual trades and stress-testing the sensitivity of the valuation model using varying inputs and assumptions. In addition, recently executed comparable transactions and other observable market data are considered for purposes of validating assumptions underlying the model. Models are independently reviewed and validated annually or more frequently, if market conditions or use of the valuation model changes.

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 on the Consolidated Statement of Financial Condition.

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, the Company borrows securities to cover short sales and to complete transactions in which customers have failed to deliver securities by the required settlement date, and loaned securities to other brokers and dealers for similar purposes. The Company has an active securities borrowed and loaned matched book business in which it borrows securities from one party and lends them to another party. When the Company borrows securities, it generally provides cash to the lender as collateral, which is reflected in the Consolidated Statement of Financial Condition as Securities borrowed. Similarly, when the Company lends securities to another party, that party provides cash to the Company as collateral, which is reflected in the Consolidated Statement of Financial Condition as Securities loaned. The initial collateral advanced or received approximates or is greater than the fair value of the securities borrowed or loaned. The Company monitors the fair value of the securities borrowed and loaned on a daily basis and requests additional collateral or returns 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. The Company monitors the fair value of the underlying securities daily versus the related receivable or payable balances. Should the fair value of the underlying securities decline or increase, additional collateral is requested or excess collateral is returned, as appropriate. The Company carries repos on a net basis by counterparty, when appropriate.

Premises and Equipment — Premises and equipment are carried at cost less accumulated depreciation. The Company computes depreciation using the straight-line method over the estimated useful lives of the related assets, which is 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. As of May 31, 2012, furniture, fixtures, equipment and software amounted to $198.2 million and leasehold improvements amounted to $91.2 million. The related accumulated depreciation and amortization was $170.9 million as of May 31, 2012.

Goodwill — Goodwill is the cost of acquired companies in excess of the fair value of net assets at the acquisition date. At least annually, and more frequently if warranted, the Company assesses whether goodwill has been impaired by comparing the estimated fair value of the reporting unit with its carrying value. If the estimated fair value exceeds the carrying value, goodwill is not impaired. If the estimated fair value is less than carrying value, further analysis is necessary to determine the amount of impairment, if any. The methodologies utilized by the Company in estimating the fair value of the reporting unit include market capitalization, price-to-book multiples of comparable exchange traded companies and multiples of merger and acquisitions of similar businesses. Periodically estimating the fair value of a reporting unit requires significant judgment and often involves the use of estimates and assumptions that could have a significant effect on whether or not an impairment charge is recorded and the magnitude of such a charge.

The Company completed its annual test of goodwill impairment as of June 1, 2012, which did not indicate goodwill was impaired. Adverse market or economic events in the future could result in impairment charges in future periods.

Intangible Assets — Intangible assets deemed to have finite lives are amortized on a straight line basis over their estimated useful lives, where the useful life is the period over which the asset is expected to contribute directly, or indirectly, to the Company’s future cash flows. Intangible assets are reviewed for impairment on an interim basis when certain events or circumstances exist. For amortizable intangible assets, impairment exists when the carrying amount of the intangible asset exceeds its fair value. At least annually, the remaining useful life is evaluated.

An intangible asset with an indefinite useful life is not amortized but assessed annually, or more frequently when certain events or circumstances exist, for impairment. Impairment exists when the carrying amount exceeds its fair value. To the extent an impairment loss is recognized, the loss establishes the new cost basis of the asset that is amortized over the remaining useful life of that asset. Subsequent reversal of impairment losses is not permitted. Intangible assets are included in Other assets on the Consolidated Statement of Financial Condition. The Company completed its annual test for impairment of intangible assets with an indefinite useful life as of June 1, 2012, which did not indicate any impairment.

Income Taxes — The results of operations of the Company are included in the consolidated Federal, New York State, New York City and other state income tax returns filed by the Parent. The Parent allocates to the Company its share of the consolidated income tax expense or benefit based upon statutory rates applied to the Company's earnings as if it were filing separate income tax returns. 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. 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. 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 Company recognizes tax positions in the Consolidated Statement of Financial Condition only when it is more likely than not, based on the technical merits, the position will be sustained upon examination by the relevant taxing authority. A tax position that meets the more likely than not recognition threshold is measured at the largest amount of tax benefit that is greater than fifty percent likely of being realized upon settlement.

Legal Reserves —In the normal course of business, the Company has been named, from time to time, as a defendant in legal and regulatory proceedings. The Company is also involved, from time to time, in other exams, investigations and similar reviews (both formal and informal) by governmental and self-regulatory agencies regarding its businesses, certain of which may result in judgments, settlements, fines, penalties or other injunctions. The Company recognizes 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, the most likely amount of such loss is accrued, and if such amount is not determinable, then the Company accrues the minimum of the range of probable loss. The determination of the outcome and loss estimates requires significant judgment on the part of management. 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. Management believes that, in the aggregate, the pending legal actions or regulatory proceedings and any other exams, investigations or similar reviews (both formal and informal) should not have a material adverse effect on the Company's consolidated financial condition. In addition, management believes 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 Statement of Financial Condition is not material.

Share-Based Compensation — The Parent issues restricted stock and restricted stock units ("RSUs") to the Company's employees under its Incentive Compensation Plan (the "Incentive Plan"), primarily in connection with employee year end compensation. The Incentive Plan allows awards in the form of incentive stock options (within the meaning of Section 422 of the Internal Revenue Code), nonqualified stock options, stock appreciation rights, restricted stock, unrestricted stock, performance awards, restricted stock units, dividend equivalents or other share-based awards pertaining to common stock of the Parent. For grants of restricted stock awards, employees are granted restricted shares of common stock subject to forfeiture. The Incentive Plan also allows for grants of RSUs. RSUs give a participant the right to receive fully vested shares at the end of a specified deferral period. One advantage of RSUs, as compared to restricted stock, is that the period during which the award is deferred as to settlement can be extended past the date the award becomes non-forfeitable, allowing a participant to hold an interest tied to common stock on a tax deferred basis. Prior to settlement, RSUs carry no voting or dividend rights associated with the stock ownership, but dividend equivalents are accrued to the extent there are dividends declared on the Parent's common stock. The terms of the awards granted in connection with year-end compensation stipulate that employees who terminate their employment or are terminated without cause may continue to vest, so long as the awards are not forfeited as a result of the other forfeiture provisions of those awards (e.g. competition). The Parent has determined that the service inception date precedes the grant date for future restricted stock and RSUs granted as part of year end compensation and, as such, the compensation expense associated with these awards is generally expensed by the Parent over the one year period prior to the grant date. In addition to year end compensation awards, the Parent grants restricted stock and RSUs to new employees as "sign-on" awards, to existing employees as "retention" awards and to certain senior executives. Sign-on and retention awards are generally subject to annual ratable vesting upon a four year service requirement and are amortized as compensation expense on a straight line basis over the related four years. Restricted stock and RSUs are granted to certain senior executives with both performance and service conditions. The Parent amortizes these awards granted to senior executives over the service period as the Parent has determined it is probable that the performance condition will be achieved. The subsequent expense of the cost of the restricted stock and RSUs is allocated to the Company by the Parent.

