JEFFERIES GROUP INC /DE/
Form 10-Q
November 05, 2009

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

FORM 10-Q

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

For the quarterly period ended September 30, 2009

OR

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

For the transition period from __________ to __________

Commission file number 1-14947

JEFFERIES GROUP, INC.

(Exact name of registrant as specified in its charter)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

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

Yes o No o

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

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

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

Yes o No þ

Indicate the number of shares outstanding of the registrant s class of common stock, as of the latest practicable date.
168,186,211 shares as of the close of business November 3, 2009.

JEFFERIES GROUP, INC. AND SUBSIDIARIES
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SEPTEMBER 30, 2009

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

	September 30, 2009	December 31, 2008
ASSETS		
Cash and cash equivalents	$ 1,405,401	$ 1,294,329
Cash and securities segregated and on deposit for regulatory purposes or deposited with clearing and depository organizations	1,252,830	1,151,522
Financial instruments owned, at fair value, including securities pledged to creditors of $555,948 and $361,765 in 2009 and 2008, respectively:		
Corporate equity securities	1,600,335	945,747
Corporate debt securities	2,552,523	1,851,216
Government, federal agency and other sovereign obligations	1,752,027	447,233
Mortgage- and asset-backed securities	3,275,192	1,035,996
Loans and other receivables	494,198	34,407
Derivatives	85,238	298,144
Investments	73,502	75,059
Total financial instruments owned, at fair value	9,833,015	4,687,802
Investments in managed funds	114,307	100,245
Other investments	184,588	140,012
Securities borrowed	8,092,955	9,011,903
Securities purchased under agreements to resell	2,905,837	1,247,002
Receivables:		
Brokers, dealers and clearing organizations	1,701,988	732,073
Customers	1,390,138	507,292
Fees, interest and other	102,810	87,151
Premises and equipment	135,823	139,390
Goodwill	355,563	358,837
Other assets	388,085	521,127
Total assets	$ 27,863,340	$ 19,978,685

See accompanying unaudited notes to consolidated financial statements.

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

	September 30, 2009	December 31, 2008
LIABILITIES AND STOCKHOLDERS EQUITY		
Financial instruments sold, not yet purchased, at fair value:		
Corporate equity securities	$ 1,472,146	$ 739,166
Corporate debt securities	1,934,129	1,578,395
Government, federal agency and other sovereign obligations	1,508,786	211,045
Mortgage- and asset-backed securities	14,486	
Loans	495,932	
Derivatives	52,306	220,738
Other		223
Total financial instruments sold, not yet purchased, at fair value	5,477,785	2,749,567
Securities loaned	2,457,029	3,259,575
Securities sold under agreements to repurchase	9,317,086	6,727,390
Payables:		
Brokers, dealers and clearing organizations	1,103,301	383,363
Customers	3,441,849	1,736,971
Accrued expenses and other liabilities	717,873	542,546
	22,514,923	15,399,412
Long-term debt	2,452,894	1,764,274
Mandatorily redeemable convertible preferred stock	125,000	125,000
Mandatorily redeemable preferred interest of consolidated subsidiaries	311,418	280,923
Total liabilities	25,404,235	17,569,609
STOCKHOLDERS EQUITY		
Common stock, $.0001 par value. Authorized 500,000,000 shares; issued 187,036,056 shares in 2009 and 171,167,666 shares in 2008	19	17
Additional paid-in capital	1,862,287	1,870,120
Retained earnings	604,968	418,445
Less:		
Treasury stock, at cost, 17,704,370 shares in 2009 and 7,951,628 shares in 2008	(278,357)	(115,190)
Accumulated other comprehensive loss:		
Currency translation adjustments	(35,942)	(43,675)
Additional minimum pension liability	(8,446)	(8,446)
Total accumulated other comprehensive loss	(44,388)	(52,121)
Total common stockholders equity	2,144,529	2,121,271
Noncontrolling interests	314,576	287,805

Total stockholders equity	2,459,105	2,409,076
Total liabilities and stockholders equity	$ 27,863,340	$ 19,978,685

See accompanying unaudited notes to consolidated financial statements.

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

	Three Months Ended		Nine Months Ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
Revenues:				
Commissions	$ 94,243	$ 113,416	$ 298,621	$ 329,588
Principal transactions	372,109	(3,430)	807,629	138,303
Investment banking	122,529	130,125	280,446	338,704
Asset management fees and investment income (loss) from managed funds	20,966	(3,431)	21,485	(17,748)
Interest	161,091	209,183	413,777	624,614
Other	6,239	7,388	28,699	20,302
Total revenues	777,177	453,251	1,850,657	1,433,763
Interest expense	76,756	178,605	218,086	565,839
Net revenues	700,421	274,646	1,632,571	867,924
Interest on mandatorily redeemable preferred interest of consolidated subsidiaries	23,596	(24,105)	30,620	(36,054)
Net revenues, less mandatorily redeemable preferred interest	676,825	298,751	1,601,951	903,978
Non-interest expenses:				
Compensation and benefits	395,031	246,186	956,619	783,651
Floor brokerage and clearing fees	23,510	18,946	60,570	50,482
Technology and communications	36,141	31,500	104,508	91,894
Occupancy and equipment rental	18,121	19,205	52,168	56,898
Business development	10,293	11,228	29,273	35,106
Other	18,699	25,342	52,273	66,440
Total non-interest expenses	501,795	352,407	1,255,411	1,084,471
Earnings (loss) before income taxes	175,030	(53,656)	346,540	(180,493)
Income tax expense (benefit)	65,210	(6,090)	130,299	(59,966)
Net earnings (loss)	109,820	(47,566)	216,241	(120,527)
Net earnings (loss) to noncontrolling interests	23,534	(16,262)	29,718	(24,301)
Net earnings (loss) to common shareholders	$ 86,286	$ (31,304)	$ 186,523	$ (96,226)
Earnings (loss) per common share:				
Basic	$ 0.42	$ (0.18)	$ 0.92	$ (0.64)

Diluted	$ 0.42	$ (0.18)	$ 0.92	$ (0.64)
Weighted average common shares:				
Basic	200,609	173,757	201,860	160,458
Diluted	204,736	173,757	205,986	160,458

See accompanying unaudited notes to consolidated financial statements.

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

	Nine Months Ended September 30, 2009	Year Ended December 31, 2008
Common stock, par value $0.0001 per share		
Balance, beginning of period	$ 17	$ 16
Issued	2	1
Balance, end of period	19	17
Additional paid-in capital		
Balance, beginning of period	1,870,120	1,115,011
Benefit plan share activity (1)	15,556	52,912
Share-based expense, net of forfeitures and clawbacks	(3,768)	561,661
Proceeds from exercise of stock options	69	840
Acquisitions and contingent consideration	(2,710)	5,647
Tax (deficiency) benefit for issuance of share-based awards	(16,980)	6,233
Issuance of treasury stock		90,160
Dividend equivalents on restricted stock units		37,656
Balance, end of period	1,862,287	1,870,120
Retained earnings		
Balance, beginning of period	418,445	1,031,764
Net earnings (loss) to common shareholders	186,523	(536,128)
Dividends		(76,477)
Acquisition adjustments		(714)
Balance, end of period	604,968	418,445
Treasury stock, at cost		
Balance, beginning of period	(115,190)	(394,406)
Purchases	(158,418)	(21,765)
Returns / forfeitures	(7,459)	(42,438)
Issued	2,710	343,419
Balance, end of period	(278,357)	(115,190)
Accumulated other comprehensive (loss) income		
Balance, beginning of period	(52,121)	9,159

Currency adjustment, net of tax		7,733		(54,661)
Pension adjustment, net of tax				(6,619)
Balance, end of period		(44,388)		(52,121)
Total common stockholders equity		2,144,529		2,121,271
Noncontrolling interests				
Balance, beginning of period		287,805		249,380
Net earnings (loss) to noncontrolling interests		29,718		(53,884)
Contributions		410		99,725
Distributions		(3,357)		(11,553)
Consolidation of asset management entity				4,137
Balance, end of period		314,576		287,805
Total stockholders equity	$	2,459,105	$	2,409,076

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

See accompanying unaudited notes to consolidated financial statements.

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

	Three Months Ended		Nine Months Ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
Net earnings (loss) to common shareholders	$ 86,286	$ (31,304)	$ 186,523	$ (96,226)
Other comprehensive income (loss):				
Currency translation adjustments	(5,751)	(23,213)	7,733	(21,288)
Total other comprehensive income (loss) (1)	(5,751)	(23,213)	7,733	(21,288)
Comprehensive income (loss)	$ 80,535	$ (54,517)	$ 194,256	$ (117,514)

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

See accompanying unaudited notes to consolidated financial statements.

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

	Nine Months Ended	
	September 30, 2009	September 30, 2008
Cash flows from operating activities:		
Net earnings (loss)	$ 216,241	$ (120,527)
Adjustments to reconcile net earnings (loss) to net cash (used in) provided by operating activities:		
Depreciation and amortization	23,390	21,998
Gain on repurchase of long-term debt	(7,673)	
Interest on mandatorily redeemable preferred interests of consolidated subsidiaries	30,620	(36,054)
Accruals related to various benefit plans, stock issuances, net of forfeitures	4,331	147,919
Increase in cash and securities segregated and on deposit for regulatory purposes or deposited with clearing and depository organizations	(101,213)	(617,039)
(Increase) decrease in receivables:		
Brokers, dealers and clearing organizations	(948,060)	(1,507,054)
Customers	(861,053)	32,654
Fees, interest and other	(15,648)	7,652
Decrease in securities borrowed	914,875	8,139,139
Increase in financial instruments owned	(5,108,735)	(266,946)
Increase in other investments	(44,576)	(51,090)
(Increase) decrease in investments in managed funds	(14,062)	167,326
Increase in securities purchased under agreements to resell	(1,658,835)	(124,071)
Decrease in other assets	143,602	118,760
Increase in payables:		
Brokers, dealers and clearing organizations	708,141	657,298
Customers	1,687,146	564,944
Decrease in securities loaned	(802,546)	(2,746,747)
Increase in financial instruments sold, not yet purchased	2,727,098	241,723
Increase (decrease) in securities sold under agreements to repurchase	2,589,696	(4,647,217)
Increase in accrued expenses and other liabilities	159,941	32,611
Net cash (used in) provided by operating activities	(357,320)	15,279
Cash flows from investing activities:		
Purchase of premises and equipment	(18,324)	(21,500)
Deconsolidation of asset management entity		(63,665)
Business acquisition	(38,760)	
Cash paid for contingent consideration	(28,653)	(37,670)
Net cash used in investing activities	(85,737)	(122,835)

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

	Nine Months Ended	
	September 30, 2009	September 30, 2008
Cash flows from financing activities:		
Excess tax benefits from the issuance of share-based awards	$ 8,155	$ 11,544
Net proceeds from (payments on):		
Equity financing		433,579
Issuance of senior notes, net of issuance costs	713,526	
Repurchase of long-term debt	(12,796)	
Bank loans		(269,717)
Mandatorily redeemable preferred interest of consolidated subsidiaries	(125)	(4,317)
Noncontrolling interest	(2,947)	(2,043)
Repurchase of treasury stock	(158,418)	(12,522)
Dividends		(38,821)
Exercise of stock options, not including tax benefits	69	743
Net cash provided by financing activities	547,464	118,446
Effect of foreign currency translation on cash and cash equivalents	6,665	10,804
Net increase in cash and cash equivalents	111,072	21,694
Cash and cash equivalents at beginning of year	1,294,329	897,872
Cash and cash equivalents at end of period	$ 1,405,401	$ 919,566
Supplemental disclosures of cash flow information:		
Cash paid (received) during the year for:		
Interest	$ 219,085	$ 599,838
Income taxes, net	(42,361)	(20,713)
Acquisitions:		
Fair value of assets acquired, including goodwill	53,104	
Liabilities assumed	14,344	
Cash paid for acquisition	38,760	

See accompanying unaudited notes to consolidated financial statements.

JEFFERIES GROUP, INC. AND SUBSIDIARIES

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

Note 1. Organization and Summary of Significant Accounting Policies

Organization

The accompanying unaudited consolidated financial statements include the accounts of Jefferies Group, Inc. and all its subsidiaries (together, we or us), including Jefferies & Company, Inc. (Jefferies), Jefferies Execution Services, Inc., (Jefferies Execution), Jefferies International Limited, Jefferies Asset Management, LLC, Jefferies Financial Products, LLC and all other entities in which we have a controlling financial interest or are the primary beneficiary, including Jefferies High Yield Holdings, LLC (JHYH), Jefferies Special Opportunities Partners, LLC (JSOP) and Jefferies Employees Special Opportunities Partners, LLC (JESOP). The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S generally accepted accounting principles for complete financial statements. All adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. These unaudited consolidated financial statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2008.

On April 21, 2008, we issued 26,585,310 shares of common stock and made a cash payment to Leucadia National Corporation (Leucadia) of approximately $100 million. In exchange, we received from Leucadia 10,000,000 common shares of Leucadia. During the second quarter of 2008, we sold the 10,000,000 common shares of Leucadia and thus realized approximately $433.6 million in net cash from the issuance of our shares.

Reclassifications

Certain reclassifications have been made to previously reported balances to conform to the current presentation. As of the quarter ended September 30, 2009, we have classified certain amounts within Receivables on the Consolidated Statements of Financial Condition that previously were classified within Other assets. Approximately $117.0 million has been reclassified from Other assets to Receivables at December 31, 2008 to conform with the current presentation.

Prior to January 1, 2009, we reported minority interest within liabilities on our Consolidated Statements of Financial Condition and in earnings (loss) of consolidated subsidiaries in the determination of net earnings (loss). We now present noncontrolling interests within stockholders equity, separately from our own equity. We have recast certain prior financial statements to retrospectively reflect noncontrolling interest within stockholders equity and to allocate net (earnings) loss to noncontrolling interests and to common shareholders . See Note 10 for further discussion.

In addition, as of January 1, 2009, net earnings are allocated among common shareholders and participating securities based on their right to share in earnings. These financial statements have been recast to retrospectively apply this accounting policy. This reduced previously reported Diluted EPS. See Note 14 to these financial statements for an explanation of the calculation of earnings per share.

Summary of Significant Accounting Policies

Accounting Standards Codification

The FASB established the Accounting Standards Codification (ASC) on July 1, 2009 as the single source of authoritative generally accepted accounting principles (GAAP) to be applied by nongovernmental entities. The ASC supersedes all existing non-SEC accounting and reporting standards. All other nongrandfathered, non-SEC accounting literature not included in the ASC is no longer authoritative.

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

Following the ASC, the FASB no longer issues new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead, it issues Accounting Standards Updates, which serve to update the ASC, provide background information about the guidance and provide the basis for conclusions on the changes to the ASC. GAAP was not changed as a result of the FASB s codification project, but the codification project changes the way the guidance is organized and presented. As a result, these changes have a significant impact on how we reference GAAP in our financial statements and in our accounting policies for financial statements issued for interim and annual periods.

Principles of Consolidation

Our policy is to consolidate all entities in which we own more than 50% of the outstanding voting stock and have control. In addition, we consolidate entities which lack characteristics of an operating entity or business for which we are the primary beneficiary. The primary beneficiary is the party that absorbs a majority of the entity s expected losses, receives a majority of its expected residual returns, or both, as a result of holding variable interests, direct or implied. In situations where we have significant influence but not control of an entity that does not qualify as a variable interest entity, we apply the equity method of accounting or fair value accounting. We also have formed nonconsolidated investment vehicles with third-party investors that are typically organized as partnerships or limited liability companies. We act as general partner or managing member for these investment vehicles and have generally provided the third-party investors with termination or kick-out rights.

All material intercompany accounts and transactions are eliminated in consolidation.

Revenue Recognition

Commissions. All customer securities transactions are reported on the Consolidated Statements of Financial Condition on a settlement date basis with related income reported on a trade-date basis. Under clearing agreements, we clear trades for unaffiliated correspondent brokers and retain a portion of commissions as a fee for our services. Correspondent clearing revenues are included in other revenue. We permit institutional customers to allocate a portion of their gross commissions to pay for research products and other services provided by third parties. The amounts allocated for those purposes are commonly referred to as soft dollar arrangements. Soft dollar expenses amounted to $9.2 million and $12.4 million for the three months ended September 30, 2009 and 2008, respectively, and $24.3 million and $32.7 million for the nine months ended September 30, 2009 and 2008, respectively. We account for the cost of these arrangements on an accrual basis. As we are not the primary obligor for these arrangements, expenses relating to soft dollars are netted against the commission revenues.

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

Investment Banking. Underwriting revenues and fees from mergers and acquisitions, restructuring and other investment banking advisory assignments are recorded when the services related to the underlying transaction are completed under the terms of the assignment or engagement. Expenses associated with such assignments are deferred until reimbursed by the client, the related revenue is recognized or the engagement is otherwise concluded. Expenses are recorded net of client reimbursements. Revenues are presented net of related unreimbursed expenses. Unreimbursed expenses with no related revenues are included in business development in the Consolidated Statements of Earnings. Reimbursed expenses totaled approximately $1.9 million and $3.1 million for the three months ended September 30, 2009 and 2008, respectively, and approximately $4.6 million and $10.7 million for the nine months ended September 30, 2009 and 2008, respectively.

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

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

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

Cash Equivalents

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

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

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

Foreign Currency Translation

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

Financial Instruments Owned and Financial Instruments Sold, not yet Purchased and Fair Value

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

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

Fair Value Hierarchy

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

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

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

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

Valuation Process for Financial Instruments

Financial instruments are valued at quoted market prices, if available. For financial instruments that do not have readily determinable fair values through 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. 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, mid-market pricing is applied and adjusted to the point within the bid-ask range that meets our best estimate of fair value. For offsetting positions in the same financial instrument, the same price within the bid-ask spread is used to measure both the long and short positions.

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

Cash products Where quoted prices are available in an active market, cash products are classified in Level 1 of the fair value hierarchy and valued based on the quoted price, primarily quoted exchange prices. Level 1 cash products are highly liquid instruments and include listed equity and money market securities and G-7 government and agency securities. Cash products classified within Level 2 of the fair value hierarchy are based primarily on broker quotations, pricing service data from external providers and prices for actual executed market transactions. If quoted

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market prices are not available for the specific security then fair values are estimated by using pricing models, quoted prices of cash products with similar characteristics or discounted cash flow models. Examples of cash products classified within Level 2 of the fair value hierarchy are corporate, convertible and municipal bonds, agency and non-agency mortgage-backed securities and to-be-announced (TBA) securities. If there is limited transaction activity or less transparency to observe market-based inputs to valuation models, cash products presented at fair value are classified in Level 3 of the fair value hierarchy. Fair values of cash products classified in Level 3 are generally based on an assessment of each underlying investment, cash flow models, market data of any recent comparable company transactions and trading multiples of companies considered comparable to the instrument being valued and incorporate assumptions regarding market outlook, among other factors. Cash products in this category include illiquid equity securities, equity interests in private companies, auction rate securities, commercial loans, private equity and hedge fund investments, distressed debt instruments and Alt-A and subprime non-agency mortgage-backed securities as little external price information is currently available for these products. For distressed debt instruments, commercial loans and loan commitments, loss assumptions must be made based on default scenarios and market liquidity and prepayment assumptions must be made for mortgage-backed securities.