Other Compensation Plans – Employees participate in other compensation plans sponsored by the Parent. The Parent has an Employee Stock Purchase Plan ("ESPP") which is considered non-compensatory effective January 1, 2007. All regular full time employees and employees who work part time over 20 hours per week are eligible for the ESPP. Annual employee contributions are limited to $21,250, are voluntary, are made via payroll deduction and are used to purchase Parent common stock at 95% of the closing price of the Parent's common stock on the last day of the applicable session (monthly). The Parent has a Deferred Compensation Plan. Employees with annual compensation of $200,000 or more are eligible to defer compensation on a pre-tax basis by investing in the Parent's common stock at a discount or by specifying the return in other alternative investments. The Parent also has a profit sharing plan, covering substantially all employees, which includes a salary reduction feature designed to qualify under Section 401(k) of the Internal Revenue Code.

Securitization Activities — The Company engages in securitization activities related to mortgage loans and mortgage-backed securities. Transfers of financial assets are accounted for as sales when the Company has relinquished control over the transferred assets. The Company 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.

When a transfer of assets does not meet the criteria of a sale, that transfer is treated as a secured borrowing. The Company continues to recognize the assets of a secured borrowing in Financial instruments owned and recognize the associated financing in Accrued expenses and other liabilities on the Consolidated Statement of Financial Condition.

Recent Accounting Developments

Balance Sheet Offsetting Disclosures. In December 2011, the Financial Accounting Standards Board ("FASB") issued an Accounting Standards Update ("ASU"), No. 2011-11, Disclosures about Offsetting Assets and Liabilities. The update requires new disclosures regarding balance sheet offsetting and related arrangements. For derivatives and financial assets and liabilities, the amendments require disclosure of gross asset and liability amounts, amounts offset on the balance sheet, and amounts subject to the offsetting requirements but not offset on the balance sheet. The guidance is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods, and is to be applied retrospectively. This guidance does not amend the existing guidance on when it is appropriate to offset; as a result, this guidance will not affect the Company's financial condition.

Goodwill Testing. In September 2011, the FASB issued ASU No. 2011-08, Testing Goodwill for Impairment. The update outlines amendments to the two step goodwill impairment test permitting an entity to first assess qualitative factors in determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step quantitative goodwill impairment test. The update is effective for annual and interim goodwill tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The adoption of this guidance will not affect the Company's financial condition.

Fair Value Measurements and Disclosures. In May 2011, the 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 IFRS, which provide clarifying guidance on how to 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 the Company's valuation processes and additional information about unobservable inputs impacting Level 3 measurements. The Company adopted this guidance on March 1, 2012 and has reflected the new disclosures in the Consolidated Statement of Financial Condition. The adoption of this guidance did not have an impact on the Company's financial condition.

Reconsideration of Effective Control for Repurchase Agreements. In April 2011, the FASB issued ASU No. 2011-03, Reconsideration of Effective Control for Repurchase Agreements. In assessing whether to account for repurchase and other agreements that both entitle and obligate the transferor to repurchase or redeem financial assets before their maturity as sales or as secured financing, this guidance removes from the assessment of effective control 1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms; and 2) the collateral maintenance implementation guidance related to that criterion. The guidance is effective prospectively for transactions beginning on January 1, 2012. The adoption of this guidance did not have an impact on the Company's financial condition.

3. CASH AND CASH EQUIVALENTS

The Company generally invests its excess cash in money market funds and other short-term investments. Cash equivalents include highly liquid investments not held for resale and with original maturities of three months or less. The following are financial instruments, classified as cash and cash equivalents, that are deemed by the Company's management to be generally readily convertible into cash as of May 31, 2012 (in thousands):

Cash and cash equivalents:		
Cash in banks	$	339,389
Money market funds		1,140,580
Total cash and cash equivalents	$	1,479,969
Cash and securities segregated (1)	$	1,043,515

(1) Consists of deposits at exchanges and clearing organizations, as well as deposits in accordance with Rule 15c3-3 of the Act, which subjects the Company 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.

4. FAIR VALUE DISCLOSURES

The following is a summary of the Company's financial assets and liabilities that are accounted for at fair value on a recurring basis as of May 31, 2012, by level within the fair value hierarchy (in thousands):

	Level 1 (1)	Level 2 (1)	Level 3	Counterparty and Cash Collateral Netting (2)	Total
Assets — Financial instruments owned:					
Corporate equity securities	$ 757,094	$ 49,790	$ 5,528	$ —	$ 812,412
Corporate debt securities	—	1,867,146	2,377	—	1,869,523
Collateralized debt obligations	—	59,608	12,714	—	72,322
U.S. government and federal agency securities	1,227,384	57,664	—	—	1,285,048
Municipal securities	—	700,531	465	—	700,996
Sovereign obligations	—	97,664	—	—	97,664
Residential mortgage-backed securities	—	2,978,448	111,536	—	3,089,984
Commercial mortgage-backed securities	—	514,280	39,267	—	553,547
Other asset-backed securities	—	4,894	1,273	—	6,167
Loans and other receivables	—	9,187	743	—	9,930
Derivatives	412,326	6,608	—	(375,178)	43,756
Investments, at fair value	—	—	31,028	—	31,028
Total financial instruments owned	$ 2,396,804	$ 6,345,820	$ 204,931	$ (375,178)	$ 8,572,377
Cash and cash equivalents	$ 1,479,969	$ —	$ —	$ —	$ 1,479,969
Cash and securities segregated and on deposit for regulatory purposes	$ 1,043,515	$ —	$ —	$ —	$ 1,043,515
Liabilities — Financial instruments sold, not yet purchased:					
Corporate equity securities	$ 1,104,935	$ 21,681	38	$ —	$ 1,126,654
Corporate debt securities	—	1,343,681	74	—	1,343,755
U.S. government and federal agency securities	901,137	—	—	—	901,137
Municipal securities	—	27	—	—	27
Sovereign obligations	—	126,931	—	—	126,931
Residential mortgage backed securities	—	46,577	—	—	46,577
Loans	—	—	—	—	—
Derivatives	374,573	2,340	2,899	(375,178)	4,634
Total financial instruments sold, not yet purchased	$ 2,380,645	$ 1,541,237	$ 3,011	$ (375,178)	$ 3,549,715

(1) There were no transfers between Level 1 and Level 2 for the six months ended May 31, 2012.
(2) Represents counterparty and cash collateral netting across the levels of the fair value hierarchy for positions with the same counterparty.