Derivative products Exchange-traded derivatives are valued using quoted market prices and are classified within Level 1 of the fair value hierarchy. Over-the-counter (OTC) derivative products are generally valued using models, whose inputs reflect assumptions that we believe market participants would use in valuing the derivative in a current period transaction. Inputs to valuation models are appropriately calibrated to market data, including but not limited to yield curves, interest rates, volatilities, equity, debt and commodity prices and credit curves. Fair value can be modeled using a series of techniques, including the Black-Scholes option pricing model and simulation models. For certain OTC derivative contracts, 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 thus classified in Level 2 include certain credit default swaps, interest rate swaps, commodity swaps, and debt and equity option contracts. Derivative products that are valued based on models with significant unobservable market inputs are classified within Level 3 of the fair value hierarchy. Level 3 derivative products include total return swaps and equity warrant and option contracts where the volatility of the underlying equity securities are not observable due to the terms of the contracts and correlation sensitivity to market indices is not transparent for the term of the derivatives.

Investments in Managed Funds

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

Other Investments

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

Receivable from and Payable to Customers

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

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Securities Borrowed and Securities Loaned

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

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

Securities purchased under agreements to resell and securities sold under agreements to repurchase (collectively repos) are accounted for as collateralized financing transactions and are recorded at their contracted repurchase amount. We earn net interest revenues from this activity which is reflected in our Consolidated Statements of Earnings.

We monitor the fair value of the underlying securities daily versus the related receivable or payable balances. Should the fair value of the underlying securities decline or increase, additional collateral is requested or excess collateral is returned, as appropriate. We carry repos on a net basis by counterparty when appropriate.

Premises and Equipment

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

Goodwill

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

Income Taxes

We file a consolidated U.S. federal income tax return, which includes all of our qualifying subsidiaries. We also are subject to income tax in various states and municipalities and those foreign jurisdictions in which we operate. Amounts provided for income taxes are based on income reported for financial statement purposes and do not necessarily represent amounts currently payable. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and for tax loss carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income taxes are provided for

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temporary differences in reporting certain items, principally, share-based compensation, deferred compensation, unrealized gains and losses on investments and tax amortization on intangible assets. The realization of deferred tax assets is assessed and a valuation allowance is recorded to the extent that it is more likely than not that any portion of the deferred tax asset will not be realized.

The tax benefit related to dividends and dividend equivalents paid on nonvested share based payment awards and outstanding equity options is recognized as an increase to additional paid in capital. Prior to January 1, 2008, such income tax benefit was recognized as a reduction of income tax expense. These amounts are included in tax benefits for issuance of share-based awards on the Consolidated Statement of Changes in Stockholders Equity.

Legal Reserves

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

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

Share-Based Compensation

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

Earnings per Common Share

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

As of January 1, 2009, unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and, therefore, are included in the earnings allocation in computing earnings per share under the two-class method of earning per share. We grant restricted stock and restricted stock units as part of our share-based compensation that contain nonforfeitable rights to dividends and dividend equivalents, respectively, and therefore, prior to the requisite service being rendered for the right to retain the award, restricted stock and restricted stock units meet the definition of a participating security. As such, we calculate Basic and Diluted earnings per share under the two-class method. All prior-period earnings per share data presented have been adjusted to include participating securities in the earnings per share computation using the two-class method.

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Securitization Activities

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

Accounting Developments

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

Earnings per Share

We adopted accounting described in ASC 260, Earnings per Share Topic, on January 1, 2009 which addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, are included in the earnings allocation in computing earnings per share under the two-class method described in ASC 260. Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of EPS pursuant to the two-class method. Accordingly, all prior-period EPS data presented has been adjusted to comply with the provisions of ASC 260. The adoption of accounting changes described in ASC 260 did not have an effect on previously reported Basic and Diluted EPS of $(0.18) for the three months ended September 30, 2008 and reduced previously reported Basic and Diluted EPS from a loss of $0.60 to a loss of $0.64 for the nine months ended September 30, 2008.

Debt

We apply the provisions of accounting updates described in ASC 470, Debt Topic, effective January 1, 2009, which clarifies that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) were not previously addressed ASC 470 and specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity s nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. This is effective for fiscal years and interim periods beginning after December 31, 2008. Adoption of this accounting update did not affect our financial condition, results of operations or cash flows.

Business Combinations

We apply the provisions of accounting described in ASC 805, Business Combinations Topic, to business combinations occurring after January 1, 2009. This requires an entity to recognize the assets acquired, liabilities assumed, contractual contingencies and contingent consideration measured at their fair value at the acquisition date for any business combination consummated after the effective date. It further requires that acquisition-related costs are to be recognized separately from the acquisition and expensed as incurred. Adoption of this accounting change did not affect our financial condition, results of operations or cash flows, but may have an effect on accounting for future business combinations.

Consolidation

We adopted the provisions of accounting described in ASC 810, Consolidation Topic, on January 1, 2009, which requires an entity to clearly identify and present ownership interests in subsidiaries held by parties other than the entity in the consolidated financial statements within the equity section but separate from the entity s equity. It also requires the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income; changes in ownership interest be accounted for

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similarly, as equity transactions; and when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary and the gain or loss on the deconsolidation of the subsidiary be measured at fair value. Refer to Note 10 for further discussion on the adoption of the changes described in ASC 810.

We will adopt further accounting changes described in ASC 810, Consolidation Topic, as of January 1, 2010, which require that the party who has the power to direct the activities of a variable interest entity that most significantly impact the entity s economic performance and who has an obligation to absorb losses of the entity or a right to receive benefits from the entity that could potentially be significant to the entity consolidate the variable interest entity. The changes to ASC 810, effective as of January 1, 2010, eliminate the quantitative approach previously applied to assessing the consolidation of a variable interest entity and require ongoing reassessments for consolidation. We are currently evaluating the impact on our consolidated financial statements.

Derivatives and Hedging

We adopted certain accounting disclosures described in ASC 815, Derivative and Hedging Topic, for our year end consolidated financial statements as of December 31, 2008. This requires enhanced disclosures by sellers of credit derivatives, including credit derivatives embedded in a hybrid instrument, and require additional disclosure about the current status of the payment/performance risk of a guarantee. The adoption did not have an effect on our financial condition, results of operations or cash flows.

We adopted accounting changes described in ASC 815, Derivative and Hedging Topic, effective January 1, 2009, requiring qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair values and amounts of gains and losses on derivative contracts and disclosures about credit-risk-related contingent features in derivative agreements. Since changes required as of January 1, 2009 required only additional disclosures concerning derivatives and hedging activities, adoption did not affect our financial condition, results of operations or cash flows.

Fair Value Measurements and Disclosures

We adopted accounting updates included in ASC 820, Fair Value Measurements and Disclosures Topic, as of April 1, 2009, which provide additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. ASC 820 also includes guidance on identifying circumstances that indicate a transaction is not orderly. The adoption of these updates did not have a material effect on our financial condition, results of operations and cash flows.

In August 2009, the FASB issued accounting updates to ASC 820, Fair Value Measurements and Disclosures Topic Measuring Liabilities at Fair Value, which provides clarifying guidance for determining the fair value of a liability. We will adopt this accounting update on October 1, 2009 and do not expect this update to have a material effect on our financial condition, results of operations or cash flows.

In September 2009, the FASB issued accounting updates to ASC 820, Fair Value Measurements and Disclosures Topic Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent). The accounting updates in this topic permit an investment that has the characteristics of an investment company and has no readily determinable fair value to be measured based on the net asset value per share of the investment. The accounting updates also require disclosure by major category of investment about the attributes of the investment, the nature of any redemption restrictions on the investment, any unfunded commitments we have pertaining to the investment and the investment strategies of the underlying investees. We will adopt the provisions contained in the accounting update in the fourth quarter of 2009 and do not expect there to be a material effect on our financial condition, results of operations or cash flows.

Subsequent Events

We adopted accounting described in ASC 855, Subsequent Events Topic, as of our financial period ended June 30, 2009, requiring that management evaluate events and transactions that may occur for potential recognition or

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disclosure in the financial statements after the balance sheet date through the date the financial statements are issued and determining the circumstances under which such events or transactions must be recognized in the financial statements. The adoption did not have an effect on our financial condition, results of operations or cash flows.

Transfers and Servicing

We adopted accounting updates included in ASC 860, Transfers and Servicing Topic, effective January 1, 2009, which require an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously or in contemplation of the initial transfer to be evaluated as a linked transaction unless certain criteria are met. The updates to ASC 860 are to be applied prospectively for new transactions entered into after the adoption date. The adoption did not have a material effect on financial condition, cash flows or results of operations.

We will adopt further accounting changes described in ASC 860, Transfers and Servicing Topic, as of January 1, 2010, which eliminate the concept of a qualifying special purpose entity, require that a transferor consider all arrangements made contemporaneously with, or in contemplation of, a transfer of assets when determining whether derecognition of a financial asset is appropriate, clarify the requirement that a transferred financial asset be legally isolated from the transferor and any of its consolidated affiliates, stipulate that constraints on a transferee s ability to freely pledge or exchange transferred assets causes the transfer to fail sale accounting, and define participating interests and provides guidance on derecognizing participating interests. We are currently evaluating the impact on our consolidated financial statements.

Use of Estimates

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

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

We generally invest our excess cash in money market funds and other short-term investments. Cash equivalents include highly liquid investments not held for resale with original maturities of three months or less. The following are financial instruments that are cash and cash equivalents or are deemed by us to be generally readily convertible into cash as of September 30, 2009 and December 31, 2008 (in thousands of dollars):

	September 30, 2009	December 31, 2008
Cash and cash equivalents:		
Cash in banks	$ 227,004	$ 765,056
Money market investments	1,178,397	529,273
Total cash and cash equivalents	1,405,401	1,294,329
Cash and securities segregated (1)	1,252,830	1,151,522
	$ 2,658,231	$ 2,445,851

(1) Consists of deposits at exchanges and clearing organizations,

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

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Note 3. Financial Instruments

The following is a summary of the fair value of major categories of financial instruments owned and financial instruments sold, not yet purchased, as of September 30, 2009 and December 31, 2008 (in thousands of dollars):

	September 30, 2009		December 31, 2008	
	Financial Instruments Owned	Financial Instruments Sold, Not Yet Purchased	Financial Instruments Owned	Financial Instruments Sold, Not Yet Purchased
Corporate equity securities	$ 1,600,335	$ 1,472,146	$ 945,747	$ 739,166
Corporate debt securities	2,552,523	1,934,129	1,851,216	1,578,395
Government, federal agency and other sovereign obligations	1,752,027	1,508,786	447,233	211,045
Mortgage- and asset-backed securities	3,275,192	14,486	1,035,996	
Loans and other receivables	494,198	495,932	34,407	
Derivatives	85,238	52,306	298,144	220,738
Investments	73,502		75,059	
Other				223
	$ 9,833,015	$ 5,477,785	$ 4,687,802	$ 2,749,567

We elected to apply the fair value option to loans and loan commitments made in connection with our investment banking and senior loan trading activities and certain investments held by subsidiaries that are not registered broker-dealers. Loans and investments at fair value are included in financial instruments owned and loan commitments are included in financial instruments sold, not yet purchased derivatives on the Consolidated Statements of Financial Condition. The fair value option was elected for loans and loan commitments and investments held by subsidiaries that are not registered broker-dealers because they are risk managed by us on a fair value basis.

Financial instruments owned includes securities pledged to creditors. The following is a summary of the fair value of major categories of securities pledged to creditors as of September 30, 2009 and December 31, 2008 (in thousands of dollars):

	September 30, 2009	December 31, 2008
Corporate equity securities	$ 555,744	$ 360,356
Corporate debt securities	204	1,409
	$ 555,948	$ 361,765

At September 30, 2009 and December 31, 2008, the approximate fair value of collateral received by us that may be sold or repledged by us was $11.3 billion and $9.7 billion, respectively. This collateral was received in connection with resale agreements and securities borrowings. At September 30, 2009 and December 31, 2008, a substantial portion of this collateral received by us had been sold or repledged.

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The following is a summary of our financial assets and liabilities that are accounted for at fair value as of September 30, 2009 and December 31, 2008 by level within the fair value hierarchy (in thousands of dollars):

	As of September 30, 2009				
	Level 1	Level 2	Level 3	Counterparty and Cash Collateral Netting	Total
Assets:					
Financial instruments owned:					
Corporate equity securities	$ 1,532,260	$ 47,672	$ 20,403	$	$ 1,600,335
Corporate debt securities	2,870	2,395,520	147,388		2,545,778
Collateralized debt obligations		3	6,742		6,745
U.S. government and federal agency securities	858,536	550,924			1,409,460
U.S. issued municipal securities		165,543	240		165,783
Foreign government issued securities		176,646	138		176,784
Residential mortgage backed securities		2,881,216	105,069		2,986,285
Commercial mortgage backed securities		171,404			171,404
Other asset backed securities		117,393	110		117,503
Derivatives	239,246	339,007	2,399	(495,414)	85,238
Loans and other receivables		7,946	486,252		494,198
Investments at fair value			73,502		73,502
Total financial instruments owned	$ 2,632,912	$ 6,853,274	842,243	$ (495,414)	$ 9,833,015
Level 3 assets for which the firm does not bear economic exposure (1)			(377,227)		
Level 3 assets for which the firm bears economic exposure			$ 465,016		
Liabilities:					
Financial instruments sold, not yet purchased:					
Corporate equity securities	$ 1,425,322	$ 46,786	$ 38	$	$ 1,472,146
Corporate debt securities		1,934,129			1,934,129
U.S. government and federal agency securities	1,055,075	272,341			1,327,416
U.S. issued municipal securities		25			25
		181,345			181,345

Foreign government issued securities					
Residential mortgage backed securities		6,214			6,214
Commercial mortgage backed securities		3,945			3,945
Other asset backed securities		4,327			4,327
Derivatives	200,181	367,244	8,017	(523,136)	52,306
Loans			495,932		495,932
Total financial instruments sold, not yet purchased	$ 2,680,578	$ 2,816,356	$ 503,987	$ (523,136)	$ 5,477,785

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

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	As of December 31, 2008				
	Level 1	Level 2	Level 3	Counterparty and Cash Collateral Netting	Total
Assets:					
Financial instruments owned:					
Securities	$ 1,125,752	$ 2,782,707	$ 371,733	$	$ 4,280,192
Loans		11,824	22,583		34,407
Derivative instruments	258,827	920,687		(881,370)	298,144
Investments			75,059		75,059
Total financial instruments owned	$ 1,384,579	$ 3,715,218	469,375	$ (881,370)	$ 4,687,802
Level 3 assets for which the firm does not bear economic exposure (1)			(146,244)		
Level 3 assets for which the firm bears economic exposure			$ 323,131		
Liabilities:					
Financial instruments sold, not yet purchased:					
Securities	$ 757,260	$ 1,768,054	$ 3,515	$	$ 2,528,829
Derivative instruments	187,806	491,876	8,197	(467,141)	220,738
Total financial instruments sold, not yet purchased	$ 945,066	$ 2,259,930	$ 11,712	$ (467,141)	$ 2,749,567

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

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The following is a summary of changes in fair value of our financial assets and liabilities that have been classified as Level 3 for the three months ended September 30, 2009 and 2008 (in thousands of dollars):

	Three Months Ended September 30, 2009						
	Balance, June 30, 2009	Total gains/ losses (realized and unrealized) (1)	Purchases, sales, settlements, and issuances	Transfers into Level 3	Transfers out of Level 3	Balance, September 30, 2009	Change in unrealized gains/ (losses) relating to instruments still held at September 30, 2009 (1)
Assets:							
Financial instruments owned:							
Corporate equity securities	$ 20,297	$ (752)	$ (44)	$ 1,581	$ (679)	$ 20,403	$ (582)
Corporate debt securities	164,466	(4,855)	(4,676)	2,038	(9,585)	147,388	(7,054)
Collateralized debt obligations	2,119	4,623				6,742	4,623
U.S. issued municipal securities	509	(193)	(76)			240	(193)
Foreign government issued securities	78	68			(8)	138	68
Residential mortgage backed securities	117,760	65,948	(79,304)	702	(37)	105,069	12,836
Commercial mortgage backed securities							
Other asset backed securities	1,422		(1,312)			110	
Derivatives	5,499	(3,100)				2,399	(3,100)
Loans and other receivables	275,694	12,558	198,000			486,252	8,725
Investments at fair value	73,441	1,121	(479)		(581)	73,502	1,121

	$ 661,285	$ 75,418	$ 112,109	$ 4,321	$ (10,890)	$ 842,243	$ 16,444
Liabilities:							
Financial instruments sold, not yet purchased:							
Corporate equity securities	$	$	$	$ 38	$	$ 38	$
Corporate debt securities	4,802	536	(3,751)		(1,587)		
Derivatives	7,538	499	(20)			8,017	(499)
Loans	229,438		266,494			495,932	
	$ 241,778	$ 1,035	$ 262,723	$ 38	$ (1,587)	$ 503,987	$ (499)

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

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

	Three Months Ended September 30, 2008				
	Non-derivative instruments Assets	Non-derivative instruments Liabilities	Derivative instruments Assets	Derivative instruments Liabilities	Investments
Balance, June 30, 2008	$ 405,850	$ 47,804	$ 727	$ 33,921	$ 90,111
Total gains/ losses (realized and unrealized) (1)	(29,279)	¾	¾	(15,156)	364
Purchases, sales, settlements, and issuances	(45,415)	(46,502)	(727)	¾	1,271
Transfers into Level 3	28,240	25	¾	¾	¾
Transfers out of Level 3	(71,684)	(1,264)	¾	¾	¾
Balance, September 30, 2008	$ 287,712	$ 63	$ ¾	$ 18,765	$ 91,746
Change in unrealized gains/ (losses) relating to instruments still held at September 30, 2008 (1)	$ (34,028)	$ ¾	$ ¾	$ 15,156	$ 364

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

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

The following is a summary of changes in fair value of our financial assets and liabilities that have been classified as Level 3 for the nine months ended September 30, 2009 and 2008 (in thousands of dollars):

	Nine Months Ended September 30, 2009						
	Balance, December 31, 2008	Total gains/ losses (realized and unrealized) (1)	Purchases, sales, settlements, and issuances	Transfers into Level 3	Transfers out of Level 3	Balance, September 30, 2009	Change in unrealized gains/ (losses) relating to instruments still held at September 30, 2009 (1)
Assets:							
Financial instruments owned:							
Corporate equity securities	$ 41,351	$ (14,134)	$ (9,323)	$ 6,391	$ (3,882)	$ 20,403	$ (12,430)
Corporate debt securities	177,603	(47,757)(2)	54,251	35,928	(72,637)	147,388	(42,204)
Collateralized debt obligations	2,179	4,563				6,742	4,563
U.S. issued municipal securities		(243)(2)	483			240	(193)
Foreign government issued securities		79		67	(8)	138	79
Residential mortgage backed securities	63,065	78,077	(91,681)	76,945	(21,337)	105,069	15,135
Commercial mortgage backed securities			322		(322)		
Other asset backed securities	2,089	(583)	485		(1,881)	110	
Derivatives		2,446	(47)			2,399	4,832
Loans and other receivables	108,029	10,304	367,919			486,252	(2,095)
Investments at fair value	75,059	(2,665)	1,727	6	(625)	73,502	(3,445)
	$ 469,375	$ 30,087	$ 324,136	$ 119,337	$ (100,692)	$ 842,243	$ (35,758)

Liabilities:							
Financial instruments sold, not yet purchased:							
Corporate equity securities	$	$	$	$ 38	$	$ 38	$
Corporate debt securities	3,515	739	(2,104)	2,952	(5,102)		
Derivatives	8,197	(180)				8,017	(2,252)
Loans			495,932			495,932	
Other		225	(225)				
	$ 11,712	$ 784	$ 493,603	$ 2,990	$ (5,102)	$ 503,987	$ (2,252)

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

(2) During the quarter ended June 30, 2009, we changed our valuation methodology for auction rate securities, which are included within corporate debt securities and U.S. issued municipal securities. Previously, auction rate securities were valued based on an internal model based on projected cash

flows for the securities discounted for lack of liquidity. As of June 30, 2009, auction rate securities are valued using a valuation technique that benchmarks the securities to transactions and market prices of comparable securities, adjusting for projected cash flows and security structure, where appropriate.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
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	Nine Months Ended September 30, 2008				
	Non-derivative instruments Assets	Non-derivative instruments Liabilities	Derivative instruments Assets	Derivative instruments Liabilities	Investments
Balance, December 31, 2007	$ 248,397	$ 8,703	$ ¾	$ 12,929	$ 104,199
Total gains/ losses (realized and unrealized) (1)	(39,669)	(343)	184	(7,945)	(4,312)
Purchases, sales, settlements, and issuances	74,222	(6,806)	(727)	(8,577)	(8,141)
Transfers into Level 3	88,247	63	543	22,358	¾
Transfers out of Level 3	(83,485)	(1,554)	¾	¾	¾
Balance, September 30, 2008	$ 287,712	$ 63	$ ¾	$ 18,765	$ 91,746
Change in unrealized gains/ (losses) relating to instruments still held at September 30, 2008 (1)	$ (20,067)	$ ¾	$ ¾	$ 6,743	$ (4,312)

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

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

Note 4. Derivative Financial Instruments

Off-Balance Sheet Risk

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

Derivative Financial Instruments

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

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

us with the ability to offset a counterparty s rights and obligations, request additional collateral when necessary or liquidate the collateral in the event of counterparty default.