The following is a description of the valuation basis, including valuation techniques and inputs, used in measuring the Company's 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 external pricing services, and are categorized within Level 1 of the fair value hierarchy.
- Non-exchange Traded Equity Securities: Non-exchange traded equity securities are measured primarily using broker quotations, pricing data from external pricing services 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 within Level 3 of the fair value hierarchy 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 categorized 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 pricing data from external pricing services and broker quotations, 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 categorized within Level 3 of the fair value hierarchy and comprise a limited portion of the Company's corporate bonds.
- High Yield Corporate and Convertible Bonds: A significant portion of the Company's high yield corporate and convertible bonds are categorized within Level 2 of the fair value hierarchy and are measured primarily using broker quotations and pricing data from external pricing services, where available, and prices observed for recently executed market transactions of comparable size. Where pricing data is less observable, valuations are categorized within 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.

Collateralized Debt Obligations

Collateralized debt obligations are measured based on prices observed for recently executed market transactions, or valuations received from third party brokers or discounted cash flow methodologies and are categorized within Level 2 or Level 3 of the fair value hierarchy depending on the observability of the pricing inputs.

U.S. Government and Federal Agency Securities

- U.S. Treasury Securities: U.S. Treasury securities are measured based on quoted market prices and categorized within 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 categorized within Level 1 and callable U.S. agency securities are categorized within Level 2 of the fair value hierarchy.

Municipal Securities

Municipal securities are measured based on quoted prices obtained from external pricing services and are generally categorized within Level 2 of the fair value hierarchy. The fair value of auction rate securities ("ARS") issued by municipal governments are measured using market data provided by external pricing services, as available, or determined by benchmarking to independent market data and adjusted for projected cash flows, level of seniority in the capital structure, leverage, liquidity and credit rating, as appropriate. ARS are categorized within Level 3 of the fair value hierarchy based on the Company's assessment of the transparency of the external market data received.

Sovereign Obligations

- Non-G-7 Government Bonds: Non-G-7 government bonds are measured based on quoted market prices obtained from external pricing services and are generally categorized within Level 2 of the fair value hierarchy.
- Emerging Market Sovereign Debt Securities: Valuations are primarily based on market price quotations from external pricing services, 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 categorized 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 pricing services 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. The Company uses prices observed for recently executed transactions to develop market-clearing spread and yield curve assumptions. Valuation inputs with regard to the underlying collateral incorporate weighted average coupon, loan-to-value, credit scores, geographic location, maximum and average loan size, originator, servicer, and weighted average loan age. Agency inverse IOs are categorized within Level 2 of the fair value hierarchy. The Company also uses 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: Government National Mortgage Association ("GNMA") project loan bonds and Federal National Mortgage Association ("FNMA") Delegated Underwriting and Servicing ("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 external pricing services and prices observed for recently executed market transactions. If external price data is not available the fair value is determined by discounted cash flow analyses. Non-agency commercial mortgage-backed securities are generally categorized within Level 2 of the fair value hierarchy unless external price data or significant inputs are unobservable, then the securities are categorized as 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 and Level 3 of the fair value hierarchy. Valuations are determined using pricing data obtained from external pricing services and prices observed for recently executed market transactions.

Loans and Other Receivables

Loans and other receivables include corporate loans the fair value of which is determined using market price quotations, where observable, from external pricing services. Corporate loans are categorized within Level 2 of the fair value hierarchy to the extent market transaction data supports the pricing data. Corporate loans categorized within Level 3 of the fair value hierarchy 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.

Derivatives

- Listed Derivative Contracts: Listed derivative contracts are measured based on quoted exchange prices, which are generally obtained from external pricing services and categorized within Level 1 of the fair value hierarchy. Fair value of listed derivatives for which there is limited trading activity are determined by incorporating the closing price of the underlying equity security and are categorized within Level 2 of the fair value hierarchy.
- OTC Derivative Contracts: OTC derivative contracts are generally valued using models whose inputs reflect assumptions that the Company believes 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 within Level 2 of the fair value hierarchy given the observability of the inputs to the valuation models. Where significant inputs to the valuation are unobservable derivative instruments are categorized within Level 3 of the fair value hierarchy.

  OTC options include OTC equity, foreign exchange and commodity options measured using a Black-Scholes model with key inputs impacting the valuation including the underlying security, foreign exchange spot rate 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 the Company's interest rate swaps, which incorporate observable inputs related to interest rate curves, valuations of the Company's foreign exchange forwards and swaps, which incorporate observable inputs related to foreign currency spot rates and forward curves and valuations of the company's commodity swaps, which incorporate observable inputs related to commodity spot prices 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 external pricing services.

Investments, at Fair Value

Investments at fair value include investments in hedge funds, fund of funds and private equity funds, measured at fair value based on the net asset value of the funds provided by the fund managers and are categorized within Level 3 of the fair value hierarchy. Investments at fair value also include direct investments in private companies, which are measured at fair value 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 investments in private companies are categorized within Level 3 of the fair value hierarchy. The following table presents further information about the Company's investments in entities that have the characteristics of an investment company at May 31, 2012 (in thousands):

	Fair Value (5)	Unfunded Commitments
Equity Long/Short Hedge Fund (1)	$ 9	$ -
High Yield Hedge Fund(2)	399	-
Fund of Funds(3)	9	-
Private Equity Funds(4)	6,211	1,313
Total(6)	$ 6,628	$ 1,313

(1) Investment in a hedge fund that invests in foreign private technology companies. The fund is in liquidation and the Company is unable to estimate when the underlying assets will be fully liquidated.

(2) Investment in a hedge fund that invests in U.S. public high yield debt, private high yield investments, senior bank loans, public leveraged equities, distressed debt, private equity investments and emerging markets debt. There are no redemption provisions, instead distributions are received through the liquidation of the underlying assets of the funds. This fund is currently in liquidation; however, the Company is unable to estimate when the underlying assets will be fully liquidated.

(3) Includes investments in fund of funds that invest in various private equity funds. The fund's investments have been redeemed; however, the Company is unable to estimate when the remaining funds will be received.

(4) This category includes investments in private equity funds that invest in the equity of various U.S. and foreign private companies in the energy, technology, internet service and telecommunication service industries including acquired or restructured companies. Investments representing approximately 89% can never be redeemed; instead distributions are received through the liquidation of the underlying assets of the funds which are expected to liquidate in one to nine years. Investments representing approximately 11% of the fair value of investments in this category are in liquidation and the Company is unable to estimate when the underlying assets will be fully liquidated.

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

(6) Investments at fair value on the Consolidated Statement of Financial Condition at May 31, 2012 include $24.4 million of direct investments which are not investment companies and therefore are not part of this disclosure table.

Quantitative Information about Significant Unobservable Inputs used in Level 3 Fair Value Measurements at May 31, 2012

The tables below present information on the valuation techniques, significant unobservable inputs and their ranges for the Company's financial assets and liabilities, subject to threshold levels related to the market value of the positions held, measured at fair value on a recurring basis with a significant Level 3 balance. The range of unobservable inputs could differ significantly across different firms given the range of products across different firms in the financial services sector. The inputs are not representative of the inputs that could have been used in the valuation of any one financial instruments; i.e., the input used for valuing one financial instrument within a particular class of financial instrument may not be appropriate for valuing other financial instruments within that given class. Additionally, the ranges of inputs presented below should not be construed to represent uncertainty regarding the fair values of the Company's financial instruments.

Financial Instruments Owned	**Market Value $'000**	**Valuation Technique**	**Significant Unobservable Input(s)**	**Range**
Corporate equity securities	$ 5,528			
Warrants		Comparable pricing	Comparable multiple	$ 2,662
		Option model	Volatility	39.469
Private equity securities		Scenario analysis	Estimated recovery percentage	45%
Investments at fair value	$ 22,640			
Private equity securities		Market approach	Price per acre	$ 40,000
		Comparable pricing	Comparable share price	$ 328
Collateralized debt obligations	$ 12,714			
		Discounted cash flows	Constant prepayment rate	15%
			Constant default rate	2%
			Loss severity	55%
			Yield	7% to 16%
Commercial mortgage-backed securities	$ 39,267			
		Discounted cash flows	Yield	20% to 42%
			Cumulative loss rate	1% to 9%
Residential mortgage-backed securities	$ 111,536			
		Discounted cash flows	Constant prepayment rate	0% to 29%
			Constant default rate	0% to 25%
			Loss severity	0% to 80%
			Yield	1% to 30%

Financial Instruments Sold, Not Yet Purchased	**Market Value $'000**	**Valuation Technique**	**Significant Unobservable Input(s)**	**Range**
Derivatives	$ (2,899)			
Equity options		Option model	Volatility	40.373

The fair values of certain Level 3 assets that were determined based on third-party pricing information, or reported net asset value or percentage of reported enterprise fair value are excluded from the above table. At May 31, 2012, the exclusions amounted to $8.4 million in aggregate and comprised certain investments in private equity funds, a loan and certain private equity investments.

For recurring fair value measurements categorized within Level 3 of the fair value hierarchy, the sensitivity of the fair value measurement to changes in significant unobservable inputs and interrelationships between those unobservable inputs (if any) are described below:

- Warrants and private equity securities using a comparable pricing or market approach valuation techniques. A significant increase (decrease) in the comparable price or other multiple in isolation would result in a significantly higher (lower) fair value measurement.
- Private equity securities using scenario analysis. A significant increase (decrease) in the possible recovery rates of the cash flow outcomes underlying the investment would result in a significantly higher (lower) fair value measurement for the financial instrument.
- Collateralized debt obligations, residential and commercial mortgage-backed securities using a discounted cash flow valuation technique. A significant increase (decrease) in isolation in the constant default rate, loss severities or cumulative loss rate and discount rate would result in a significantly lower (higher) fair value measurement. The impact of changes in the constant prepayment rate would have differing impacts depending on the capital structure of the security. A significant increase (decrease) in the yield would result in a significant lower (higher) fair value measurement.
- Long warrant positions and short derivative equity options using an option model. A significant increase (decrease) in volatility would result in a significant lower (higher) fair value measurement.

Fair Value Option Election

The Company has elected the fair value option for all loans and loan commitments made by the Company's capital markets businesses and securitization activities. Loans and loan commitments are managed on a fair value basis and are included in Financial instruments owned and Financial instruments sold, not yet purchased – derivatives, respectively, on the Consolidated Statement of Financial Condition. At May 31, 2012, the fair value of loan commitments was $4.6 million and relates to the commitment to purchase GNMA pools from an affiliate, Jefferies Mortgage Finance, Inc.

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.

5. DERIVATIVE FINANCIAL INSTRUMENTS

Off-Balance Sheet Risk — The Company has 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 contain 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 the Company's Consolidated Statement of Financial Condition.

Derivative Financial Instruments — The Company's derivative activities are recorded at fair value on the Consolidated Statement of Financial Condition in Financial instruments owned and Financial instruments sold, not yet purchased 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. Acting in a trading capacity, the Company may enter into derivative transactions to satisfy the needs of its clients and to manage its own exposure to market and credit risks resulting from its trading activities. (See Note 4, Fair Value Disclosures and Note 15, Commitments and Guarantees 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, the Company 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 the Company's other trading-related activities. The Company manages the risks associated with derivatives on an aggregate basis along with the risks associated with proprietary trading as part of its firm wide risk management policies. In connection with its derivative activities, the Company may enter into master netting agreements and collateral arrangements with counterparties. These agreements provide the Company 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.