A portion of our derivative activities are performed by Jefferies Financial Products, LLC (JFP). JFP is a market maker in commodity index products and a trader in commodity futures and options. Where appropriate, JFP utilizes various credit enhancements, including guarantees, collateral, margin and master netting agreements to mitigate the credit exposure relating to these swaps and options. JFP establishes credit limits based on, among other things, the creditworthiness of the counterparties, the transaction s size and tenor, and estimated potential exposure. JFP maintains credit intermediation facilities with highly rated European banks (the Banks), which allow JFP customers that require a counterparty with a high credit rating for commodity index transactions to transact with the Banks. The Banks simultaneously enter into offsetting transactions with JFP and receive a fee from JFP for providing credit support. In certain cases, JFP is responsible to the Banks for the performance of JFP s customers.

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

The following table presents the fair value and related notional amounts of derivative contracts at September 30, 2009 categorized by predominant risk exposure. The fair value of assets/liabilities related to derivative contracts represents our receivable/payable for derivative financial instruments, gross of counterparty netting and cash collateral received and pledged:

	September 30, 2009			
	Assets		Liabilities	
(in thousands)	Fair Value	Notional Amount	Fair Value	Notional Amount
Interest rate contracts	$ 19,321	$ 1,472,956	$ 30,897	$ 1,788,227
Foreign exchange contracts	238,471	280,809	243,295	445,064
Equity contracts	248,864	2,661,976	207,658	8,230,370
Commodity contracts	52,789	4,681,789	89,938	3,681,489
Credit contracts	21,207	353,163	3,654	15,000
Total	580,652	$ 9,450,693	575,442	$ 14,160,150
Counterparty/cash-collateral netting	(495,414)		(523,136)	
Total per consolidated statement of financial position	$ 85,238		$ 52,306	

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

The following table presents unrealized and realized gains and losses on derivative contracts for the three and nine months ended September 30, 2009:

(in thousands)	Three Months Ended September 30, 2009 (Loss) Gain	Nine Months Ended September 30, 2009 (Loss) Gain
Interest rate contracts	$ (6,834)	$ (14,181)
Foreign exchange contracts	(102)	(1,050)
Equity contracts	4,670	(203,869)
Commodity contracts	(830)	(5,697)
Credit contracts	5,825	23,305
Total	$ 2,729	$ (201,492)

The following tables set forth the remaining contract maturity of the fair value of OTC derivative assets and liabilities as of September 30, 2009 (in thousands). Derivative fair values include counterparty netting and are gross of cash collateral received and pledged:

	OTC derivative assets (1) (2)				
	0 12 Months	1 5 Years	Greater Than 5 Years	Cross-Maturity Netting (3)	Total
Commodity swaps	$ 5,602	$ 171	$	$ (171)	$ 5,602
Commodity options	14,668	10,927			25,595
Total return swaps	2,703	11,519			14,222
Credit default swaps		14,326	2,630		16,956
Equity options	574				574
Fx forwards and swaps	374				374
Interest rate swaps			435		435
Total	$ 23,921	$ 36,943	$ 3,065	$ (171)	$ 63,758

(1) At September 30, 2009, we held exchange traded derivative assets of $34.0 million.

(2) Option and swap contracts

in the table above are gross of collateral received. Option and swap contracts are recorded net of collateral received on the Consolidated Statement of Financial Condition. At September 30, 2009, collateral received was $12.6 million.

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

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	OTC derivative liabilities (1) (2)				
	0 12 Months	1 5 Years	Greater Than 5 Years	Cross-Maturity Netting (3)	Total
Commodity swaps	$ 54,038	$	$	$ (171)	$ 53,867
Commodity options	8,017	7,268			15,285
Credit default swaps		416	1,387		1,803
Equity options	581	8,017			8,598
Fx forwards and swaps	732	4,465			5,197
Interest rate swaps		7,154	6,674		13,828
Total	$ 63,368	$ 27,320	$ 8,061	$ (171)	$ 98,578

(1) At September 30, 2009, we held no exchange traded derivative liabilities.

(2) Option and swap contracts in the table above are gross of collateral pledged. Option and swap contracts are recorded net of collateral pledged on the Consolidated Statement of Financial Condition. At September 30, 2009, collateral pledged was $46.3 million.

(3) Amounts represent the

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

At September 30, 2009, the counterparty credit quality with respect to the fair value of our OTC derivatives assets was as follows (in thousands). Derivative fair values include counterparty netting and are gross of cash collateral received:

Counterparty credit quality:	
A or higher	$ 54,249
B to BBB	339
Unrated	9,170
Total	$ 63,758

Contingent Features

Certain of our derivative instruments contain provisions that require our debt to maintain an investment grade credit rating from each of the major credit rating agencies. If our debt were to fall below investment grade, it would be in violation of these provisions, and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on our derivative instruments in liability positions. The aggregate fair value of all derivative instruments with such credit-risk-related contingent features that are in a liability position at September 30, 2009, is $18.4 million for which we have posted collateral of $19.1 million in the normal course of business. If the credit-risk-related contingent features underlying these agreements were triggered on September 30, 2009, we would be required to post an additional $8.8 million of collateral to our counterparties.

JEFFERIES GROUP, INC. AND SUBSIDIARIES
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Note 5. Securitization Activities and Variable Interest Entities

Securitization Activities

We engage in securitization activities related to residential mortgage-backed and other asset-backed securities. In our securitization activities, we use special purpose entities (SPEs). We do not consolidate certain securitization vehicles, commonly known as qualifying special purpose entities (QSPEs), if they meet certain criteria regarding the types of assets and derivatives they may hold, the types of sales they may engage in and the range of discretion they may exercise in connection with the assets they hold. The determination of whether a SPE meets the criteria to be a QSPE requires considerable judgment, particularly in evaluating whether the permitted activities of the SPE are significantly limited and in determining whether derivatives held by the SPE are passive and non-excessive.

We derecognize financial assets transferred in securitizations when we have relinquished control over such assets. Transferred assets are carried at fair value prior to securitization, with unrealized gains and losses reflected in principal transactions in the Consolidated Statements of Earnings. We act as placement or structuring agent in connection with the beneficial interests issued by securitization vehicles. Net revenues are recognized in connection with these activities.

During the three and nine months ended September 30, 2009 we transferred assets of $5,224.4 million and $8,279.4 million, respectively, as part of our securitization activities, received proceeds of $5,229.4 million and $8,302.1 million, respectively, and recognized net revenues of $11.0 million and $26.0 million, respectively. During the three and nine month period ended September 30, 2008, we transferred assets of $157.8 million and $157.8 million, respectively, as part of our securitization activities, received proceeds of $178.2 million and $178.2 million, respectively, and recognized net revenues of $3.9 million and $3.9 million, respectively. These transfers were accounted for as sales of assets.

The following table presents the total assets (unpaid principal amount) of, and retained interests in, QSPEs to which we, acting as transferor, have transferred assets and for which we received sale accounting treatment at September 30, 2009 (in millions):

Securitization Type	Total QSPE Assets	Retained Interests (1)
Residential mortgage-backed securities	$ 3,739.0	$ 250.7
Commercial mortgage-backed securities	220.4	0.1

(1) At September 30, 2009, 100% of our retained interests in these securitizations are AAA-rated.

The following table presents cash flows received on retained interests during the nine months ended September 30, 2009 (in millions):

	Residential mortgage-backed securities
Cash flows received on retained interests	$ 2.1

We have not provided financial or other support to these QSPEs during the three and nine months ended September 30, 2009. We have no explicit or implicit arrangements to provide additional financial support to these

QSPEs and have no liabilities related to these QSPEs at September 30, 2009.

JEFFERIES GROUP, INC. AND SUBSIDIARIES
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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 that absorbs a majority of the entity s expected losses, receives a majority of its expected residual returns, or both, as a result of holding variable interests, direct or implied.

VIEs Where We Are The Primary Beneficiary

We conduct our high yield secondary market trading activities through Jefferies High Yield Trading, LLC (JHYT). JHYT is a registered broker-dealer engaged in the secondary sales and trading of high yield securities and special situation securities, including bank debt, post-reorganization equity, public and private equity, equity derivatives, credit default swaps and other financial instruments. JHYT makes markets in high yield and distressed securities and provides research coverage on these types of securities. JHYT is a wholly-owned subsidiary of Jefferies High Yield Holdings, LLC (JHYH).

We own voting and non-voting interests in JHYH and have entered into management, clearing, and other services agreements with JHYH. We and Leucadia National Corporation (Leucadia) each have the right to nominate two of a total of four directors to JHYH s board of directors. Two funds managed by us, Jefferies Special Opportunities Fund (JSOP) and Jefferies Employees Special Opportunities Fund (JESOP), are also investors in JHYH. The arrangement term is through April 2013, with an option to extend. As a result of agreements entered into with Leucadia in April 2008, any request to Leucadia for additional capital investment in JHYH requires the unanimous consent of our Board of Directors, including the consent of any Leucadia designees to our board. (See Note 1, *Organization and Summary of Significant Accounting Policies*, herein for additional discussion of agreements entered into with Leucadia.)

We determined that JHYH and JESOP meet the definition of a variable interest entity. We are the primary beneficiary of JHYH and JESOP and accordingly consolidate JHYH (and the assets, liabilities and results of operations of its wholly-owned subsidiary JHYT) and JESOP.

The following tables present information about the assets and liabilities of our consolidated VIEs which are presented within our Consolidated Statement of Financial Condition in the respective asset and liability categories, as of September 30, 2009 and December 31, 2008 (in millions):

	VIE Assets	
	September 30, 2009	December 31, 2008
Cash	$ 321.3	$ 277.1
Financial instruments owned	1,011.5	546.9
Securities borrowed	457.3	242.7
Receivable from brokers and dealers	522.5	
Other	4.3	49.3
	$ 2,316.9	$ 1,116.0

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	VIE Liabilities	
	September 30, 2009	December 31, 2008
Financial instruments sold, not yet purchased	$ 935.9	$ 230.8
Payable to brokers and dealers	405.8	
Mandatorily redeemable interests (1)	945.9	854.0
Other	29.3	31.4
	$ 2,316.9	$ 1,116.2

(1) After consolidation, which eliminates our interests and the interests of our consolidated subsidiaries, JSOP and JESOP, the carrying amount of the mandatorily redeemable financial interests pertaining to the above VIEs included within mandatorily redeemable preferred interests of consolidated subsidiaries in the Consolidated Statements of Financial Condition was approximately $311.4 million and $280.9 million

at
September 30,
2009 and
December 31,
2008,
respectively.

The assets of these VIE s are available for the benefit of the mandatorily redeemable interest holders.

Our maximum exposure to loss at September 30, 2009 and December 31, 2008 was $322.9 million and $291.2 million, respectively, which consist of our debt, equity and partnership interests in JHYH and JESOP which are eliminated in consolidation.

JHYH s net revenue and formula-determined non-interest expenses amounted $90.6 million and $18.8 million, respectively, for the three months ended September 30, 2009 and amounted to $144.2 million and $51.1 million, respectively, for the nine months ended September 30, 2009. JHYH s net revenue and formula-determined non-interest expenses amounted $(53.9) million and $11.6 million, respectively, for the three months ended September 30, 2008 and amounted to $(63.4) million and $34.5 million, respectively, for the nine months ended September 30, 2008. These revenues and expenses are included in commissions and principal transactions and in our non-interest expenses. These formula-determined non-interest expenses do not necessarily reflect the actual expenses of operating JHYH. Based on the terms of our interests in JHYH and JESOP, percentages of JHYH and JESOP s net revenue and non-interest expenses are allocated to us and to third party interest holders.

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

VIEs Where We Have a Significant Variable Interest

We also hold significant variable interests in VIEs in which we are not the primary beneficiary and accordingly do not consolidate. Determining whether an interest in a VIE is significant is a matter of judgment and is based on an assessment of our exposure to the overall assets and liabilities of a VIE. We do not consolidate these VIEs as we do not absorb a majority of the entity s expected losses or receive a majority of its expected residual returns as a result of holding these variable interests. We have not provided financial or other support to these VIEs during the three and nine months ended September 30, 2009. We have no explicit or implicit arrangements to provide additional financial support to these VIEs and have no liabilities related to these VIEs at September 30, 2009.

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The following table presents total assets in these nonconsolidated VIEs and our maximum exposure to loss associated with these non-consolidated VIEs in which we hold significant variable interests at September 30, 2009 and December 31, 2008 (in millions):

	September 30, 2009		
	VIE Assets	Maximum exposure to loss in non-consolidated VIEs (2)	Carrying Amount
Managed CLOs	$ 1,274.2	$ 2.3	$ 2.3
Third Party Managed CLO	541.2	10.1	10.1
Mortgage- and Asset-Backed Vehicles (1)	273,783.1	524.1	524.1
Total	$ 275,598.5	$ 536.5	$ 536.5

(1) VIE assets represent the unpaid principal balance of the assets in these vehicles at September 30, 2009.

(2) Our maximum exposure to loss in non-consolidated VIEs is limited to our investment.

	December 31, 2008		
	VIE Assets	Maximum exposure to loss in non-consolidated VIEs (2)	Carrying Amount
Managed CLOs	$ 925.0	$ 4.1	$ 4.1
Third Party Managed CLO	390.2	3.3	3.3
Mortgage- and Asset-Backed Vehicles (1)	19,274.9	86.8	86.8
Total	$ 20,590.1	$ 94.2	$ 94.2

(1) VIE assets represent the unpaid principal balance of the assets in these vehicles at December 31, 2008.

(2) Our maximum exposure to loss in non-consolidated VIEs is limited to our investment.

Managed CLOs. We own significant variable interests in various managed collateralized loan obligations (CLOs) for which we are not the primary beneficiary, and therefore, do not consolidate these entities. We also receive management fees in connection with managing these CLOs. Our exposure to loss is limited to our capital contributions. Our investments in these VIEs consists of securities and are accounted for at fair value and are included in investments in managed funds on our Consolidated Statements of Financial Condition. On September 16, 2009, we entered into an agreement to assign our rights to manage the CLOs and rights to the related fees in exchange for our receiving a portion of future management fees. The closing of the transaction is pending certain conditions precedent.

Third Party Managed CLO. We have significant variable interests in Babson Loan Opportunity CLO, Ltd., a third party managed CLO. This VIE has assets consisting primarily of senior secured loans, unsecured loans and high yield bonds. Our variable interests in this VIE consists of debt securities. The fair value of our interests in this VIE consist of a direct interest and an indirect interest via Jefferies Finance, LLC. The direct investment is accounted for at fair value and included in financial instruments owned in our Consolidated Statements of Financial Condition.

Mortgage and Asset-Backed Vehicles. We purchase and sell variable interests in VIEs, which primarily issue mortgage-backed and other asset-backed securities, in connection with our trading and market-making activities. Our variable interests in these VIEs consist of mortgage and asset-backed securities and are accounted for at fair value and included in financial instruments owned on our Consolidated Statements of Financial Condition.

JEFFERIES GROUP, INC. AND SUBSIDIARIES
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Note 6. Acquisitions

On March 27, 2009, we acquired 100% of the membership interests of Depfa First Albany Securities LLC (Depfa), a leading New York City-based municipal securities broker-dealer that provides integrated investment banking, advisory, and sales and trading services. As of March 31, 2009, Depfa has been merged into Jefferies & Company.

The Depfa acquisition is being accounted for under the acquisition method of accounting. Accordingly, the purchase price is allocated to the acquired assets and liabilities based on their estimated fair values at acquisition date as summarized in the following table. Goodwill of $568,000 is measured as the excess of the cash consideration over fair value of net assets acquired, including identified intangible assets, and represents the value expected from the synergies and economies of scale created from combining Depfa s municipal securities business with our full-service sales and trading, and investment banking capabilities. All goodwill is assigned to our capital markets segment and is expected to be deductible for income tax purposes.

The following table presents the consideration paid for Depfa and the amounts of the assets acquired and liabilities assumed at the acquisition date (in thousands):

Cash consideration	$ 38,760
Recognized assets and assumed liabilities:	
Cash	$ 300
Financial instruments owned	31,458
Receivable from broker	16,691
Premises and equipment	155
Intangible assets	1,151
Other assets	2,781
Financial instruments sold, not yet purchased	(1,084)
Other liabilities	(13,260)
Total identifiable net assets	$ 38,192

The following is a summary of goodwill activity for the nine months ended September 30, 2009 (in thousands of dollars):

	Nine Months Ended September 30, 2009
Balance, at December 31, 2008	$ 358,837
Add: Acquisition	568
Add: Contingent Consideration	1,200
Less: Translation adjustment	(5,042)
Balance, at September 30, 2009	$ 355,563

Acquisitions of LongAcre Partners Limited, Helix Associates, and Randall & Dewey executed in prior years each contain a five-year contingency for additional consideration to the selling owners, based on future revenues. This additional consideration is paid in cash annually. There is no contractual dollar limit to the potential of additional

consideration. The last contingency period of these acquisitions expires in 2012. During the three and nine months ended September 30, 2009, we paid approximately $5.9 million and $28.7 million, respectively, in cash related to contingent consideration that had been earned during the current year or prior periods.

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Note 7. Short-Term Borrowings

Bank loans represent short-term borrowings that are payable on demand and generally bear interest at a spread over the federal funds rate. Unsecured bank loans are typically overnight loans used to finance securities owned or clearing related balances. We had no outstanding unsecured or secured bank loans as of September 30, 2009 and December 31, 2008. Average daily bank loans for the nine months ended September 30, 2009 and the year ended December 31, 2008 were $20.2 million and $94.9 million, respectively.

Note 8. Long-Term Debt

The following summarizes our long-term debt carrying values (includes unamortized discounts and premiums) at September 30, 2009 and December 31, 2008 (in thousands of dollars):

	September 30, 2009	December 31, 2008
7.75% Senior Notes, due 2012	$ 307,041	$ 328,215
5.875% Senior Notes, due 2014	248,774	248,608
5.5% Senior Notes, due 2016	348,819	348,683
8.5% Senior Notes, due 2019	709,331	
6.45% Senior Debentures, due 2027	346,412	346,333
6.25% Senior Debentures, due 2036	492,517	492,435
	$ 2,452,894	$ 1,764,274

We previously entered into a fair value hedge with no ineffectiveness using interest rate swaps in order to convert $200 million aggregate principal amount of unsecured 7.75% senior notes due March 15, 2012 into floating rates based upon LIBOR. During the third quarter of 2007, we terminated these interest rate swaps and received cash consideration less accrued interest of $8.5 million. The $8.5 million basis difference related to the fair value of the interest rate swaps at the time of the termination is being amortized as a reduction in interest expense of approximately $1.9 million per year over the remaining life of the notes through March 2012.