The following table presents the fair value and related number of derivative contracts at May 31, 2012 categorized by predominant risk exposure. The fair value of assets/liabilities related to derivative contracts represents the Company's receivable/payable for derivative financial instruments, gross of counterparty netting and cash collateral received and pledged (dollars in thousands):

	Assets		Liabilities	
	Fair Value	Number of Contracts	Fair Value	Number of Contracts
Interest rate contracts	$ 14,510	64,053	$ 7,678	83,565
Foreign exchange contracts	2,013	349	2,390	233
Equity contracts	397,767	1,826,637	369,744	1,574,457
Commodity contracts	-	-	-	86
Credit contracts	4,644	24	-	-
Total	418,934	1,891,063	379,812	1,658,341
Counterparty/cash-collateral netting	(375,178)		(375,178)	
Total	$ 43,756		$ 4,634	

The table below sets forth the remaining contract maturity of the fair value of OTC derivative assets and liabilities as of May 31, 2012 (in thousands):

	OTC Derivatives (3)				
	Assets (1)		Liabilities (2)		
	0-12 months	Total	0-12 months	1-5 years	Total
Foreign exchange forwards	$ 1,360	$ 1,360	$ 1,735	$ —	$ 1,735
Fixed income forwards	4,644	4,644	—	—	—
Equity options	—	—	—	2,899	2,899
Total	$ 6,004	$ 6,004	$ 1,735	$ 2,899	$ 4,634

(1) At May 31, 2012, the Company held exchange-traded derivative assets of $37.8 million, which are not included in the table above.

(2) At May 31, 2012, there were no exchange-traded derivative liabilities and other credit enhancements.

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

At May 31, 2012, the counterparty credit quality with respect to the fair value of the Company's OTC derivative assets was as follows (in thousands):

Counterparty credit quality (1):		
A- or higher	$	942
BBB- to BBB+		4,869
BB+ or lower		117
Unrated		76
Total	$	6,004

(1) Credit ratings of external rating agencies are used when available. When credit ratings are not available, internal credit ratings determined by the Company's credit risk management are applied. Credit risk management use methodologies that produce ratings generally consistent with those produced by external rating agencies.

Credit Risk — In the normal course of business, the Company is involved in the execution, settlement and financing of various customer and principal securities transactions. Customer activities are transacted on a cash, margin or delivery-vs.-payment basis. Securities transactions are subject to the risk of counterparty or customer nonperformance. However, transactions are collateralized by the underlying security, thereby reducing the associated risk to changes in the market value of the security through settlement date or to the extent of margin balances.

The Company seeks to control the risk associated with these transactions by establishing and monitoring credit limits and by monitoring collateral and transaction levels daily. The Company may require counterparties to deposit additional collateral or return collateral pledged. In the case of aged securities failed to receive, the Company may, under industry regulations, purchase the underlying securities in the market and seek reimbursement for any losses from the counterparty.

Concentration of Credit Risk — As a securities firm, the Company's activities are executed primarily with and on behalf of other financial institutions, including brokers and dealers, banks and other institutional customers. Concentrations of credit risk can be affected by changes in economic, industry or geographical factors. The Company seeks to control its credit risk and the potential risk concentration through a variety of reporting and control procedures, including those described in the preceding discussion of credit risk.

6. COLLATERIALIZED TRANSACTIONS

The Company enters into secured borrowing and lending arrangements to obtain collateral necessary to effect settlement, finance inventory positions, meet customer needs or re-lend as part of its dealer operations. The Company manages its exposure to credit risk associated with these transactions by entering into master netting agreements. The Company also monitors the fair value of the securities loaned and borrowed on a daily basis and requests additional collateral or the return of excess collateral, as appropriate.

The Company pledges financial instruments as collateral under repurchase agreements, securities lending agreements and other secured arrangements, including clearing arrangements. The agreements with counterparties generally contain contractual provisions allowing the counterparty the right to sell or repledge the collateral. Pledged securities owned that can be sold or repledged by the counterparty are included within Financial instruments owned and noted as Securities pledged on the Consolidated Statement of Financial Condition.

The Company receives securities as collateral under resale agreements, securities borrowed transactions, derivative transactions and customer margin loans. In many instances, the Company is permitted by contract or custom to re-hypothecate the securities received as collateral. These securities may be used to secure repurchase agreements, enter into security lending or derivative transactions or cover short positions. At May 31, 2012, the approximate fair value of securities received as collateral that can be sold or repledged by the Company was approximately $16,205.4 million. At May 31, 2012, a substantial portion of the securities received had been sold or repledged.

7. SECURITIZATION ACTIVITIES

The Company engages in securitization activities related to mortgage loans and mortgage-backed securities, a significant portion of which are assets issued or guaranteed by U.S. government agencies. In its securitization activities, the Company uses special purpose entities ("SPEs") and acts as the placement or structuring agent for the beneficial interests issued to investors by the SPE. The Company's securitization vehicles generally meet the criteria of variable interest entities; however, it generally does not consolidate the securitization vehicles as it is not considered the primary beneficiary for these vehicles. See Note 8, Variable Interest Entities for further discussion on variable interest entities and the determination of the primary beneficiary.

The Company accounts for its securitization transactions as sales provided it has relinquished control over the transferred assets. If the Company has not relinquished control over the transferred assets, the assets continue to be recognized in Financial instruments owned and a corresponding secured borrowing is recognized in Accrued expenses and other liabilities on the Consolidated Statement of Financial Condition. Transferred assets are carried at fair value prior to securitization.

The Company generally receives cash proceeds in connection with the transfer of assets as the security interests issued by the securitization vehicles are sold to investors. The Company may, however, have continuing involvement with the transferred assets, which is limited to retaining one or more tranches of the securitization (primarily senior and subordinated debt securities). Retained interests are accounted for at fair value and included within Financial instruments owned on the Consolidated Statement of Financial Condition.

The following table presents activity related to the Company's securitization activities that were accounted for as sales in which it had continuing involvement (in millions):

		Six Months Ended May 31, 2012
Transferred assets	$	4,938.6
Proceeds on new securitizations	$	5,279.0
Cash flows received on retained interests	$	24.9

Assets received as proceeds in the form of mortgage-backed-securities issued by the securitization vehicles have been 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, Fair Value Disclosures.

The Company has not provided financial or other support to these securitization vehicles during the six months ended May 31, 2012. Further, the Company has no explicit or implicit arrangements to provide additional financial support to these securitization vehicles and has no liabilities related to these securitization vehicles at May 31, 2012.

Although not obligated, the Company may make a market in the securities issued by these securitization vehicles in connection with its secondary market-making activities. In these market-making transactions, the Company buys the securities from and sells these securities to investors. Securities purchased through these market-making activities are not considered to be continuing involvement in the securitization vehicles, although the securities are included in Financial instruments owned – Mortgage- and asset-backed securities on the Company's Consolidated Statement of Financial Condition. To the extent the securities purchased through these market-making activities meet specific thresholds and the Company is not deemed to be the primary beneficiary of the variable interest entity, these securities are included in agency and non-agency mortgage- and asset-backed securitizations in the nonconsolidated variable interest entities table presented in Note 8, Variable Interest Entities.

The following table summarizes the Company's retained interests in SPEs where the Company, acting as transferor, has transferred assets where it has continuing involvement and for which it received sale accounting treatment.

(in millions)	As of May 31, 2012			
Securitization Type		**Total Assets**		**Assets Retained**
U.S. Government agency residential mortgage-backed securities	$	7,740.5	$	414.4 (1)
U.S. Government agency commercial mortgage-backed securities		3,033.1		32.0 (1)

(1) A significant portion of these securities have been subsequently sold in secondary-market transactions to third parties. As of June 22, 2012, the Company continues to hold approximately $280.8 million and $26.2 million of these Residential mortgage-backed securities and Commercial mortgage-backed securities, respectively.

The Company does not have any derivative contracts executed in connection with these securitization activities. In the table above, assets retained in connection with securitization represent the fair value of the securities of one or more tranches of the securitization held by the Company at May 31, 2012. The Company's risk of loss is limited to this fair value amount . The total assets amount represents the unpaid principal amount of assets in the securitization vehicles in which the Company has continuing involvement and is presented to provide information regarding the size of the securitization, and is not considered representative of the risk of potential loss associated with the securitizations.

8. 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.

The Company initially determines whether it is the primary beneficiary of a VIE upon its initial involvement with the VIE and continues to reassesses whether it is the primary beneficiary of the VIE on an ongoing basis. The determination of whether the Company is the primary beneficiary of a VIE is based upon the facts and circumstances for each VIE and requires significant judgment by management. In determining whether the Company has the power to direct the VIE's most significant activities, the Company first identifies the activities of the VIE that most significantly impact its economic performance. The 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. The Company then assesses whether it has the power to direct those significant activities. The considerations in determining whether the Company has 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 it has determined that the power over a VIE's most significant activities is shared, the Company assessed whether it is the party with the power over the majority of the significant activities. If the Company is the party with the power over the majority of the significant activities, it meets the "power" criteria of the primary beneficiary. If the Company does not have the power over a majority of the significant activities or determines that decisions require consent of each sharing party, the Company does not meet the "power" criteria of the primary beneficiary.

The Company assesses its variable interests in a VIE both individually and in aggregate to determine whether it has 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 the Company's variable interests are significant to a VIE requires significant judgment. In determining the significance of its variable interests, the Company considers the terms, characteristics and size of the variable interests, the design and characteristics of the VIE, its involvement in the VIE and its market-making activities related to the variable interests.

At May 31, 2012, the Company held variable interests in VIEs in which it was not the primary beneficiary as it did not have the power to direct the activities that most significantly impact their economic performance and therefore, has not consolidated these VIEs. Further, the Company has not provided financial or other support to these VIEs during the period ended May 31, 2012 and it has no explicit or implicit arrangements to provide additional financial support to these VIEs and has no liabilities related to these VIEs at May 31, 2012.

The following table present information about nonconsolidated VIEs in which the Company had variable interests aggregated by principal business activity. The tables include VIEs where the Company has determined that the maximum exposure to loss is greater than specific thresholds, or meets certain other criteria. A substantial portion of the variable interests in mortgage- and asset-backed VIEs are sponsored by unrelated third parties and consist entirely of mortgage-backed securities purchased or retained in connection with the Company's market making activities.

	As of May 31, 2012		
(in millions)	**Financial Statement Carrying Amount**	**Maximum exposure to loss**	**VIE Assets** [1]
Agency mortgage- and asset-backed securitizations	$ 1,209.9 [2]	$ 1,209.9 [3]	$ 4,110.5
Non-agency mortgage- and asset-backed securitizations	561.8 [2]	561.8 [3]	52,993.0
High Yield	9.9	9.9	1,982.1
Total	$ 1,781.6	$ 1,781.6	$ 59,085.6

(1) VIE assets represent the unpaid principal balance of the assets in these vehicles at May 31, 2012 and represents the underlying assets that provide the cash flows supporting the Company's variable interests
(2) Consists of debt securities accounted for at fair value, which are included within Financial instruments owned.
(3) The maximum exposure to loss in these non-consolidated VIEs is limited to the Company's investment, which is represented by the financial statement carrying amount of the purchased or retained interest.

Mortgage- and Asset-Backed Vehicles. In connection with the Company's trading and market-making activities, it buys and sells mortgage- and asset-backed securities. Mortgage- and asset-backed securities issued by securitization entities are generally considered variable interests in VIEs.

High Yield. The Company holds variable interests in Jefferies High Yield Holdings, LLC ("JHYH"), Jefferies Special Opportunities Partners, LLC ("JSOP") and Jefferies Employees Special Opportunities Partners, LLC ("JESOP"). JHYH conducts the high yield secondary market trading activities of the Parent. JSOP and JESOP are investors in JHYH. The Parent is the primary beneficiary of JHYH, JSOP and JESOP and accordingly consolidates these entities.

The Company holds the Series A nonvoting interest of JHYH, which entitles it to a 20% carried interest of the earnings of JHYH, after adjustments for prior period net losses. The Company is the Class B member of JSOP and JESOP, which entitles it to a 20% carried interest of the earnings of these entities, after adjustments for prior period net losses and carried interest allocated to it by JHYH. At May 31, 2012, the carrying value of its interests in JHYH, JSOP and JESOP was approximately $9.9 million, which is accounted for under the equity method and included in Other assets on the Consolidated Statement of Financial Condition. The Company's exposure to loss is limited to the carrying value of its interests in JHYH, JSOP and JESOP.