In June and September 2009, we issued 8.5% Senior Notes, due in 2019, with a par amount of $400 million and $300 million, respectively, and received proceeds of $393.9 million and $321.0 million, respectively. During the nine months ended September 30, 2009, we repurchased approximately $20.3 million of our outstanding long-term debt, resulting in a gain on debt extinguishment of $7.7 million, which is recognized in other income on the Consolidated Statements of Earnings.

Note 9. Mandatorily Redeemable Convertible Preferred Stock

In February 2006, Massachusetts Mutual Life Insurance Company (MassMutual) purchased in a private placement $125.0 million of our Series A convertible preferred stock. Our Series A convertible preferred stock has a 3.25% annual, cumulative cash dividend and is currently convertible into 4,105,138 shares of our common stock at an effective conversion price of approximately $30.45 per share. The preferred stock is callable beginning in 2016 and will mature in 2036. As of September 30, 2009, 10,000,000 shares of preferred stock were authorized and 125,000 shares of preferred stock were issued and outstanding. The dividend is recorded as a component of interest expense as the Series A convertible preferred stock is treated as debt for accounting purposes. The dividend is not deductible for tax purposes because the Series A convertible preferred stock is considered equity for tax purposes.

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Note 10. Noncontrolling Interest and Mandatorily Redeemable Preferred Interests of Consolidated Subsidiaries

Noncontrolling Interest

Noncontrolling interest represents equity interests in consolidated subsidiaries that are not attributable, either directly or indirectly, to us (i.e., minority interests). Noncontrolling interest includes the minority equity holders proportionate share of the equity of JSOP, JESOP and our consolidated asset management entities. The following table presents our noncontrolling interests at September 30, 2009 and December 31, 2008 (in millions):

	September 30, 2009	December 31, 2008
JSOP	$ 278.7	$ 252.3
JESOP	32.5	29.4
Consolidated asset management entities	3.4	6.1
Noncontrolling interests	$ 314.6	$ 287.8

Prior to January 1, 2009, we reported minority interests within liabilities on our Consolidated Statements of Financial Condition. As of January 1, 2009, we identify and present ownership interests in subsidiaries held by parties other than the entity in the consolidated financial statements within the equity section but separate from the entity s equity. Accordingly, we now present noncontrolling interests within stockholders equity, separately from our own equity. This change in presentation resulted in an increase to total stockholders equity of $287.8 million and a decrease to total liabilities of $287.8 million on our Consolidated Statement of Financial Condition as of December 31, 2008. Previously reported balances have been reclassified.

Revenues, expenses, net income or loss, and other comprehensive income or loss are reported in the consolidated financial statements at the consolidated amounts, which includes amounts attributable to both owners of the parent and noncontrolling interests. Net income or loss and other comprehensive income or loss shall then be attributed to the parent and noncontrolling interest. Prior to January 1, 2009, we recorded minority interest in earnings (loss) of consolidated subsidiaries in the determination of net earnings (loss). As of January 1, 2009, net loss to noncontrolling interests is deducted from net earnings (loss) to determine net earnings (loss) to common shareholders. This change in presentation resulted in a decrease to net loss of approximately $16.3 million and $24.3 million for the three and nine months ended September 30, 2008, respectively. There has been no impact on other comprehensive income or loss because all other comprehensive income or loss is attributable to us.

Mandatorily Redeemable Interests of Consolidated Subsidiaries

Certain interests in consolidated subsidiaries meet the definition of a mandatorily redeemable financial instrument and require liability classification and remeasurement at the estimated amount of cash that would be due and payable to settle such interests under the applicable entity s organization agreement. These mandatorily redeemable financial instruments represent interests held in Jefferies High Yield Holdings, LLC (JHYH), which are entitled to a pro rata share of the profits and losses of JHYH and are scheduled to terminate in 2013, with an option to extend up to three additional one-year periods. We previously reported these mandatorily redeemable financial instruments within minority interest. Financial instruments issued by a subsidiary that are classified as equity in the subsidiary s financial statements are treated as noncontrolling interests in the consolidated financial statements. Therefore, these mandatorily redeemable financial instruments are reported within liabilities as mandatorily redeemable preferred interests of consolidated subsidiaries on our Consolidated Statements of Financial Condition. In addition, changes to these mandatorily redeemable financial instruments of JHYH were previously reflected as minority interest in earnings (loss) of consolidated subsidiaries. As of January 1, 2009, we reclassified these changes to be part of net revenues and are reflected as interest on mandatorily redeemable preferred interest of consolidated subsidiaries on our

Consolidated Statements of Earnings. The reclassification did not impact net loss, but resulted in an increase to net revenues of $24.1 million and $36.1 million for the three and nine months ended September 30, 2008, respectively. The carrying amount of the mandatorily redeemable interests of consolidated subsidiaries was approximately $311.4 million and $280.9 million at September 30, 2009 and December 31, 2008, respectively.

JEFFERIES GROUP, INC. AND SUBSIDIARIES
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(Unaudited)

Note 11. Benefit Plans

The following summarizes the net periodic pension cost for the three and nine months ended September 30, 2009 and 2008 (in thousands of dollars):

	Three Months Ended		Nine Months Ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
Net pension cost included the following components:				
Service cost (1)	$ 50	$ 31	$ 150	$ 169
Interest cost on projected benefit obligation	635	671	1,951	1,860
Expected return on plan assets	(595)	(825)	(1,823)	(2,287)
Net amortization	224	¾	682	¾
Net periodic pension cost (income)	$ 314	$ (123)	$ 960	$ (258)

(1) Service cost relates to administrative expenses incurred during the periods.

We did not contribute to our pension plan during the nine months ended September 30, 2009 and do not anticipate any contributions during 2009. Effective December 31, 2005, benefits under the pension plan have been frozen. There are no incremental benefit accruals for service after December 31, 2005.

Note 12. Compensation Plans

We sponsor the following share-based compensation plans: incentive compensation plan, director plan, employee stock purchase plan and the deferred compensation plan. The fair value of share based awards is estimated on the date of grant based on the market price of our common stock less the impact of selling restrictions subsequent to vesting, if any, and is amortized as compensation expense on a straight-line basis over the related requisite service periods.

As of September 30, 2009, we had $47.1 million of total unrecognized compensation cost related to nonvested share based awards, which is expected to be recognized over a remaining weighted-average vesting period of approximately 5.4 years. Cash flows resulting from tax deductions in excess of the grant-date fair value of share-based awards are included in cash flows from financing activities; accordingly, we reflected the excess tax benefit of $8.2 million and $11.5 million related to share-based compensation in cash flows from financing activities for the nine-months ended September 30, 2009 and 2008 respectively. We have historically and generally expect to issue new shares of common stock when satisfying our issuance obligations pursuant to share based awards, as opposed to reissuing shares from our treasury stock.

In addition, we sponsor non-share based compensation plans. Non-share based compensation plans sponsored by us include an employee stock ownership plan and a profit sharing plan. The following are descriptions of the compensation plans sponsored by us and the activity of such plans for the three and nine months ended September 30, 2009 and 2008:

Incentive Compensation Plan. We have an Incentive Compensation Plan (Incentive Plan) which 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. The plan imposes a limit on the number of shares of our common stock that may be subject to awards. An award relating to shares may be granted if the aggregate number of shares subject to then-outstanding awards (as defined in the Incentive Plan) plus the number of shares subject to the award being granted do not exceed 30% of the number of shares issued and outstanding immediately prior to the grant.

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Restricted Stock and Restricted Stock Units

The Incentive Plan allows for grants of restricted stock awards, whereby employees are granted restricted shares of common stock subject to forfeiture. The Incentive Plan also allows for grants of restricted stock units. Restricted stock units give a participant the right to receive fully vested shares at the end of a specified deferral period. One advantage of restricted stock units, 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, restricted stock units carry no voting or dividend rights associated with the stock ownership, but dividend equivalents are paid or accrued to the extent there are dividends declared on our common stock.

On December 2, 2008, we approved an overall compensation strategy that modified the terms of all outstanding restricted stock and restricted stock units of active employees and addressed the terms of future restricted stock and restricted stock units granted as part of year-end compensation. We modified these awards by removing the service requirement employees must fulfill in exchange for the right to those awards. As such, 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). Prior to the modifications, these awards were generally subject to annual ratable vesting upon a five year service requirement, with provisions related to retirement eligibility. As a result of the removal of the service requirements, we accelerated the remaining compensation cost of the outstanding awards to be recognized on the modification date and recognized the compensation expense associated with 2008 year-end compensation awards on the date of grant (December 30, 2008).

Upon approval of the overall compensation strategy, we determined that the service inception date precedes the grant date for future restricted stock and restricted stock units granted as part of year-end compensation, and, as such, the compensation expense associated with these awards is accrued over the one-year period prior to the grant date. For the three and nine months ended September 30, 2009, we accrued compensation expense of approximately $37.7 million and $100.4 million related to restricted stock and restricted stock units that we expect to grant as part of our 2009 year-end compensation.

In addition to year-end compensation awards, we may grant restricted stock and restricted stock units to new employees as sign-on awards. Sign-on 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.

The total compensation cost associated with restricted stock and restricted stock units amounted to $41.7 million and $36.7 million for the three months ended September 30, 2009 and 2008, respectively, and $96.6 million and $138.1 million for the nine months ended September 30, 2009 and 2008, respectively. Total compensation cost includes accrual of expected 2009 year-end compensation and amortization of sign-on awards, less forfeitures and clawbacks.

The following table details the activity of restricted stock:

	Period Ended September 30, 2009 (Shares in 000s)	Weighted Average Grant Date Fair Value
Restricted stock		
Balance, beginning of year		$
Grants	2,579(1)	$ 18.64
Fulfillment of service requirement	(510) (1)	$ 14.76

Balance, end of period	2,069(2)	$	19.60

(1) Includes approximately 502,000 shares of restricted stock granted with no future service requirement in the nine months ended September 30, 2009. As such, these shares are shown as granted and vested in the nine months ended September 30, 2009.

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(2) Represents restricted stock with a future service requirement.

The following table details the activity of restricted stock units:

	Period Ended September 30, 2009 (Shares in 000s)		Weighted Average Grant Date Fair Value	
	Future Service Required	No Future Service Required	Future Service Required	No Future Service Required
Restricted stock units				
Balance, beginning of period		34,262	$	$ 14.78
Grants	597	313	$ 14.31	$ 7.09
Distribution of underlying shares		(7,338)	$	$ 14.93
Forfeited		(361)	$	$ 20.03
Balance, end of period	597	26,876	$ 14.31	$ 14.58

The aggregate fair value of restricted stock and restricted stock units vested during the nine months ended September 30, 2009 and 2008 was $7.5 million and $101.8 million, respectively. In addition, we granted restricted stock units with no future service period during the nine months ended September 30, 2009 with an aggregate fair value of $2.2 million.

Stock Options

The fair value of all option grants are estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for all fixed option grants in 2004: dividend yield of 0.9%; expected volatility of 32.6%; risk-free interest rates of 3.0%; and expected lives of 4.8 years. There are no option grants subsequent to 2004. A summary of our stock option activity for the nine months ended September 30, 2009 is presented below (amounts in thousands, except per share data):

	Nine Months Ended September 30, 2009	
	Options	**Weighted Average Exercise Price**
Outstanding at beginning of year	60	$ 7.24
Exercised	(12)	$ 5.64
Outstanding at end of period	48	$ 7.65
Options exercisable at period-end	48	$ 7.65

The total intrinsic value of stock options exercised during the nine months ended September 30, 2009 and 2008 was $94,000 and $750,000, respectively. Cash received from the exercise of stock options during the nine months ended

September 30, 2009 and 2008 totaled $69,000 and $743,000, respectively, and the tax benefit realized from stock options exercised during the nine months ended September 30, 2009 and 2008 was $37,000 and $302,000, respectively.

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The table below provides additional information related to stock options outstanding at September 30, 2009:

Dollars and shares in thousands, except per share data **September 30, 2009**	**Outstanding, Net of Expected Forfeitures**	**Options Exercisable**
Number of options	48	48
Weighted-average exercise price	$ 7.65	$7.65
Aggregate intrinsic value	$ 920	$ 920
Weighted-average remaining contractual term, in years	4.35	4.35

At September 30, 2009, the intrinsic value of vested options was approximately $920,000 for which tax benefits expected to be recognized in equity upon exercise are approximately $361,000.

Directors Plan. We have a Directors Stock Compensation Plan (Directors Plan) which provides for an annual grant to each non-employee director of $100,000 of restricted stock or deferred shares (which are similar to restricted stock units). These grants are made automatically on the date directors are elected or reelected at our annual shareholders meeting. These grants vest three years after the date of grant and are expensed over the requisite service period. Additionally, the Directors Plan permits each non-employee director to elect to be paid annual retainer fees, meeting fees and fees for service as chairman of a Board committee in the form of cash, deferred cash or deferred shares. If deferred cash is elected, interest is credited to such deferred cash at the prime interest rate in effect at the date of each annual meeting of stockholders. If deferred shares are elected, dividend equivalents equal to dividends declared and paid on our common stock are credited to a Director s account and reinvested as additional deferred shares.

Employee Stock Purchase Plan. We also have an Employee Stock Purchase Plan (ESPP) which we consider 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 and are made via payroll deduction. The employee contributions are used to purchase our common stock. The stock price used is 95% of the closing price of our common stock on the last day of the applicable session (monthly).

Deferred Compensation Plan. We also have a Deferred Compensation Plan, which was established in 2001. In 2009 and 2008, employees with annual compensation of $200,000 or more were eligible to defer compensation on a pre-tax basis by investing it in our common stock at a discount (DCP shares) and/or stock options (prior to 2004) or by specifying the return in other alternative investments. We often invest directly, as a principal, in such investment alternatives related to our obligations to perform under the Deferred Compensation Plan. The compensation deferred by our employees is expensed in the period earned. As of the third quarter of 2008, the change in fair value of the specified other alternative investments are recognized in investment income and changes in the corresponding deferral compensation liability are reflected as compensation and benefits expense in our Consolidated Statements of Earnings. Prior financial statement periods have not been adjusted for this change in presentation as the impact of such change does not have a material impact on the related line items within the Consolidated Statements of Earnings for each of the periods presented.

Additionally, we recognize compensation cost related to the discount provided to employees in electing to defer compensation in DCP shares. This compensation cost was $0.1 million and $0.2 million during the three months ended September 30, 2009 and 2008, respectively, and $0.5 million and $0.8 million during the nine months ended September 30, 2009 and 2008, respectively. As of September 30, 2009, there were 3,444,000 DCP shares issuable under the Plan.

Employee Stock Ownership Plan. We have an Employee Stock Ownership Plan (ESOP) which was established in 1988. We had no contributions and no compensation cost related to the ESOP during the three-month and nine-month periods ended September 30, 2009 and 2008.

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Profit Sharing Plan. We have 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. The compensation cost related to this plan was $0.8 million and $1.6 million for the three months ended September 30, 2009 and 2008, respectively, and $3.8 million and $8.3 million for the nine months ended September 30, 2009 and 2008, respectively.

Note 13. Income Taxes

As of September 30, 2009 and December 31, 2008, we had approximately $13.7 million and $13.5 million, respectively, of total gross unrecognized tax benefits. The total amount of unrecognized benefits that, if recognized, would favorably affect the effective tax rate in future periods was $8.9 million and $8.8 million (net of federal benefit of state taxes) at September 30, 2009 and December 31, 2008, respectively.

We are subject to U.S. federal income tax as well as income tax in multiple state and foreign jurisdictions. We have concluded all U.S federal income tax matters for the years through 2005. Substantially all material state and local and foreign income tax matters have been concluded for the years through 2001. The New York State income tax returns for the years 2001 through 2004 are currently under examination. The final outcome of these examinations is not yet determinable. The resolution of tax matters is not expected to have a material effect on our financial condition, but could be material to our results of operations for a particular period depending upon the results for that period.

We recognize interest accrued related to unrecognized tax benefits in interest expense. Penalties, if any, are recognized in other expenses. As of September 30, 2009 and December 31, 2008, we have accrued interest related to unrecognized tax benefits of approximately $4.2 million and $3.7 million, respectively. No penalties were accrued at September 30, 2009 and December 31, 2008.

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Note 14. Earnings Per Share

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per common share computations for the three and nine months ended September 30, 2009 and 2008 (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
Earnings for basic earnings per common share:				
Net earnings (loss)	$ 109,820	$ (47,566)	$ 216,241	$ (120,527)
Net earnings (loss) to noncontrolling interests	23,534	(16,262)	29,718	(24,301)
Net earnings (loss) to common shareholders	86,286	(31,304)	186,523	(96,226)
Less: Allocation of earnings to participating securities (1)	1,108		1,096	6,831
Net earnings (loss) available to common shareholders	$ 85,178	$ (31,304)	$ 185,427	$ (103,057)
Earnings for diluted earnings per common share:				
Net earnings (loss)	$ 109,820	$ (47,566)	$ 216,241	$ (120,527)
Net earnings (loss) to noncontrolling interests	23,534	(16,262)	29,718	(24,301)
Net earnings (loss) to common shareholders	86,286	(31,304)	186,523	(96,226)
Add: Convertible preferred stock dividends	1,016		3,047	
Less: Allocation of earnings to participating securities (1)	1,098		1,092	6,831
Net earnings (loss) available to common shareholders	$ 86,204	$ (31,304)	$ 188,478	$ (103,057)
Shares:				
Average common shares used in basic computation	200,609	173,757	201,860	160,458
Stock options	22		21	
Mandatorily redeemable convertible preferred stock	4,105		4,105	
Average common shares used in diluted computation	204,736	173,757	205,986	160,458
Earnings (loss) per common share:				
Basic	$ 0.42	$ (0.18)	$ 0.92	$ (0.64)

Diluted	$ 0.42	$ (0.18)	$ 0.92	$ (0.64)

(1) Represents dividends declared during the period on participating securities plus an allocation of undistributed earnings to participating securities. Losses are not allocated to participating securities. Participating securities represent restricted stock and restricted stock units for which requisite service has not yet been rendered and amounted to weighted average shares of 2,609,000 and 28,874,000 for the three months ended September 30, 2009 and 2008, respectively, and 1,194,000 and 30,099,000 for the nine months ended September 30, 2009 and 2008, respectively. No dividends were declared during the nine months ended September 30, 2009 and the three months

ended September 30, 2008. Dividends declared on participating securities during the nine months ended September 30, 2008 amounted to approximately $6.8 million. Undistributed earnings are allocated to participating securities based upon their right to share in earnings if all earnings for the period had been distributed.

The following securities were considered antidilutive and, therefore, not included in the computation of Diluted EPS:

	Number of securities outstanding at	
	September 30, 2009	September 30, 2008
Stock options		79,460
Mandatorily redeemable convertible preferred stock		4,105,138

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Note 15. Segment Reporting

The Capital Markets reportable segment includes our traditional securities brokerage trading activities, including the results of our high yield secondary market trading activities, and investment banking activities. The Capital Markets reportable segment is managed as a single operating segment that provides the sales, trading and origination effort for various fixed income, equity and advisory products and services. The Capital Markets segment comprises a number of interrelated divisions. In addition, we choose to voluntarily disclose the Asset Management segment even though it is currently an immaterial non-reportable segment.

Our reportable business segment information is prepared using the following methodologies:

Net revenues and expenses directly associated with each reportable business segment are included in determining earnings before taxes.

Net revenues and expenses not directly associated with specific reportable business segments are allocated based on the most relevant measures applicable, including each reportable business segment s net revenues, headcount and other factors.

Reportable business segment assets include an allocation of indirect corporate assets that have been fully allocated to our reportable business segments, generally based on each reportable business segment s capital utilization.

Our net revenues, expenses, and total assets by segment are summarized below (amounts in millions):

	Capital Markets	Asset Management	Total
Three months ended September 30, 2009			
Net revenues	$ 679.4	$ 21.0	$ 700.4
Expenses	$ 495.6	$ 6.2	$ 501.8
Nine months ended September 30, 2009			
Net revenues	$ 1,611.1	$ 21.5	$ 1,632.6
Expenses	$ 1,238.9	$ 16.5	$ 1,255.4
Segment assets	$ 27,702.9	$ 160.4	$ 27,863.3
Three months ended September 30, 2008			
Net revenues	$ 278.0	$ (3.4)	$ 274.6
Expenses	$ 341.0	$ 11.4	$ 352.4
Nine months ended September 30, 2008			
Net revenues	$ 885.6	$ (17.7)	$ 867.9
Expenses	$ 1,044.6	$ 39.9	$ 1,084.5
Segment assets	$ 23,785.3	$ 205.6	$ 23,990.9

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Net Revenues by Geographic Region

Net revenues are recorded in the geographic region in which the senior coverage banker is located in the case of investment banking, or where the position was risk-managed within Capital Markets or the location of the investment advisor in the case of Asset Management. In addition, certain revenues associated with U.S. financial instruments and services that result from relationships with non-U.S. clients have been classified as non-U.S. revenues using an allocation consistent with our internal reporting. The following table presents net revenues by geographic region for the three and nine months ended September 30, 2009 and 2008 (amounts in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
Americas (1)	$ 624,128	$ 228,330	$ 1,456,036	$ 707,419
Europe	75,087	38,678	175,656	146,201
Asia (including Middle East)	1,206	7,638	879	14,304
Net Revenues	$ 700,421	$ 274,646	$ 1,632,571	$ 867,924

(1) Substantially all relates to U.S. results.

Note 16. Commitments, Contingencies and Guarantees

The following table summarizes other commitments and guarantees at September 30, 2009:

		Maturity Date				
	Notional / Maximum Payout	2009	2010	2011 and 2012	2013 and 2014	2015 and Later
	(Dollars in Millions)					
Bank credit	$ 36.0		$ 18.0	$18.0		
Equity commitments	$ 418.3	$ 0.1	$250.0	$ 0.9	$21.0	$146.3
Loan commitments	$ 159.5	$ 154.3	$ 5.0		$ 0.2	
Derivative contracts- non credit related	$2,257.2	$1,937.9	$299.3	$17.1	$ 2.9	
Derivative contracts- credit related:						
Single name credit default swaps	$ 5.0			$ 5.0		
Index credit default swaps	$ 10.0					$ 10.0

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The following table summarizes the external credit ratings of the underlyings or referenced assets for credit related guarantees and derivatives:

	Notional / Maximum Payout	External Credit Rating AAA/ Aaa	A	Unrated
		(Dollars in Millions)		
Bank credit	$ 36.0			$ 36.0
Loan commitments	$159.5			$159.5
Derivative contracts- credit related:				
Single name credit default swaps	$ 5.0		$5.0	
Index credit default swaps	$ 10.0	$10.0		

Bank Credit. As of September 30, 2009, we had outstanding guarantees of $36.0 million relating to bank credit obligations ($3.6 million of which is undrawn) of associated investment vehicles in which we have an interest.

Equity Commitments. On October 7, 2004, we entered into an agreement with Babson Capital and MassMutual to form Jefferies Finance LLC, a joint venture entity created for the purpose of offering senior loans to middle market and growth companies. The total committed equity capitalization by the partners to Jefferies Finance LLC is $500 million as of September 30, 2009. Loans are originated primarily through the investment banking efforts of Jefferies & Company, Inc., with Babson Capital providing primary credit analytics and portfolio management services. As of September 30, 2009, we have funded $107.5 million of our aggregate $250.0 million commitment leaving $142.5 million unfunded.

As of September 30, 2009, we have an aggregate commitment to invest equity of approximately $16.2 million in Jefferies Capital Partners IV L.P. and its related parallel fund, a private equity fund managed by a team led by Brian P. Friedman (one of our directors and Chairman, Executive Committee).

We have an aggregate commitment to fund JHYH of $600.0 million and have funded approximately $350.0 million as of September 30, 2009, leaving $250.0 million unfunded.

As of September 30, 2009, we had other equity commitments to invest up to $9.6 million in various other investments.

Loan Commitments. From time to time we make commitments to extend credit to investment-banking and other clients in loan syndication, acquisition-finance and securities transactions. These commitments and any related drawdowns of these facilities typically have fixed maturity dates and are contingent on certain representations, warranties and contractual conditions applicable to the borrower. As of September 30, 2009, we had $155.2 million of loan commitments outstanding to clients.

On August 11, 2008, we entered into a Credit Agreement with JCP Fund V Bridge Partners, LLC (the Borrower or JCP V), pursuant to which we may make loans to the Borrower in an aggregate principal amount of up to $50.0 million. As of September 30, 2009, we have funded approximately $45.7 million of the aggregate principal balance leaving approximately $4.3 million unfunded. (See Note 19 for additional discussion of the credit agreement with JCP V.)

Derivative Contracts. We disclose certain derivative contracts meeting the definition of a guarantee under U.S. generally accepted accounting principles. Such derivative contracts include credit default swaps (whereby a default or significant change in the credit quality of the underlying financial instrument may obligate us to make a payment) and

JEFFERIES GROUP, INC. AND SUBSIDIARIES
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(Unaudited)

written equity put options. At September 30, 2009, the maximum payout value of derivative contracts deemed to meet the definition of a guarantee was approximately $2,272.2 million. For purposes of determining maximum payout, notional values are used; however, we believe the fair value of these contracts is a more relevant measure of these obligations because we believe the notional amounts overstate our expected payout. At September 30, 2009, the fair value of such derivative contracts approximated $(35.2) million. In addition, the derivative contracts deemed to meet the definition of a guarantee under U.S. generally accepted accounting principles are before consideration of hedging transactions. We substantially mitigate our risk on these contracts through hedges, such as other derivative contracts and/or cash instruments. We manage risk associated with derivative contracts meeting the definition of a guarantee consistent with our risk management policies.

Jefferies Financial Products, LLC. JFP maintains credit intermediation facilities with highly rated European banks (the Banks), which allow JFP customers that require a counterparty with a high credit rating for commodity index transactions to transact with the Banks. The Banks simultaneously enter into offsetting transactions with JFP and receive a fee from JFP for providing credit support. In certain cases, JFP is responsible to the Banks for the performance of JFP s customers.

Other Guarantees. In the normal course of business we provide 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. To mitigate these performance risks, the exchanges and clearinghouses often require members to post collateral. Our obligations under such guarantees could exceed the collateral amounts posted; however, the potential for us to be required to make payments under such guarantees is deemed remote.

Note 17. Net Capital Requirements

As registered broker-dealers, Jefferies, Jefferies Execution and Jefferies High Yield Trading are subject to the Securities and Exchange Commission Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum net capital. Jefferies, Jefferies Execution and Jefferies High Yield Trading have elected to use the alternative method permitted by the Rule.

As of September 30, 2009, Jefferies, Jefferies Execution and Jefferies High Yield Trading s net capital and excess net capital were as follows (in thousands of dollars):

	Net Capital	Excess Net Capital
Jefferies	$598,846	$546,335
Jefferies Execution	$ 7,003	$ 6,753
Jefferies High Yield Trading	$619,497	$619,247

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

Note 18. Quarterly Dividends

The only restrictions on our present ability to pay dividends on our common stock are the dividend preference terms of our Series A convertible preferred stock and the governing provisions of the Delaware General Corporation Law.

Dividends per Common Share (declared and paid):

	1st Quarter	2nd Quarter	3rd Quarter
2009			
2008	$0.125	$0.125	

No dividends have been declared or paid on our common stock since the second quarter of 2008.

During the year ended December 31, 2008, we recognized dividend equivalents of $34.4 million distributed on restricted stock units that were granted in prior periods, but which had not previously been charged against retained earnings.

Note 19. Related Party Transactions

On August 11, 2008, we entered into a Credit Agreement (the Credit Facility) with JCP Fund V Bridge Partners, LLC, a Delaware limited liability company (the Borrower), pursuant to which we may make loans to the Borrower in an aggregate principal amount of up to $50.0 million. The Borrower is owned by its two managing members, including Brian P. Friedman, one of our directors and executive officers. The loan proceeds may be used by the Borrower to make investments that are expected to be sold to Jefferies Capital Partners V, L.P. (Fund V) upon its capitalization by third party investors. Fund V will be managed by a team led by Mr. Friedman.

In July of 2009, the Borrower exercised its right to extend the final maturity date of the Credit Facility from August 12, 2009 to January 11, 2010; and in October 2009, we and the Borrower agreed to extend the final maturity date to June 30, 2010. The interest rate on any loans made under the Credit Facility is the Prime Rate (as defined in the Credit Facility) plus 200 basis points, payable at the final maturity date, or upon repayment of any principal amounts, as applicable. The obligations of the Borrower under the Credit Facility are secured by its interests in each investment. As of September 30, 2009 and December 31, 2008, loans in the aggregate principal amount of approximately $45.7 million and $31.3 million, respectively, were outstanding under the Credit Facility and recorded in other investments on the consolidated statements of financial condition.

Note 20. Subsequent Events

We have evaluated whether events or transactions have occurred after September 30, 2009 that would require recognition or disclosure in these consolidated financial statements through November 5, 2009, which is the date of issuance of these financial statements.

On October 26, 2009, we issued 3.875% convertible senior debentures (the debentures), maturing in 2029, with an aggregate principal amount of $345 million, each $1,000 debenture convertible into 25.5076 shares of our common stock (equivalent to a conversion price of approximately $39.20 per share of common stock). We received net proceeds $339 million in connection with the offering. Approximately $275 million of the net proceeds will be allocated to long-term borrowings, approximately $5 million will be allocated to other assets as debt issuance costs and approximately $42 million will be allocated to additional paid-in capital, net of deferred taxes of $27 million, on the Consolidated Statements of Financial Condition.

In addition to ordinary interest, beginning on November 1, 2017, contingent interest will accrue at 0.375% if the average trading price of a debenture for 5 trading days ending on and including the third trading day immediately preceding a six-month interest period equals or exceed $1,200 per $1,000 debenture. The debentures are convertible

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED
(Unaudited)

at the holders option any time beginning on August 1, 2029 and convertible at any time if 1) our common stock price is greater than 130% of the conversion price for at least 20 trading days in a period of 30 consecutive trading days; 2) if the trading price per debenture is less than 95% of the price of our common stock times the conversion ratio for any 10 consecutive trading days; 3) if the debentures are called for redemption; or 4) upon the occurrence of specific corporate actions. We may redeem the debentures for par, plus accrued interest, on or after November 1, 2012 if the price of our common stock is greater than 130% of the conversion price for at least 20 days in a period of 30 consecutive trading days and we may redeem the debentures for par, plus accrued interest, at our election any time on or after November 1, 2017. Holders may require us to repurchase the debentures for par, plus accrued interest, on November 1, 2017, 2019 and 2024.

JEFFERIES GROUP, INC. AND SUBSIDIARIES
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

This report contains or incorporates by reference forward-looking statements within the meaning of the safe harbor provisions of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements include statements about our future and statements that are not historical facts. These forward-looking statements are usually preceded by the words believe, intend, may, will, or similar expressions. Forward-looking statements may contain expectations regarding revenues, earnings, operations and other financial projections, and may include statements of future performance, plans and objectives. Forward-looking statements also include statements pertaining to our strategies for future development of our business and products. Forward-looking statements represent only our belief regarding future events, many of which by their nature are inherently uncertain and outside of our control. It is possible that the actual results may differ, possibly materially, from the anticipated results indicated in these forward-looking statements. Information regarding important factors that could cause actual results to differ, perhaps materially, from those in our forward-looking statements is contained in this report and other documents we file. You should read and interpret any forward-looking statement together with these documents, including the following:

- the description of our business and risk factors contained in our annual report on Form 10-K for the fiscal year ended December 31, 2008 and filed with the SEC on February 27, 2009;
- the discussion of our analysis of financial condition and results of operations contained in this report under the caption Management s Discussion and Analysis of Financial Condition and Results of Operations ;
- the notes to the consolidated financial statements contained in this report; and
- cautionary statements we make in our public documents, reports and announcements.

Any forward-looking statement speaks only as of the date on which that statement is made. We will not update any forward-looking statement to reflect events or circumstances that occur after the date on which the statement is made.

Critical Accounting Policies

The consolidated financial statements are prepared in conformity with U.S. generally accepted accounting principles, which require management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and related notes. Actual results can and will differ from estimates. These differences could be material to the financial statements.

We believe our application of accounting policies and the estimates required therein are reasonable. These accounting policies and estimates are constantly re-evaluated, and adjustments are made when facts and circumstances dictate a change. Historically, we have found our application of accounting policies to be appropriate, and actual results have not differed materially from those determined using necessary estimates.

We believe our critical accounting policies (policies that are both material to the financial condition and results of operations and require our most subjective or complex judgments) are our valuation of financial instruments, assessment of goodwill and our use of estimates related to compensation and benefits during the year. For further discussion of these and other significant accounting policies, see Note 1, Organization and Summary of Significant Accounting Policies, in our consolidated financial statements.

JEFFERIES GROUP, INC. AND SUBSIDIARIES

Valuation of Financial Instruments

Financial instruments owned and financial instruments sold, not yet purchased are recorded at fair value. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). Unrealized gains or losses are generally recognized in principal transactions in our Consolidated Statements of Earnings.

The following is a summary of the fair value of major categories of financial instruments owned and financial instruments sold, not yet purchased, as of September 30, 2009 and December 31, 2008 (in thousands of dollars):

	September 30, 2009		December 31, 2008	
	Financial Instruments Owned	Financial Instruments Sold, Not Yet Purchased	Financial Instruments Owned	Financial Instruments Sold, Not Yet Purchased
Corporate equity securities	$ 1,600,335	$ 1,472,146	$ 945,747	$ 739,166
Corporate debt securities	2,552,523	1,934,129	1,851,216	1,578,395
Government, federal agency and other sovereign obligations	1,752,027	1,508,786	447,233	211,045
Mortgage- and asset-backed securities (1)	3,275,192	14,486	1,035,996	¾
Loans and other receivables	494,198	495,932	34,407	¾
Derivatives	85,238	52,306	298,144	220,738
Investments	73,502	¾	75,059	¾
Other	¾	¾	¾	223
	$ 9,833,015	$ 5,477,785	$ 4,687,802	$ 2,749,567

(1) A portion of our mortgage- and asset-backed securities inventory has been economically hedged through the forward sale of such securities with the execution of to-be-announced (TBA) securities with a notional amount outstanding of $2,403 million and $534 million at September 30, 2009 and

December 31, 2008, respectively. TBA securities had a net fair value of $6.7 million and $1.7 million at September 30, 2009 and December 31, 2008, respectively, and are included in Financial Instruments Owned and Financial Instruments Sold, Not Yet Purchased in our Consolidated Statement of Financial Condition.

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

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

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

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

JEFFERIES GROUP, INC. AND SUBSIDIARIES

The availability of observable inputs can vary for different products. Fair value is a market-based measure; therefore, when market observable inputs are not available, our judgment is applied to reflect those judgments that a market participant would use in valuing the same asset or liability. We use prices and inputs that are current as of the measurement date even in periods of market disruption or illiquidity. Greater judgment in valuation is required when inputs are less observable or unobservable in the marketplace and judgment must be applied in determining the appropriateness of available prices, particularly in assessing whether available data reflects current prices and/or reflects the results of recent market transactions. The valuation of financial instruments classified in Level 3 of the fair value hierarchy involves the greatest amount of management judgment.

Greater use of management judgment is required in determining fair value when the volume or level of trading activity for a financial instrument has decreased and when certain factors suggest that observed transactions may not be reflective of orderly market transactions. Prices or quotes are weighed when estimating fair value with greater reliability placed on information from transactions that are considered to be representative of orderly market transactions.

Valuation Process for Financial Instruments   Financial instruments are valued at quoted market prices, if available. For financial instruments that do not have readily determinable fair values through quoted market prices, the determination of fair value is based upon consideration of available information, including current financial information, restrictions on dispositions, fair values of underlying financial instruments and quotations for similar instruments. 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, mid-market pricing is applied and adjusted to the point within the bid-ask range that meets our best estimate of fair value. For offsetting positions in the same financial instrument, the same price within the bid-ask spread is used to measure both the long and short positions.

The valuation process for 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 nonactive market or other features of the financial instrument such as its complexity, or the market in which the financial instrument is traded require that an adjustment be made to the value derived from the models. An adjustment may be made if a financial instrument is subject to sales restrictions that would result in a price less than the quoted market price. Adjustments from the price derived from a valuation model reflect management s judgment that other participants in the market for the financial instrument being measured at fair value would also consider in valuing that same financial instrument and are adjusted for assumptions about risk uncertainties and market conditions. Results from valuation models and valuation techniques in one period may not be indicative of future period fair value measurements.

Cash products - Where quoted prices are available in an active market, cash products are classified in Level 1 of the fair value hierarchy and valued based on the quoted exchange price, which is generally obtained from pricing services. Level 1 cash products are highly liquid instruments and include listed equity and money market securities and G-7 government and agency securities. Cash products classified within Level 2 of the fair value hierarchy are based primarily on broker quotations, pricing service data from external providers and prices observed for recently executed market transactions. If quoted market prices are not available for the specific security, then fair values are estimated by using pricing models, quoted prices of cash products with similar characteristics or discounted cash flow models. Examples of cash products classified within Level 2 of the fair value hierarchy are corporate, convertible and municipal bonds, agency and non-agency mortgage-backed securities and to-be-announced (TBA) securities. If there is limited transaction activity or less transparency to observe market-based inputs to valuation models, cash products presented at fair value are classified in Level 3 of the fair value hierarchy. Fair values of cash products classified in Level 3 are generally based on an assessment of each underlying investment, cash flow models, market data of any recent comparable company transactions and trading multiples of companies considered comparable to the instrument being valued and incorporate assumptions regarding market outlook, among other factors. Cash products in this category include illiquid equity securities, equity interests in private companies, auction rate securities, commercial loans, private equity and hedge fund investments, distressed debt instruments and certain mortgage-backed securities as little external price information is currently available for these products. For distressed debt instruments and

commercial loans, loss assumptions must be made based on default scenarios and market liquidity and prepayment assumptions must be made for mortgage-backed securities.

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Derivative products - Exchange-traded derivatives are valued using quoted market prices, which are generally obtained from pricing services, and are classified within Level 1 of the fair value hierarchy. Over-the-counter (OTC) derivative products are generally valued using models, whose inputs reflect assumptions that we believe market participants would use in valuing the derivative in a current period transaction. Inputs to valuation models are appropriately calibrated to market data, including, but not limited to, yield curves, interest rates, volatilities, equity, debt and commodity prices and credit curves. Fair value can be modeled using a series of techniques, including the Black-Scholes option pricing model and other comparable simulation models. For certain OTC derivative contracts, 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 classified in Level 2 include credit default swaps, interest rate swaps, foreign currency forwards, commodity swaps and option contracts, and debt and equity option contracts. Derivative products that are valued based on models with significant unobservable market inputs are classified within Level 3 of the fair value hierarchy. Level 3 derivative products include total return swaps and equity warrant and option contracts where the volatility of the underlying equity securities is not observable due to the terms of the contracts and the correlation sensitivity to market indices is not transparent for the term of the derivatives.