9. RECEIVABLE FROM, AND PAYABLE TO, BROKERS, DEALERS AND CLEARING ORGANIZATIONS

At May 31, 2012, receivable from, and payable to, brokers, dealers and clearing organizations consisted of (in thousands):

	Receivable	Payable
Securities failed to deliver/receive	$ 99,771	$ 95,765
Trades in process of settlement, net	493,468	627
Clearing organizations	7,218	477,784
Futures margin from affiliates and brokers	82,544	-
Other	1,265	-
	$ 684,266	$ 574,176

10. OTHER INTANGIBLE ASSETS

The table below presents the gross carrying amount, accumulated amortization, net carrying amount of identifiable intangible assets and weighted average amortization period as of May 31, 2012 (dollar amounts in thousands):

	Gross cost	Accumulated amortization	Net carrying amount	Weighted average remaining lives (years)
Exchange and clearing organization membership interests and registrations	$ 1	$ -	$ 1	N/A
Customer relationships	4,732	(1,893)	2,839	5.5
Other	100	(12)	88	13.3
	$ 4,833	$ (1,905)	$ 2,928	

11. SHORT-TERM BORROWINGS

Bank loans represent short-term borrowings that are payable on demand and generally bear interest at spread over the federal funds rate. Bank loans at May 31, 2012, totaled $150.0 million of which $100.0 million is secured.

12. LIABILITIES SUBORDINATED TO CLAIMS OF GENERAL CREDITORS

At May 31, 2012, the Company had outstanding borrowings of $1.25 billion from the Parent under three subordinated loan agreements: two $500.0 million subordinated loan agreements dated December 7, 2009 and May 20, 2011, and a subordinated loan agreement for $250.0 million dated May 31, 2012. The subordinated liabilities bear interest at 9% per annum and are for a 5 year term and will automatically extend for additional one year periods, unless terminated.

All subordinated liabilities of the Company have been approved by the Financial Industry Regulatory Authority ("FINRA") and, therefore, qualify as capital in computing net capital under the SEC’s Uniform Net Capital Rule 15c3-1 under the Act ("Rule 15c3-1"). To the extent that such borrowings are required for the Company’s continued compliance with minimum net capital requirements, they may not be repaid.

13. EMPLOYEE BENEFIT PLANS

Certain employees of the Company are covered by a defined benefit pension plan sponsored by the Parent. The plan is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended. Benefits are based on years of service and the employee’s career average pay. The Parent’s funding policy is to contribute to the plan at least the minimum amount that can be deducted for Federal income tax purposes. The plan assets consist of approximately 49% equities, 49% fixed income and 2% other securities. Effective December 31, 2005, benefits under the pension plan have been frozen.

The Company participates in various benefit plans of the Parent covering substantially all employees, including an ESPP designed to qualify under Section 423 of the Internal Revenue Code ("IRC") and a profit sharing plan, which includes a salary reduction feature designed to qualify under Section 401(k) of the IRC.

14. INCOME TAXES

The Company is subject to U.S. Federal income tax as well as income tax in multiple state jurisdictions. The Company files a consolidated U.S. Federal and state combined or unitary income tax returns with its Parent. In states that neither accept nor require combined or unitary tax returns, the Company files separate state income tax returns.

At May 31, 2012, the Company had deferred tax assets primarily related to compensation. Management believes it is more likely than not that the Company will generate sufficient taxable income in the future to realize the deferred tax asset and therefore, no valuation allowance for deferred tax assets is required. As of May 31, 2012 the Company had approximately $79.9 million of total gross unrecognized tax benefits. The total amount of unrecognized benefits that, if recognized, would favorably affect the effective tax rate was $51.9 million (net of federal benefit of taxes) at May 31, 2012. As of May 31, 2012, the Company had accrued interest related to unrecognized tax benefits of approximately $9.9 million, which is included in Accrued expenses and other liabilities. No penalties were accrued at May 31, 2012.

The Company is currently under examination by the Internal Revenue Service and other major tax jurisdictions in which it has business operations. The Company does not expect that resolution of these examinations will have a material effect on its Consolidated Statement of Financial Condition. The table below summarizes the earliest tax years that are subject to examination in the major tax jurisdictions in which the Company operates:

Jurisdiction	Tax Year
United States	2006
California	2004
Connecticut	2000
Massachusetts	2006
New Jersey	2007
New York State	2001
New York City	2003

15. COMMITMENTS AND GUARANTEES

Commitments

The Company's commitments at May 31, 2012 were as follows (in millions):

	Expected Maturity Date					
	2012	2013	2014 and 2015	2016 and 2017	2018 and Later	Notional/ Maximum Payout
Equity commitments	$ 0.1	$ -	$ 0.9	$ -	$ 0.3	$ 1.3
Mortgage-related commitments	762.4	-	740.5	-	-	1,502.9
Forward starting repos	500.0	-	-	-	-	500.0
Forward starting reverse repos	101.7	-	-	-	-	101.7
Total	$ 1,364.2	$ -	$ 741.4	$ -	$ 0.3	$ 2,105.9

Equity Commitments — On May 12, 2005, the Company committed to invest an aggregate of $1.5 million in JCP Partners IV LLC, the General Partner of a private equity fund managed by a director and

Chairman of the Executive Committee of the Parent. As of May 31, 2012, the Company had funded approximately $1.4 million of its aggregate commitment leaving $0.1 million unfunded.

As of May 31, 2012, the Company had commitments to invest up to $1.2 million in various other investments.

Mortgage-Related Commitments — The Company enters into forward contracts to purchase mortgage participation certificates and mortgage-backed securities as part of its securitization activities. The mortgage participation certificates evidence interests in mortgage loans insured by the Federal Housing Administration and the mortgage-backed securities are insured or guaranteed by the FNMA, the Federal Home Loan Mortgage Corporation ("Freddie Mac") or the GNMA. The fair value of mortgage-related commitments recorded on the Consolidated Statement of Financial Condition was $72.1 million at May 31, 2012.

Forward Starting Repurchase and Reverse Repurchase Agreements — The Company enters into commitments to sell securities with agreements to repurchase and commitments to purchase securities with agreement to resell on a forward starting basis that are primarily secured by U.S. government, agency and municipal securities.

Guarantees

Derivative Contracts — Certain derivative contracts that the Company has entered into meet the accounting definition of a guarantee under U.S. GAAP. Such derivative contracts include written equity put options, written currency contracts, and interest rate caps, floors and swaptions. On certain of these contracts, such as written interest rate caps and foreign currency options, the maximum payout cannot be quantified since the increase in interest or foreign exchange rates are not contractually limited by the terms of the contract. As such, the Company has disclosed notional values as a measure of the maximum potential payout under these contracts. At May 31, 2012, the maximum payout value of derivative contracts deemed to meet the definition of a guarantee was approximately $6,805.2 million. It is however management’s belief that notional amounts generally overstate expected payout and that fair value of these contracts is a more relevant measure of the Company’s obligations. At May 31, 2012, the fair value of derivative contracts meeting the definition of a guarantee is a liability of approximately $244.1 million. The derivative contracts deemed to meet the definition of a guarantee under U.S. GAAP are before consideration of hedging transactions. The Company substantially mitigates its exposure to market risk on these contracts through hedges, such as other derivative contracts and/or cash instruments. The Company manages risk associated with derivative contracts meeting the definition of a guarantee consistent with its risk management policies.