At September 30, 2009, the measurements of our cash products and derivative products at fair value were based on the following:

Valuation Basis	Financial Instruments Owned	Financial Instruments Sold, Not Yet Purchased
Exchange closing prices	16%	26%
Recently observed transaction prices	5%	1%
Data providers/pricing services	59%	48%
Broker quotes	9%	19%
Valuation techniques	11%	6%
	100%	100%

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

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Certain cash products and derivative products trade infrequently and therefore have little price transparency. As a result, we may use alternative valuation techniques or valuation models as methods for determining fair value. When using alternative valuation techniques or valuation models, the following techniques are applied to different financial instruments classes:

Financial Instrument Classes	Valuation Techniques
Equity securities and convertible bonds	Valuations based on pending transactions involving the issuer or comparable companies, subsequent financings or recapitalizations, changes in financial ratios and cash flows of the underlying issuer and prices of comparable securities
High-yield corporate bonds	Valuations based on pending transactions involving the issuer or comparable companies, subsequent financings or recapitalizations, changes in financial ratios and cash flows of the underlying issuer and prices of comparable securities
Non-agency mortgage-backed and other asset-backed securities	Benchmarked to yields from market prices for comparable securities and calibrated based on expected cash flow characteristics of the underlying assets
Auction rate securities	Benchmarked to transactions and market prices of comparable securities and adjusted for projected cash flows and security structure, where appropriate *
Corporate bank and other commercial loans and other receivables	References to prices for other debt instruments of the same issuer; estimates of expected future cash flows incorporating assumptions regarding creditor default and/or recovery
Investments in hedge funds, funds of funds and certain private equity funds	Net asset values, as adjusted for any redemption restrictions
Investments in certain private equity funds	Discounted cash flow techniques
OTC equity and commodity options and equity warrants	Black-Scholes and comparable simulation models
Interest rate, credit default, commodity and total return swaps and foreign exchange forward contracts	Modeling, primarily involving discounted cash flows, which incorporate observable inputs related to interest rate curves, commodity indices, equity prices and volatilities, foreign currency spot curves and credit spreads of the underlying credit

* Prior to the second quarter of 2009, a valuation technique utilizing an

internal
methodology
based on
projected cash
flows
discounted for
lack of liquidity
was applied in
determining fair
value.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES

Level 3 Assets and Liabilities Level 3 assets were $842.2 million and $469.4 million as of September 30, 2009 and December 31, 2008, respectively, and represented approximately 9% and 10%, respectively, of total assets measured at fair value. Level 3 liabilities were $504.0 million and $11.7 million as of September 30, 2009 and December 31, 2008, respectively, and represented approximately 9% and 0.4%, respectively, of total liabilities measured at fair value. While our financial instruments sold, not yet purchased, which are included within liabilities on our Consolidated Statement of Financial Condition, are accounted for at fair value, we do not account for any of our other liabilities at fair value. At September 30, 2009 and December 31, 2008, Level 3 financial instruments were comprised of the following asset and liability classes:

	Financial Instruments Owned		Financial Instruments Sold, Not Yet Purchased	
(in thousands)	September 30, 2009	December 31, 2008	September 30, 2009	December 31, 2008
Loans and other receivables	$ 486,252	$ 107,929	$ 495,932	$
Mortgage and asset-backed securities	105,179	65,154		
Corporate debt securities	93,321	165,248		3,515
Investments	73,502	75,059		
Auction rate securities	54,307	10,579		
Corporate equity securities	20,403	43,227	38	
Collateralized debt obligations	6,742	2,179		
Derivatives	2,399		8,017	8,197
Foreign government issued securities	138			
Total Level 3 financial instruments	842,243	469,375	503,987	11,712
Level 3 financial instruments for which the firm bears no economic exposure	(377,227)	(146,244)		
Level 3 financial instruments for which the firm bears economic exposure	$ 465,016	$ 323,131	$ 503,987	$ 11,712

During the three and nine months ended September 30, 2009, we had transfers of assets of $4.3 million and $119.3 million, respectively, from Level 2 to Level 3 and transfers of $10.9 million and $100.7 million, respectively, from Level 3 to Level 2. Transfers of assets from Level 2 to Level 3 during the three and nine months ended September 30, 2009 were primarily related corporate equity warrants and corporate debt securities where observable transaction data became less available for the specific class of securities in inventory that were transferred. During the nine months ended September 30, 2009, transfers of assets from Level 2 to Level 3 were primarily related to residential mortgage-backed securities where observable transaction data was less available and some high yield corporate bond positions as market quotes became less observable throughout the quarter due to less frequent or nominal market activity and the opaqueness of observable credit spreads. Transfers of assets from Level 3 to Level 2 for the three and nine months ended September 30, 2009 were primarily related to high yield corporate bonds where pricing information, trading activity observed and recently executed transactions provided transparency for purposes of determining fair values and related to residential mortgage-backed securities. During the three and nine months ended September 30, 2009, we had transfers of liabilities of $-0- million and $3.0 million, respectively, from Level 2 to Level 3 and transfers of liabilities of $1.6 and $5.1 million from Level 3 to Level 2. Net gains on Level 3 assets of $75.4 million for the three months ended September 30, 2009 are attributed primarily to increases in the fair value of

certain mortgage-backed securities and corporate loans. For the nine months ended September 30, 2009, net gains on Level 3 assets of $30.1 million were primarily attributed to increases in the fair value of certain mortgage-backed securities, partially offset by equity warrants and certain equity securities due to declining underlying equity prices and increased market volatility, declines in the pricing for certain corporate debt securities and net writedowns on auction rate securities as market-based pricing levels and redemptions dampened in the second quarter of 2009. Net losses on Level 3 liabilities were $1.0 million and $0.8 million for the three and nine months ended September 30, 2009, respectively.

JEFFERIES GROUP, INC. AND SUBSIDIARIES

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

See Note 3, Financial Instruments, to the consolidated financial statements for information regarding the classification of our assets and liabilities measured at fair value.

Controls Over the Valuation Process for Financial Instruments Our Risk Management Department, independent of the trading function, plays an important role in determining that our 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. These control processes include reviews of the pricing model s theoretical soundness and appropriateness by risk management personnel with relevant expertise who are independent from the trading desks. Where a pricing model is used to determine fair value, recently executed comparable transactions and other observable market data are considered for purposes of validating assumptions underlying the model. An independent price verification process, separate from the trading process, is in place to ensure that observable market prices and market-based inputs are applied in valuation where possible.

Goodwill

As a result of acquisitions, we have acquired goodwill. Our goodwill balance of $355.6 million at September 30, 2009 is wholly attributed to our Capital Markets segment, which is our reporting unit. At least annually, we are required to assess goodwill for impairment by comparing the estimated fair value of the operating segment with its net book value. Periodically estimating the fair value of the Capital Markets segment requires significant judgment. We estimate the fair value of the operating segment based on valuation methodologies we believe market participants would use, including consideration of control premiums for recent acquisitions observed in the marketplace. We completed our annual impairment test as of September 30, 2009 and no impairment was identified.

Compensation and Benefits

The use of estimates is important in determining compensation and benefits expenses for interim periods. A portion of our compensation and benefits represents discretionary bonuses, which are finalized at year end. In addition to the level of net revenues, our overall compensation expense in any given year is influenced by prevailing labor markets, revenue mix and our use of share-based compensation programs. We believe the most appropriate way to allocate estimated annual total compensation among interim periods is in proportion to projected net revenues earned. Consequently, during the year we accrue compensation and benefits based on annual targeted compensation ratios, taking into account the timing of expense recognition.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES

Consolidated Results of Operations

The following table provides an overview of our consolidated results of operations:

	Three Months Ended		Nine Months Ended	
(Dollars in Thousands, except for per share amounts)	**September 30, 2009**	**September 30, 2008**	**September 30, 2009**	**September 30, 2008**
Net revenues, less mandatorily redeemable preferred interest	$676,825	$298,751	$1,601,951	$ 903,978
Non-interest expenses	501,795	352,407	1,255,411	1,084,471
Earnings (loss) before income taxes	175,030	(53,656)	346,540	(180,493)
Income tax expense (benefit)	65,210	(6,090)	130,299	(59,966)
Net earnings (loss)	109,820	(47,566)	216,241	(120,527)
Net earnings (loss) to noncontrolling interests	23,534	(16,262)	29,718	(24,301)
Net earnings (loss) to common shareholders	86,286	(31,304)	186,523	(96,226)
Earnings (loss) per diluted common share	$ 0.42	$ (0.18)	$ 0.92	$ (0.64)
Effective tax rate	37%	11%	38%	33%

Our consolidated results of operations for the three and nine months ended September 30, 2009 and 2008 include the effect of presenting noncontrolling interests within stockholders equity, separate from our own equity, and allocating net (earnings) loss to noncontrolling interests and to common shareholders. In addition, net earnings are allocated among common shareholders and participating securities based on their right to share in earnings. The results of operations and earnings per share information for 2008 have been retrospectively adjusted to conform with these new accounting pronouncements. For further discussion, see Note 10, Noncontrolling Interest and Mandatorily Redeemable Preferred Interests of Consolidated Subsidiaries, and Note 14, Earnings Per Share, in our consolidated financial statements.

Net revenues, less mandatorily redeemable preferred interest, for the three and nine months ended September 30, 2009 (total revenues, net of interest expense and mandatorily redeemable preferred interest) increased 127% and 77%, respectively, from the three and nine months ended September 30, 2008 to $676.8 million and $1,602.0 million, respectively, reflective of the strong performance from our expanded Fixed Income business, positive contributions from our High Yield and Asset Management businesses and improving capital markets activities, partially offset by declines in advisory investment banking revenues. Non-interest expenses of $501.8 million and $1,255.4 million for the third quarter and nine months ended September 30, 2009, respectively, increased 42% and 16% from the comparable 2008 periods, respectively, primarily due to increased compensation costs due to revenue growth.

The effective tax rate was 37% for the third quarter of 2009, compared to an effective tax rate of 11% for the third quarter of 2008. The increase in our effective tax rate for the three months ended September 30, 2009 as compared to the same period ended September 30, 2008 is attributable to greater net income for the 2009 third quarter as compared to net losses for the comparable 2008 period.

On March 27, 2009, we acquired 100% of the membership interests of Depfa First Albany Securities LLC (Depfa), a leading New York City-based municipal securities broker-dealer that provides integrated investment banking, advisory, and sales and trading services. As of March 31, 2009, Depfa has been merged into Jefferies & Company and

our consolidated results of operations for the three and nine months ended September 30, 2009 include these municipal securities activities since the date of acquisition. See Note 6, Acquisitions, in our consolidated financial statements for further information regarding the acquisition of Depfa.

JEFFERIES GROUP, INC. AND SUBSIDIARIES

Effective June 18, 2009, Jefferies & Company, our wholly-owned subsidiary and a U.S. regulated broker-dealer, was designated a Primary Dealer by the Federal Reserve Bank of New York (FRBNY). As a Primary Dealer, Jefferies & Company, is a counterparty to FRBNY in its open market operations, participates directly in U.S. Treasury auctions and provides market information and analysis to the trading desks at the FRBNY.

At September 30, 2009, we had 2,513 employees globally compared to 2,465 employees at September 30, 2008 and 2,270 at December 31, 2008.

Our business, by its nature, does not produce predictable earnings. Our results in any given period can be materially affected by conditions in global financial markets and economic conditions generally. For a further discussion of the factors that may affect our future operating results, see Risk Factors in Part I, Item IA of our Annual Report on Form 10-K for the year ended December 31, 2008.

Revenues by Source

The Capital Markets reportable segment includes our traditional securities trading activities and our investment banking activities. The Capital Markets reportable segment is managed as a single operating segment that provides the sales, trading and origination effort for various equity, fixed income, high yield and advisory products and services. The Capital Markets segment comprises many divisions, with interactions among each. In addition, we choose to voluntarily disclose the Asset Management segment, even though it is currently an immaterial non-reportable segment.

For presentation purposes, the remainder of Results of Operations is presented on a detailed product and expense basis rather than on a business segment basis because the Asset Management segment is immaterial as compared to the consolidated Results of Operations. Beginning with the first quarter of 2009, the net revenues presented of our equity, fixed income and high yield businesses include allocations of interest income and interest expense as we assess the profitability of these businesses inclusive of the net interest revenue or expense generated by the respective sales and trading activities, which is a function of the mix of each business assets and liabilities and the underlying funding requirements of such positions. Reclassifications have been made to our previous presentation of Revenues by Source for the three and nine months ended September 30, 2008 to conform to the current presentation.

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The composition of our net revenues has varied over time as financial markets and the scope of our operations have changed. The composition of net revenues can also vary over the shorter term due to fluctuations in economic and market conditions and our own performance. The following provides a summary of revenues by source for the three and nine months ended September 30, 2009 and 2008:

	Three Months Ended			
	September 30, 2009		September 30, 2008	
(Dollars in Thousands)	Amount	% of Net Revenues	Amount	% of Net Revenues
Equities	$ 149,385	21%	$ 134,853	49%
Fixed income and commodities	312,659	45	72,875	27
High yield	94,882	14	(59,776)	(22)
Total	556,926	80	147,952	54
Investment banking	122,529	17	130,125	47
Asset management fees and investment income from managed funds:				
Asset management fees	12,564	2	3,804	1
Investment income (loss) from managed funds	8,402	1	(7,235)	(3)
Total	20,966	3	(3,431)	(1)
Net revenues	700,421	100%	274,646	100%
Interest on mandatorily redeemable preferred interests	23,596		(24,105)	
Net revenues, less mandatorily redeemable preferred interest	$ 676,825		$ 298,751	

	Nine Months Ended			
	September 30, 2009		September 30, 2008	
(Dollars in Thousands)	Amount	% of Net Revenues	Amount	% of Net Revenues
Equities	$ 381,862	23%	$ 442,654	51%
Fixed income and commodities	792,619	49	185,933	21
High yield	148,487	9	(81,619)	(9)
Other	7,672	1	¾	¾
Total	1,330,640	82	546,968	63
Investment banking	280,446	17	338,704	39
Asset management fees and investment income from managed funds:				
Asset management fees	20,040	1	14,847	2
Investment income (loss) from managed funds	1,445	¾	(32,595)	(4)

Total	21,485	1	(17,748)	(2)
Net revenues	1,632,571	100%	867,924	100%
Interest on mandatorily redeemable preferred interests	30,620		(36,054)	
Net revenues, less mandatorily redeemable preferred interest	$ 1,601,951		$ 903,978	

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Net Revenues

Net revenues, before interest on mandatorily redeemable preferred interests, for the third quarter of 2009 were a record $700.4 million, an increase of 155%, as compared to net revenues of $274.6 million for the third quarter of 2008. The considerable increase was primarily due to record quarterly fixed income and commodities revenues of $312.7 million, record quarterly high yield revenues of $94.9 million, and enhanced revenue contributions from equities of $149.4 million and asset management of $21.0 million, while investment banking revenues for the 2009 third quarter were $122.5 million as compared to $130.1 million for the 2008 third quarter.

Net revenues, before interest on mandatorily redeemable preferred interests, for the first nine months of 2009 were $1,632.6 million, an increase of 88%, as compared to net revenues of $867.9 million for the first nine months of 2008. The increase in net revenues was due to significant increases in fixed income and commodities revenues of $792.6 million for the period, high yield revenues of $148.5 million and positive contributions from our asset management business as compared to the first nine months of 2008, partially offset by a decrease in equities revenues and investment banking revenues for the first nine months of 2009 as compared to the comparable 2008 period.

Interest on mandatorily redeemable preferred interests represents the allocation of earnings and losses from our consolidated high yield business to third party noncontrolling interest holders invested in that business through mandatorily redeemable preferred securities.

Equities Revenue

Equities revenue is comprised of equity commissions and principal transactions revenue, correspondent clearing, prime brokerage, electronic trading and execution product revenues and alternative investment revenues.

Total equities revenue was $149.4 million and $134.9 million for the three months ended September 30, 2009 and 2008, respectively, representing an 11% increase from the third quarter of 2008, primarily driven by growth in our prime brokerage and electronic trading businesses, positive trading opportunities and gains in alternative investments revenue, partially offset by declines in U.S. cash equities, equity derivatives and securities lending revenues, and declines in trading results from certain strategic investment strategies. The decrease in revenues generated by our customer cash equities business is reflective of overall reduced market activity in the third quarter of 2009 and partly due to a lower average price of securities trades. Securities lending revenues for the third quarter of 2009 declined as compared to 2008 due to the lower interest rate environment. Revenues from prime brokerage and electronic trading activities were up as compared to the third quarter of 2008 as market share and customer balances continue to grow. Third quarter 2009 principal trading revenues reflect a strong contribution from our investment in the Jefferies Finance joint venture and benefited from several exceptional trading opportunities.

Total equities revenue was $381.9 million and $442.7 million for the nine months ended September 30, 2009 and 2008, respectively, representing a 14% decrease from the first nine months of 2008. The decrease in equities revenue was primarily driven by declines in revenue from U.S. cash equities and equity derivatives and declines in trading results from certain strategic investment strategies. The decrease in equities revenue was partially offset by growth in our prime brokerage and electronic trading businesses, positive trading opportunities and gains in alternative investments revenue. The decrease in equities revenues generated in our customer cash equities business is reflective of lower trading levels in the first nine months of 2009, particularly cash equity trading by hedge funds, and compressed commissions on lower average stock prices. Securities lending revenues for the first nine months of 2009 declined as compared to 2008 due to the lower interest rate environment, reduced dividends and a general decline in equity asset values. Revenues from prime brokerage and electronic trading activities were up as compared to the 2008 period as market share and customer balances continue to grow. For the nine months ended September 30, 2009 net revenues were also impacted by gains from higher valuations on certain alternative investments, including strong performance from our investment in the Jefferies Finance joint venture as well as gains from certain trading opportunities.

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Fixed Income and Commodities Revenue

Fixed income and commodities revenue is primarily comprised of commissions, principal transactions and net interest revenue from investment grade corporate bonds, mortgage- and asset-backed securities, government and agency securities, municipal bonds, emerging markets debt, convertible securities, and commodities trading activities.

Fixed income and commodities revenue was $312.7 million, up 329% from revenue of $72.9 million for the third quarter of 2008. The significant increase in revenues in the third quarter of 2009 reflects the continued growth of our fixed income businesses, with strong contributions from our corporate bond, mortgage-backed securities, government and agencies, emerging markets, and convertible debt trading activities and the addition of municipal bond trading activities as a result of our acquisition of Depfa in March 2009. Revenues from commodities were substantially unchanged for the three months ended September 30, 2009 as compared to the third quarter of 2008. Corporate bond revenues were up substantially over the prior comparable period benefiting from continued growth in market share and record volume. This resulted in increased principal transactions trading revenues, predominantly arising from customer flow business, partially muted by tightening credit spreads. Significant increases in mortgage-backed securities revenues were driven by higher levels of customer trading volume and certain trading transactions, as well as net interest revenue contributions from high-yielding trading positions. Increases in revenues from government and agencies also were driven by greater volumes with the expansion of our government and agency platform, partly reduced by tightening interest rate spreads. Emerging markets revenues included strong profits from its principal transactions activities as both volumes and market share grew, assisted by trading opportunities from new issuances and sovereign debt restructurings. Growth in convertible debt commissions and principal trading revenues for the third quarter of 2009 as compared to the 2008 period is partly a result of expanding market share and the addition of sales and trading personnel. Municipal bond trading revenues benefited from strong market activity and improving municipal bond spreads.

Fixed income and commodities revenue was $792.6 million, up from revenue of $185.9 million for the first nine months of 2008. The increased revenues in the first nine months of 2009 reflect the continued growth of our fixed income businesses across virtually all of our fixed income sales and trading activities, nominally offset by lower commodities revenues. Corporate bond, mortgage-backed securities, government and agencies, emerging markets and convertible debt revenues all benefited from increased trading volumes and greater market share. Mortgage-backed securities revenues also included an increase in net interest revenue over the prior comparable quarter in part due to the growth of its portfolio.

High Yield Revenue

High yield revenue is primarily comprised of commissions, principal transactions and net interest revenue from secondary market trading activities in high yield and distressed securities and bank loans.

High yield revenue was $94.9 million for the third quarter ended September 30, 2009, compared to a third quarter 2008 loss of $59.8 million. The increase in revenues was driven by an increase in sales volumes generating higher commission revenue for the quarter, as well as significant net principal transaction gains given the improved markets and certain exceptional trading opportunities. High yield revenues for the 2009 third quarter also reflect the strategic expansion of our bank loan trading business throughout 2009, which benefitted from increased trading volume as well as favorable principal transaction and net interest revenues as compared to the comparable 2008 quarter.

For the nine months ended September 30, 2009, high yield revenue was $148.5 million as compared to negative revenue of $81.6 million for the nine months ended September 30, 2008. High yield revenues were up considerably for the nine month 2009 period due to increased trading volumes, certain exceptional trading opportunities and the substantial growth in our bank loan trading business versus the comparable 2008 period, which experienced considerably worse market conditions.

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Of the results recognized in Jefferies High Yield Holdings, LLC (our high yield and distressed securities trading and investment business), approximately 66% and 62% of such results for the quarters and nine month periods ended September 30, 2009 and 2008, respectively, are allocated to the minority investors and are presented within interest on mandatorily redeemable preferred interests and net earnings (loss) to noncontrolling interests in our Consolidated Statements of Earnings.

Investment Banking Revenue

Our investment banking division provides a full range of financial advisory services to our clients across nearly all industry sectors, as well as debt, equity and equity-linked capital raising services, and encompasses both U.S. and international capabilities. Capital markets revenues include underwriting revenues related to debt, equity and convertible financing services. Advisory revenues are generated from our business advisory services with respect to merger, acquisition and restructuring transactions and fund placement activities. The following table sets forth our investment banking revenues:

	Three Months Ended			Nine Months Ended		
	September 30, 2009	September 30, 2008	% Change	September 30, 2009	September 30, 2008	% Change
(in thousands)						
Capital markets	$ 78,973	$ 51,062	55%	$ 177,762	$ 108,967	63%
Advisory	43,556	79,063	-45%	102,684	229,737	-55%
Total	$ 122,529	$ 130,125	-6%	$ 280,446	$ 338,704	-17%

Capital markets produced revenues of $79.0 million for the three months ended September 30, 2009, compared to $51.1 million for the three months ended September 30, 2008, a 55% increase, reflective of an improved market environment for debt underwritings, the contribution of our mortgage underwriting platform, the addition of our municipal securities underwriting capabilities during the current year and a meaningful increase in healthcare banking headcount in the third quarter of 2009. Revenues from our advisory business of $43.6 million for the third quarter of 2009 declined as compared to the third quarter of 2008 revenues of $79.1 million, reflective of the dampened general market for mergers and acquisitions, given currently less than attractive company valuations, partially offset by growing revenues generated by our restructuring advisory services.

Capital markets revenues totaled $177.8 million for the nine months ended September 30, 2009, compared to $109.0 million for the nine months ended September 30, 2008, an increase of 63% over the periods, primarily driven by fixed income underwriting revenues in our mortgage-backed and municipal securities business. Revenues from our advisory business of $102.7 million for the nine months of 2009 declined 55% compared to comparable 2008 period revenues of $229.7 million, reflective of the overall decline in closed mergers and transaction volume for these comparative periods experienced by the investment banking advisory sector as a whole and the strong advisory revenue performance experienced in the earlier part of 2008.

Asset Management Fees and Investment Earnings (Loss) from Managed Funds

Asset management revenue includes revenues from management, administrative and performance fees from funds managed by us, revenues from asset management and performance fees from third-party managed funds and investment earnings (loss) from our investments in these funds. The following summarizes revenues from asset management fees and investment earnings (loss) for the three and nine months ended September 30, 2009, and 2008 (in thousands of dollars):

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	Three Months Ended		Nine Months Ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
Asset management fees:				
Fixed Income	$ 1,659	$ 1,941	$ 4,603	$ 6,555
Equities	1,046	10	2,508	707
Convertibles	9,604	1,853	12,431	7,570
Commodities/Real Assets	255		498	15
	12,564	3,804	20,040	14,847
Investment earnings (loss) from managed funds (1)	8,402	(7,235)	1,445	(32,595)
Total	$ 20,966	$ (3,431)	$ 21,485	$ (17,748)

(1) Of the total investment earnings (loss) from managed funds, $0.1 million and $(0.2) million is attributed to noncontrolling interest holders for the three and nine months ended September 30, 2009, respectively, and $0.2 million and $(0.8) million is attributed to noncontrolling interest holders for the three and nine months ended September 30, 2008, respectively.

Asset management fees increased to $12.6 million for the three months ended September 30, 2009 as compared to asset management fees of $3.8 million for the three months ended September 30, 2008, primarily as a result of strong

performance fee revenue generated by our global convertible bond fund business and increased capital inflows to our equity funds. Investment earnings from managed funds totaled $8.4 million for the third quarter of 2009 as compared to an investment loss of $7.2 million for the third quarter of 2008 primarily due to improved asset valuations across our managed funds.
Asset management fees were $20.0 million for the nine months ended September 30, 2009 as compared to asset management fees of $14.8 million for the nine months ended September 30, 2008, primarily as a result of strong performance fee revenue generated by our global convertible bond fund business and fee revenue generated from increased capital inflows to our equity funds and by new commodity managed accounts opened during the second quarter of 2009. The increase in asset management fees was partially offset by fee revenue declines due to the closure of certain fixed income funds and the decline in asset valuations for our collateralized loan obligations as compared to 2008 periods. Investment earnings from managed funds totaled $1.4 million for the first nine months of 2009 as compared to an investment loss of $32.6 million for the first nine months of 2008 primarily due to the closure or liquidation of several of our managed funds, partially offset by investment revenues generated from portfolio strategies in our convertible bond fund and improved asset valuations across most fund classes, particularly in the third quarter of 2009.

Assets under Management

Period end assets under management (based on the fair value of the assets) by predominant asset strategy were as follows (in millions of dollars):

(in millions)		September 30, 2009		September 30, 2008
Assets under management (1):				
Fixed Income	$	1,563	$	1,500
Equities		76		132
Convertibles		1,607		1,880
		3,246		3,512
Assets under management by third parties (2):				
Private Equity		600		600
Total	$	3,846	$	4,112

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(1) Assets under management include assets actively managed by us and third parties including hedge funds, collateralized loan obligations (CLOs), managed accounts and other private investment funds. Assets under management do not include the assets of funds that are consolidated due to the level or nature of our investment in such funds.

(2) Third party managed funds in which we have a 50% or less interest in the entities that manage these assets or otherwise receive a portion of the management fees.

We manage certain portfolios as mandated by client arrangements and management fees are assessed based upon an agreed upon notional account value. Managed accounts based on this measure by predominant asset strategy were as follows (in millions of dollars):

(notional account value)	September 30, 2009	September 30, 2008
Managed Accounts:		

Equities	$	51	$
Comodities		115	
	$	166	$

Change in Assets under Management

	Three Months Ended			Nine Months Ended		
(in millions)	September 30, 2009	September 30, 2008	% Change	September 30, 2009	September 30, 2008	% Change
Balance, beginning of period	$ 3,632	$ 4,758	-24%	$ 3,491	$ 5,575	-37%
Net cash flow out	(108)	(173)		(508)	(914)	
Net market appreciation (depreciation)	322	(473)		863	(549)	
	214	(646)		355	(1,463)	
Balance, end of period	$ 3,846	$ 4,112	-6%	$ 3,846	$ 4,112	-6%

The net increase in assets under management of $0.2 million and $0.4 million during the three and nine months ended September 30, 2009, respectively, is primarily attributable to market appreciation of the underlying assets in our global convertible bond funds and in our managed CLOs, partially offset by redemptions from our global convertible bond funds. The decline in assets under management for the three months and nine months ended September 30, 2008 is primarily due to customer redemptions from our global convertible bond funds and net market depreciation in our managed CLOs and other fixed income funds due to the deteriorating credit market conditions experienced in the first nine months of 2008 and our global convertible bond funds.

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Change in Managed Accounts

(notional account value) (in millions)	Three Months Ended September 30, 2009		Nine Months Ended September 30, 2009	
Balance, beginning of period	$	150	$	
Net account additions		9		166
Net account appreciation		7		
Balance, end of period	$	166	$	166

The change in the notional account value of managed accounts for the three months and nine months ended September 30, 2009 is primarily attributed to the additions of new equity and commodity accounts where the management fees are assessed on the agreed upon notional account value.

The following table presents our invested capital in managed funds at September 30, 2009 and December 31, 2008 (in thousands):

	September 30, 2009		December 31, 2008	
Unconsolidated funds (1)	$	113,540	$	95,728
Consolidated funds (2)		52,563		70,465
Total	$	166,103	$	166,193

(1) Our invested capital in unconsolidated funds is reported within Investments in managed funds on the Consolidated Statement of Financial Condition.

(2) Assets under management include assets actively managed by us and third parties including hedge funds, CLOs, managed

accounts and other private investment funds. Due to the level or nature of our investment in such funds, certain funds are consolidated and the assets and liabilities of these funds are reflected in our consolidated financial statements primarily within financial instruments owned or financial instruments sold, not yet purchased. We do not recognize asset management fees for funds that we have consolidated.

Compensation and Benefits

Compensation and benefits expense consists primarily of salaries, benefits, cash bonuses, commissions, accruals for annual share-based compensation awards and the amortization of certain non-annual share-based compensation to employees. Compensation and benefits totaled $395.0 million and $956.6 million for the three and nine months ended September 30, 2009, respectively, compared to $246.2 million and $783.7 million for the comparable periods in 2008, an increase of 60% and 22%. Our ratio of compensation and benefits to net revenues for the third quarter of 2009 was 56% as compared to 90% for the third quarter of 2008 and 59% and 90% for the first nine months of 2009 and 2008, respectively. Employee headcount increased to 2,513 total global employees at September 30, 2009 as compared to 2,465 employees at September 30, 2008.

The increase in compensation and benefits expense for the third quarter of 2009 as compared to the same 2008 period is due to our revenue growth seen in the third quarter of 2009 as we have expanded our fixed income and international equity trading capabilities, partially offset by actions taken in 2008 to reduce our cost base as reflected in the decline in our compensation and benefits to net revenues ratio over the periods. For the nine month period ended September 30, 2009, compensation and benefits increased as compared to the comparable 2008 period primarily due to added revenue from our expanding our fixed income and equity businesses. Compensation costs also increased due to staffing both domestically and internationally in connection with personnel investments associated with our strategic business growth, which has been offset by savings from reduction in force actions taken in December 2008. The first nine months of 2008 also includes additional compensation costs recognized in the first quarter of 2008 related to employee terminations in early 2008.

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In December 2008, we approved an overall compensation strategy that modified the terms of all outstanding restricted stock and restricted stock unit (RSUs) awards of active employees and of future restricted stock and RSUs granted as part of year-end compensation programs, such 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 other forfeiture provisions of those awards. Accordingly, we accrue compensation costs associated with year-end share-based awards on a quarterly basis as the service period is attributed during the compensation year. Prior to this modification, restricted stock and RSUs awarded to employees as part of year-end compensation were generally subject to continued service and employment requirements with the grant date fair value of these awards amortized as compensation expense over the required service period, which was typically five years. Awards granted to new employees in connection with the commencement of employment with Jefferies generally contain service conditions and are amortized over the life of those conditions.

Non-Compensation Expenses

Non-compensation expenses were $106.8 million and $298.8 million for the three and nine months ended September 30, 2009, respectively, versus $106.2 million and $300.8 million for the three and nine months ended September 30, 2008, respectively, an increase of 1% and a 1% decrease. Non-compensation expenses for the third quarter of 2009 as compared to the 2008 third quarter reflect an increase in floor brokerage and clearing fees due to the level of trading volumes and an increase in technology and communications costs as the expansion of our personnel and business platforms has increased the demand for market data and technology connections. Increases in floor brokerage and clearing fees and technology and communications costs are offset by the decline in other expenses as other expenses in the third quarter of 2008 include losses incurred in connection with unwinding certain securities lending transactions with Lehman Brothers as counterparty. For the first nine months of 2009, non-compensation expenses include increases in brokerage and clearing expenses and technology and communications expenses due to business expansion, which were more than offset by declines in occupancy and equipment, business development and other expenses as a result of the cost-reduction initiatives enacted at the end of 2008. Additionally, non-compensation expenses for the nine months ended September 30, 2008 include other expenses associated with losses attributed to the Lehman Brothers bankruptcy.

Earnings / (Loss) before Income Taxes

Earnings before income taxes was $175.0 million for the third quarter of 2009 up from a (loss) before income taxes of $53.7 million for the third quarter of 2008. For the nine months ended September 30, 2009, we recorded earnings before income taxes of $346.5 million as compared to a (loss) before income taxes of $180.5 million for the nine months ended September 30, 2008.

Income Taxes

The provision for income taxes totaled a tax expense of $65.2 million and a tax (benefit) of $(6.1) million for the three months ended September 30, 2009 and 2008, respectively. The provision for income taxes resulted in effective tax rates of 37% and 11%, respectively. The change in our effective tax rate for the three months ended September 30, 2009 as compared to the same period ended September 30, 2008 is attributable to net income for the 2009 third quarter as compared to a net loss for the comparable 2008 period and due to the changes in the mix of our businesses that generated increased earnings over those periods.

The provision for income taxes totaled a tax expense/(benefit) of $130.3 million and $(60.0) million for the nine months ended September 30, 2009 and 2008, respectively, and resulted in effective tax rates of 38% and 33%, respectively. The increase in our effective tax rate for the nine months ended September 30, 2009 as compared to the nine months ended September 30, 2008 is primarily attributable to greater net income for the nine month 2009 period and the difference in the mix of our businesses that generated earnings over the differing periods.

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Earnings / (Loss) per Common Share

Diluted earnings per common share was $0.42 for the third quarter of 2009 on 204,736,000 shares compared to diluted (loss) per common share of $(0.18) for the third quarter of 2008 on 173,757,000 shares. Diluted earnings per common share was $0.92 for the first nine months of 2009 on 205,986,000 shares compared to diluted (loss) per common share of $(0.64) for the first nine months of 2008 on 160,458,000 shares. Convertible preferred stock dividends were not included in the calculation of diluted earnings/ (loss) per common share for the three and nine months ended September 30, 2008 due to their anti-dilutive nature. See Note 14, Earnings Per Share, in our consolidated financial statements for further information regarding the calculation of earnings/ (loss) per common share.

Mortgage and Lending Related Trading Exposures

We have exposure to residential mortgage-backed securities through our fixed income mortgage- and asset-backed sales and trading business and exposure to other credit products through our corporate lending and investing activities. The following table provides a summary of these exposures as of September 30, 2009 and December 31, 2008 (in millions):

	September 30, 2009		December 31, 2008	
Residential mortgage-backed agency securities (1)	$	2,732	$	952
Government guaranteed mortgage loans and certificates		12		
TBA securities (2)		(2,403)		(534)
Net agency mortgage-backed security and government guaranteed mortgage loan exposure (2)		341		418
Prime mortgage-backed securities (3)		94		20
Alt-A mortgage-backed securities (4)		193		74
Subprime mortgage-backed securities (4)		50		30
Commercial mortgage-backed securities (5)		87		
Other mortgage- and asset-backed securities		119		3
Total nonagency mortgage- and asset-backed security exposure		543		127
Total net mortgage loan and mortgage- and asset-backed security exposure	$	884	$	545
Corporate loans (6)	$	468.6	$	95.2
Collateralized loan obligation (CLOs) certificates (7)	$	9.0	$	6.3

Additionally, we have executed interest rate derivatives to reduce certain interest rate risk exposure arising from the above instruments.

(1) Residential mortgage-backed agency securities are represented at fair value and classified within

Financial Instruments Owned in our Consolidated Statements of Financial Condition and represent securities issued by government sponsored entities backed by mortgage loans with an implicit guarantee from the U.S. government as to payment of principal and interest. These assets are classified primarily within Level 2 of the fair value hierarchy.

(2) Our exposure to government agency mortgage loans and mortgage-backed agency securities is reduced through the forward sale of such loans and securities as represented by the notional amount of outstanding TBA securities at September 30, 2009 and December 31, 2008. Such contracts are accounted for at a net fair value of $6.7 and $1.7 million at

September 30,
2009

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and December 31, 2008, respectively, which are included in Financial Instruments Owned and Financial Instruments Sold, Not Yet Purchased in our Consolidated Statements of Financial Condition and are classified in Level 2 of the fair value hierarchy.

(3) Prime mortgage-backed securities are presented at fair value, are primarily classified within Level 2 of the fair value hierarchy and included within Financial Instruments Owned in our Consolidated Statements of Financial Condition.

(4) Alt-A mortgage-backed securities are backed by mortgage loans which are categorized between prime

mortgage loans and subprime mortgage loans due to certain underwriting and other loan characteristics. Subprime mortgage-backed securities are backed by mortgage loans secured by real property made to a borrower with diminished, impaired or limited credit history. Amounts at September 30, 2009 and December 31, 2008 are presented at their fair value, are generally classified within Level 3 of the fair value hierarchy and included within Financial Instruments Owned in our Consolidated Statements of Financial Condition.

(5) Commercial mortgage-backed securities are presented at fair value, are classified within Level 3 of the fair value hierarchy and included within Financial Instruments Owned in our Consolidate

Statements of Financial Condition.

(6) Corporate loans represent primarily senior unsecured bank loans purchased or issued in connection with our trading and investing activities are presented at fair value as included within Financial Instruments Owned in our Consolidated Statements of Financial Condition and are primarily classified within Level 3 of the fair value hierarchy at September 30, 2009 and December 31, 2008.

(7) We own interests consisting of various classes of senior, mezzanine and subordinated notes in CLO vehicles which are comprised of corporate senior secured loans, unsecured loans and high yield bonds, of which $6.7 million and $2.1 million are reported at fair value and included within Financial

Instruments Owned in our Consolidated Statements of Financial Condition and classified within Level 3 of the fair value hierarchy at September 30, 2009 and December 31, 2008, respectively, and $2.3 million and $4.2 million are accounted for at fair value and included in Investments in Managed Funds in our Consolidated Statements of Financial Condition at September 30, 2009 and December 31, 2008, respectively.

Of our nonagency mortgage-backed securities and other asset-backed securities at September 30, 2009, the following table provides further information regarding the credit ratings of the securities and the issue date of the securities (in millions):

	Credit Ratings						
Vintage year	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	Below Investment Grade	Private Placement	Total Fair Value
2009	3.7					1.5	5.2
2008	1.1						1.1
2007	42.4	0.6	0.4	2.6	35.1	0.1	81.2
2006	30.9	5.3	1.2	5.1	88.9	1.4	132.8
2005 and prior	111.9	38.9	52.3	61.9	55.4	1.9	322.3
Total	$ 190.0	$ 44.8	$ 53.9	$ 69.6	$ 179.4	$ 4.9	$ 542.6

Liquidity, Financial Condition and Capital Resources

Our Chief Financial Officer and Treasurer are responsible for developing and implementing our liquidity, funding and capital management strategies. These policies are determined by the nature of our day to day business operations, business growth possibilities, regulatory obligations, and liquidity requirements.