At May 31, 2012, the notional amounts associated with the Company's derivative contracts meeting the definition of a guarantee under U.S. GAAP were as follows (in millions):

	Expected Maturity Date					
	2012	**2013**	**2014 and 2015**	**2016 and 2017**	**2018 and Later**	**Notional/ Maximum Payout**
Derivative contracts - non-credit derivatives	$ 6,339.0	$ 421.2	$ 45.0	$ -	$ -	$ 6,805.2

Other Guarantees — The Company is a member of numerous exchanges and clearing houses. In the normal course of business the Company provides guarantees to securities clearinghouses and exchanges. These guarantees generally are required under the standard membership agreements, such that members are required to guarantee the performance of other members. Additionally, if a member becomes unable to satisfy its obligations to the clearinghouse, other members would be required to meet these shortfalls. To mitigate these performance risks, the exchanges and clearinghouses often require members to post collateral. The Company's obligations under such guarantees could exceed the collateral amounts posted. The maximum potential liability under these arrangements cannot be quantified; however, the potential for the Company to be required to make payments under such guarantees is deemed remote. Accordingly, at May 31, 2012, no contingent liability is recorded in the Consolidated Statement of Financial Condition for these guarantees.

16. RELATED PARTY TRANSACTIONS

Amounts outstanding to and from related parties are reflected on the Consolidated Statement of Financial Condition as set forth below (in thousands):

	Assets	Liabilities
Amounts due to Parent	$ —	$ 393,649
Amounts due from/ due to Affiliates	21,323	95,691
	$ 21,323	$ 489,340

In the ordinary course of business, the Company obtains advances from the Parent which are generally payable on demand. Management believes amounts arising through related party transactions are reasonable and approximate amounts that would have been recorded if it operated as an unaffiliated entity. Amounts Due to and Due from affiliates are periodically settled in cash.

Trading, clearance and administrative activities — The Company has entered into expense sharing agreements with Jefferies International Limited ("JIL") (a wholly owned subsidiary of the Parent), Jefferies High Yield Trading, LLC, ("JHYT") an indirect consolidated subsidiary of the Parent, Jefferies Execution Services, Inc. ("JefEx") (a wholly owned subsidiary of the Parent), Jefferies Finance, LLC ("JFin") (a joint venture entity created for the purpose of offering senior loans to middle market and growth companies), Jefferies Mortgage Finance, Inc. (a wholly owned subsidiary of the Parent), and

Jefferies Capital Partners, LLC ("JCP") The agreements govern the services provided and reimbursements thereof. Additionally, the Company has executed clearing and execution agreements with JefEx and JIL.

The Company provides clearing and administrative services to JefEx. JefEx provides execution services to the Company.

The Company provides trading, clearing, and general and administrative services to and which are reimbursed by JHYT. Under a service agreement, the Company provides JFin with certain administrative services. In addition, the Company engages in debt capital markets transactions with JFin related to the originations of loans by JFin. In connection with such transactions, during the six months ended May 31, 2012, the Company purchased participation certificates in loans originated by JFin of $900.0 million, of which $207.8 million was held as of May 31, 2012.

The Company executes securities lending transactions with JHYT and JIL related to its securities lending business. At May 31, 2012, approximately $276.5 million of securities borrowed and $756.4 million of securities loaned on the Consolidated Statement of Financial Condition were with these affiliates.

In 2011, the Company entered into a clearing arrangement with Jefferies Bache, LLC ("Jefferies Bache") an indirectly wholly-owned subsidiary of the Company's Parent. Under the arrangement, Jefferies Bache executes and clears futures trades for the Company. At May 31, 2012, the Company had a margin deposit of $15.2 million with Jefferies Bache.

In connection with its sales and trading activities, from time to time the Company makes a market in long-term debt securities of the Parent (i.e., the Company buys and sells debt securities issued by its Parent). At May 31, 2012, approximately $12.3 million and $8.8 million of debt securities issued by the Parent are included in Financial instruments owned and Financial instruments sold, not yet purchased, respectively, on the Consolidated Statement of Financial Condition.

Berkadia Commercial Mortgage, LLC — At May 31, 2012, the Company had commitments to purchase $217.2 million in agency commercial mortgage-backed securities from Berkadia Commercial Mortgage, LLC, which is partially owned by Leucadia National Corporation, a significant shareholder of the Parent.

Dividend payments — On May 31, 2012, the Company paid a $250.0 million dividend to the Parent, which was approved by FINRA.

Stock Compensation Plans — The Company's employees participate in the share-based compensation plans of the Parent. The plans allow awards to certain employees in the form of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, unrestricted stock, performance awards, restricted stock units, dividend equivalents or other stock based awards.

Employee loans — At May 31, 2012, the Company had $26.5 million of loans outstanding to its employees that are included in Other assets on the Consolidated Statement of Financial Condition.

17. REGULATORY CAPITAL REQUIREMENT

The Company is a registered broker-dealer and futures commission merchant and, accordingly, is subject to the SEC Rule 15c3-1, Regulation 1.17 of the CFTC and the capital compliance rule of FINRA. The Company is required to maintain minimum net capital, as defined under Rule 15c3-1, of not less than the greater of $1.5 million or 2% of aggregate debit items arising from customer transactions. Additionally, under Regulation 1.17 of the CFTC, the Company is required to maintain minimum net capital of the greater of $1.0 million or the capital required under Rule 15c3-1. FINRA may require a member firm to reduce its business if its net capital is less than 4% of such aggregate debit items and may prohibit a firm from expanding its business if its net capital is less than 5% of such aggregate debit items.

At May 31, 2012, the Company had net capital, as defined under such rules, of $770.6 million which was approximately 38% of aggregate debit items and exceeded the minimum regulatory net capital requirement of $46.2 million by $724.4 million.

The Company performs the computation of assets in the proprietary accounts of its introducing brokers ("PAIB") in accordance with the customer reserve computation set forth in SEC Rule 15c3-3 under the Act, so as to enable introducing brokers to include PAIB assets as allowable assets in their net capital computations (to the extent allowable under the Net Capital Rule).

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