Market conditions, which had been volatile throughout 2008, began to stabilize in the second quarter of 2009, resulting in some tightening of credit spreads and improvements in market liquidity. The availability of financing sources has improved as 2009 has progressed. During the nine months ended September 30, 2009, we successfully accessed the public debt markets with the issuance of $700 million ten-year notes and were designated as a Primary Dealer by the New York Federal Reserve Bank. Subsequent to September 30, 2009 we additionally accessed the capital markets with the issuance of $345 million convertible senior debentures. Our long-term borrowings have an average tenor of 13.8 years; and we have no scheduled debt maturities until 2012, nominal short-term borrowings and significant cash balances on hand. We continue to actively manage our liquidity profile and counterparty relationships to ensure ongoing access to both short and longer-term funding.

Our actual level of capital, total assets, and financial leverage are a function of a number of factors, including, asset

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composition, business initiatives, regulatory requirements and cost availability of both long term and short term funding. We have historically maintained a highly liquid balance sheet, with a substantial portion of our total assets consisting of cash, highly liquid marketable securities and short-term receivables, arising principally from traditional securities brokerage activity. The highly liquid nature of these assets provides us with flexibility in financing and managing our business.

Liquidity

The following are financial instruments that are cash and cash equivalents or are deemed by management to be generally readily convertible into cash, marginable or accessible for liquidity purposes within a relatively short period of time (in thousands of dollars):

	September 30, 2009	December 31, 2008
Cash and cash equivalents:		
Cash in banks	$ 227,004	$ 765,056
Money market investments	1,178,397	529,273
Total cash and cash equivalents	1,405,401	1,294,329
Cash and securities segregated (1)	1,252,830	1,151,522
	$ 2,658,231	$ 2,445,851

(1) Consists of deposits at exchanges and clearing organizations, as well as deposits in accordance with Rule 15c3-3 of the Securities Exchange Act of 1934, which subjects Jefferies, as a broker dealer carrying client accounts, to requirements related to maintaining cash or qualified securities in a segregated reserve account for the exclusive benefit of its

clients.

A substantial portion of our assets are liquid, consisting of cash or assets readily convertible into cash. The majority of securities positions (both long and short) in our trading accounts are readily marketable and actively traded. In addition, receivables from brokers and dealers are primarily current open transactions, margin deposits or securities borrowed transactions, which are typically settled or closed out within a few days. Receivable from customers includes margin balances and amounts due on transactions in the process of settlement. Most of our customer receivables are secured by marketable securities.

Our assets are funded by equity capital, senior debt, mandatorily redeemable convertible preferred stock, mandatorily redeemable preferred interests, securities loaned, securities sold under agreements to repurchase, customer free credit balances, bank loans and other payables. Bank loans represent temporary (usually overnight) secured and unsecured short-term borrowings, which are generally payable on demand and generally bear interest at a spread over the federal funds rate. We had no outstanding secured bank loans as of September 30, 2009 and December 31, 2008. Unsecured bank loans are typically overnight loans used to finance financial instruments owned or clearing related balances. We had no outstanding unsecured bank loans as of September 30, 2009 and December 31, 2008. Average daily bank loans for the nine months ended September 30, 2009 and the year ended December 31, 2008 were $20.2 million and $94.9 million, respectively. We have arrangements with various banks for financing of up to $1,050.3 million, including $975.0 million of bank loans and $75.3 million of letters of credit. Of the $1,050.3 million of uncommitted lines of credit, $250.3 million is unsecured and $800.0 million is secured. Secured amounts are collateralized by a combination of customer, non-customer and firm securities. Letters of credit are used in the normal course of business mostly to satisfy various collateral requirements in lieu of depositing cash or securities.

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Liquidity Management Policies

The primary goal of our liquidity management activities is to ensure adequate funding over a range of market environments. The key objectives of the liquidity management framework are to support the successful execution of our business strategies while ensuring sufficient liquidity through the business cycle and during periods of financial distress. Our liquidity management policies are designed to mitigate the potential risk that we may be unable to access adequate financing to service our financial obligations without material franchise or business impact.

The principal elements of our liquidity management framework are the Funding Action Plan and the Cash Capital Policy.

Funding Action Plan. The Funding Action Plan models a potential liquidity contraction over a one-year time period. Our funding action plan model scenarios incorporate potential cash outflows during a liquidity stress event, including, but not limited to, the following: (a) repayment of all unsecured debt maturing within one year and no incremental unsecured debt issuance; (b) maturity roll-off of outstanding letters of credit with no further issuance and replacement with cash collateral; (c) higher margin requirements on or lower availability of secured funding; (d) client cash withdrawals; (e) the anticipated funding of outstanding investment commitments and (f) certain accrued expenses and other liabilities and fixed costs.

Cash Capital Policy. We maintain a cash capital model that measures long-term funding sources against requirements. Sources of cash capital include our equity, preferred stock and the non-current portion of long-term borrowings. Uses of cash capital include the following: (a) illiquid assets such as buildings, equipment, goodwill, net intangible assets, exchange memberships, deferred tax assets and certain investments; (b) a portion of securities inventory that is not expected to be financed on a secured basis in a credit-stressed environment (i.e., margin requirements) and (c) drawdowns of unfunded commitments. We seek to maintain a surplus cash capital position. Our equity capital of $2,459.1 million, mandatorily redeemable convertible preferred stock of $125.0 million, mandatorily redeemable preferred interest of consolidated subsidiaries of $311.4 million, and long-term borrowings (debt obligations scheduled to mature in more than 12 months) of $2,452.9 million comprise our total capital of $5,348.4 million as of September 30, 2009, which exceeded cash capital requirements.

Analysis of Financial Condition and Capital Resources

Financial Condition

As previously discussed, we have historically maintained a highly liquid balance sheet, with a substantial portion of our total assets consisting of cash, highly liquid marketable securities and short-term receivables, arising principally from traditional securities brokerage activity. Total assets increased to $27,863.3 million at September 30, 2009 or by 39%, from $19,978.7 million at December 31, 2008 primarily due to an increase in the level of our financial instruments owned inventory and receivables associated with principal and agency transactions consistent with the increase in the level of our financial instruments owned inventory. Our financial instruments owned, including securities pledged to creditors, increased to $9,833.0 million at September 30, 2009 from $4,687.8 million at September 30, 2008, while our financial instruments sold, not yet purchased also increased to $5,477.8 million at September 30, 2009 from $2,749.6 million at September 30, 2008. Our securities borrowed and securities purchased under agreements to resell increased to $10,998.8 million at September 30, 2009, or by 7%, while our securities loaned and securities sold under agreements to repurchase increased to $11,774.1 million at September 30, 2009, or by 18%. On September 25, 2009, we issued an additional $300 million principal amount of our 8.5% senior unsecured notes, maturing 2019, and received net cash proceeds of $321.0 million. On October 23, 2009, we issued 3.875% convertible senior debentures, maturing in 2029, with an aggregate principal amount of $345 million, each $1,000 debenture convertible into 25.5076 shares of our common stock. See Note 20, Subsequent Events, in our consolidated financial statements for further description of our convertible senior debentures.

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Common stockholders equity increased to $2,144.5 million at September 30, 2009 from $2,121.3 million at December 31, 2008. The increase in our common stockholders equity is principally attributed to net earnings to common shareholders of $186.5 million for the first nine months of 2009 and net currency translation adjustments as the British pound strengthened against the U.S. dollar in the first half of 2009, partially offset by repurchases of approximately 9.7 million shares of our common stock during the first nine months of 2009, which increased our treasury stock by $158.4 million, and the impact of a tax deficiency on the deductibility of employee share-based awards upon distribution of the awards to employees, which occurred in the first quarter of 2009.

The following table sets forth book value, pro forma book value, tangible book value and pro forma tangible book value per share (dollars in thousands, except per share data):

	September 30, 2009	December 31, 2008
Common stockholders equity	$ 2,144,529	$ 2,121,271
Less: Goodwill	(355,563)	(358,837)
Tangible common stockholders equity	$ 1,788,966	$ 1,762,434
Shares outstanding	169,331,686	163,216,038
Outstanding restricted stock units (5)	27,280,983	34,260,077
Adjusted shares outstanding	196,612,669	197,476,115
Common book value per share (1)	$ 12.66	$ 13.00
Adjusted common book value per share (2)	$ 10.91	$ 10.74
Tangible common book value per share (3)	$ 10.56	$ 10.80
Adjusted tangible common book value per share (4)	$ 9.10	$ 8.92

(1) Common book value per share equals common stockholders equity divided by common shares outstanding.

(2) Adjusted common book value per share equals common stockholders equity divided

by common shares outstanding adjusted for outstanding restricted stock units.

(3) Tangible common book value per share equals tangible common stockholders equity divided by common shares outstanding.

(4) Adjusted common tangible book value per share equals tangible common stockholders equity divided by common shares outstanding adjusted for outstanding restricted stock units.

(5) Outstanding restricted stock units, which give the recipient the right to receive common shares at the end of a specified deferral period, are granted in connection with our share-based employee incentive plans and include both

awards that contain future service requirements and awards for which the future service requirements have been met.

Tangible common stockholders equity, tangible common book value per share, adjusted common book value per share and adjusted tangible common book value per share are non-GAAP financial measures. A non-GAAP financial measure is a numerical measure of financial performance that includes adjustments to the most directly comparable measure calculated and presented in accordance with GAAP, or for which there is no specific GAAP guidance. We calculate tangible common stockholders equity as common stockholders equity less intangible assets, specifically goodwill. Goodwill is subtracted from common stockholders equity in determining tangible common stockholders equity as we believe that goodwill does not constitute an operating asset, which can be deployed in a liquid manner. We calculate tangible common book value per share by dividing tangible common stockholders equity by common stock outstanding. We calculate adjusted common book value per share as common stockholders equity divided by common shares outstanding adjusted for outstanding restricted stock units. We calculate adjusted tangible common book value per share by dividing tangible common stockholders equity by common shares outstanding adjusted for outstanding restricted stock units. We believe the adjustment to shares outstanding for outstanding restricted stock units reflects potential economic claims on our net assets enabling shareholders to better assess their standing with respect to our financial condition. Valuations of financial companies are often measured as a multiple of

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tangible common stockholders equity, inclusive of any dilutive effects, making these ratios, and changes in these ratios, a meaningful measurement for investors.

On December 30, 2008 we granted 5,138,821 shares of restricted stock as part of year-end compensation. The closing price of our common stock was $13.80 on December 30, 2008. Approximately, 5.0 million of the granted shares of restricted stock were issued during the first nine months of 2009, which increased shares outstanding at September 30 2009, which was offset by the repurchase of approximately 6.2 million shares at an average price of $12.77 per share, approximately 72,000 shares at an average price of $20.29 per share, and approximately 3.5 million shares at an average price of $23.05 per share during the first, second and third quarters of 2009, respectively.

At September 30, 2009, we have $125.0 million of Series A convertible preferred stock outstanding, which is convertible into 4,105,138 shares of our common stock at an effective conversion price of approximately $30.45 per share.

Leverage Ratios

The following table presents total assets, adjusted assets, total stockholders equity and tangible stockholders equity with the resulting leverage ratios as of September 30, 2009 and December 31, 2008:

	September 30, 2009	December 31, 2008
Total assets	$ 27,863,340	$ 19,978,685
Deduct: Securities borrowed	(8,092,955)	(9,011,903)
Securities purchased under agreements to resell	(2,905,837)	(1,247,002)
Add: Financial instruments sold, not yet purchased	5,477,785	2,749,567
Less derivative liabilities	(52,306)	(220,738)
Subtotal	5,425,479	2,528,829
Deduct: Cash and securities segregated and on deposit for regulatory purposes or deposited with clearing and depository organizations	(1,252,830)	(1,151,522)
Goodwill	(355,563)	(358,837)
Adjusted assets	$ 20,681,634	$ 10,738,250
Total stockholders equity	$ 2,459,105	$ 2,409,076
Deduct: Goodwill	(355,563)	(358,837)
Tangible stockholders equity	$ 2,103,542	$ 2,050,239
Leverage ratio (1)	11.3	8.3
Adjusted leverage ratio (2)	9.8	5.2

(1) Leverage ratio equals total assets divided by total stockholders

equity.

(2) Adjusted leverage ratio equals adjusted assets divided by tangible stockholders equity.

Adjusted assets is a non-GAAP financial measures and excludes certain assets that are considered self-funded and, therefore, of lower risk, which are generally financed by customer liabilities through our securities lending activities. We view the resulting measure of adjusted leverage also a non-GAAP financial measure as a more relevant measure of financial risk when comparing financial services companies.

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Capital Resources

We had total long-term capital of $5.3 billion and $4.6 billion resulting in a long-term debt to equity capital ratio of 117% and 90%, at September 30, 2009 and December 31, 2008, respectively. Our total capital base as of September 30, 2009 and December 31, 2008 was as follows (in thousands):

	September 30, 2009	December 31, 2008
Long-Term Debt	$ 2,452,894	$ 1,764,274
Mandatorily Redeemable Convertible Preferred Stock	125,000	125,000
Mandatorily Redeemable Preferred Interest of Consolidated Subsidiaries	311,418	280,923
Total Stockholders Equity	2,459,105	2,409,076
Total Capital	$ 5,348,417	$ 4,579,273

Our ability to support increases in total assets is largely a function of our ability to obtain short-term secured and unsecured funding, primarily through securities lending, and through our $1,050.3 million of uncommitted secured and unsecured bank lines. Our ability is further enhanced by the cash proceeds from our $400 million and $300 million senior unsecured debt issuances in June 2009 and September 2009, respectively, as well as the sale of 26,585,310 shares of our common stock to Leucadia National Corporation in April 2008 (see Note 1, Organization and Summary of Significant Accounting Policies, to the consolidated financial statements for additional discussion). Further, our issuance of $345 million convertible senior debentures in October 2009 demonstrates our access to long-term funding in the capital markets. We had no outstanding bank loans as of September 30, 2009 and December 31, 2008. We did not declare dividends to be paid during the third or fourth quarter of 2008 or during 2009.

At September 30, 2009, our senior long-term debt, net of unamortized discounts and premiums, consisted of contractual principal payments (adjusted for amortization) of $492.5 million, $346.4 million, $709.3 million, $348.8 million, $248.8 million and $307.0 million due in 2036, 2027, 2019, 2016, 2014 and 2012, respectively. At September 30, 2009, contractual interest payment obligations related to our senior long-term debt are $141.5 million for 2009, $170.9 million for 2010 and 2011, $152.2 million for 2012, $147.3 million for 2013, and $1,370.9 million for all of the remaining periods after 2013.

We rely upon our cash holdings and external sources to finance a significant portion of our day-to-day operations. Access to these external sources, as well as the cost of that financing, is dependent upon various factors, including our debt ratings. Our current debt ratings are dependent upon many factors, including industry dynamics, operating and economic environment, operating results, operating margins, earnings trend and volatility, balance sheet composition, liquidity and liquidity management, our capital structure, our overall risk management, business diversification and our market share and competitive position in the markets in which we operate. Deteriorations in any of these factors could impact our credit ratings thereby increasing the cost of obtaining funding and impacting certain trading revenues, particularly where collateral agreements are referenced to our external credit ratings. On June 17, 2009, Fitch Ratings affirmed our long-term and short-term ratings at BBB and F2, respectively, and retained its outlook of negative for all ratings. On October 19, 2009, Standard and Poor s affirmed our long-term debt ratings at BBB and revised its outlook to stable from negative. Our long-term debt ratings are as follows:

	Rating
Moody s Investors Services	Baa2
Standard and Poor s	BBB
Fitch Ratings	BBB

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Net Capital

Jefferies, Jefferies Execution and Jefferies High Yield Trading are subject to the net capital requirements of the SEC and other regulators, which are designed to measure the general financial soundness and liquidity of broker-dealers. Jefferies, Jefferies Execution and Jefferies High Yield Trading use the alternative method of calculation.

As of September 30, 2009, Jefferies, Jefferies Execution and Jefferies High Yield Trading s net capital and excess net capital were as follows (in thousands of dollars):

	Net Capital	Excess Net Capital
Jefferies	$598,846	$546,335
Jefferies Execution	$ 7,003	$ 6,753
Jefferies High Yield Trading	$619,497	$619,247

Contractual Obligations and Commitments

The tables below provide information about our commitments related to debt obligations and guarantees as of September 30, 2009. For debt obligations, leases and investments, the table presents principal cash flows with expected maturity dates.

		Expected Maturity Date				
	Notional / Maximum Payout	**2009**	**2010**	**2011 and 2012**	**2013 and 2014**	**2015 and Later**
		(Dollars in Millions)				
Debt obligations:						
Senior notes	$2,452.9			$307.0	$248.8	$1,897.1
Mandatorily redeemable convertible preferred stock	$ 125.0					$ 125.0
Bank credit	$ 36.0		$ 18.0	$ 18.0		
Equity commitments	$ 418.3	$ 0.1	$250.0	$ 0.9	$ 21.0	$ 146.3
Loan commitments	$ 159.5	$ 154.3	5.0		0.2	
Derivative contracts- non credit related	$2,257.2	$1,937.9	$299.3	$ 17.1	$ 2.9	
Derivative contracts- credit related	$ 15.0			$ 5.0		$ 10.0

Certain of our derivative contracts meet the definition of a guarantee and are therefore included in the above table. For additional information on these commitments, see Note 16, Commitments, Contingencies and Guarantees, to the consolidated financial statements.

In the normal course of business we engage in other off-balance sheet arrangements, including derivative contracts. Neither derivatives notional amounts nor underlying instrument values are reflected as assets or liabilities in on our consolidated Statements of Financial Condition. Rather, the fair value of derivative contracts are reported in the consolidated Statements of Financial Condition as Financial instruments owned derivative contracts or Financial instruments sold, not yet purchased derivative contracts as applicable. Derivative contracts are reflected net of cash paid or received pursuant to credit support agreements and are reported on a net-by-counterparty basis when a legal right of offset exists under an enforceable master netting agreement. For additional information about our accounting policies and our derivative activities see Note 1, Organization and Summary of Significant Accounting Policies, and Note 3, Financial Instruments, to the consolidated financial statements.

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Due to the uncertainty regarding the timing and amounts that will ultimately be paid, our liability for unrecognized tax benefits has been excluded from the above contractual obligations table. See Note 13 to the consolidated financial statements for further information.

Risk Management

Risk is an inherent part of our business and activities. The extent to which we properly and effectively identify, assess, monitor and manage each of the various types of risk involved in our activities is critical to our financial soundness and profitability. We seek to identify, assess, monitor and manage the following principal risks involved in our business activities: market, credit, operational, legal and compliance, new business, reputational and other. Risk management is a multi-faceted process that requires communication, judgment and knowledge of financial products and markets. Senior management takes an active role in the risk management process and requires specific administrative and business functions to assist in the identification, assessment and control of various risks. Our risk management policies, procedures and methodologies are fluid in nature and are subject to ongoing review and modification.

Market Risk. The potential for changes in the value of financial instruments is referred to as market risk. Our market risk generally represents the risk of loss that may result from a change in the value of a financial instrument as a result of fluctuations in interest rates, credit spreads, equity prices, commodity prices and foreign exchange rates, along with the level of volatility. Interest rate risks result primarily from exposure to changes in the yield curve, the volatility of interest rates, and credit spreads. Equity price risks result from exposure to changes in prices and volatilities of individual equities, equity baskets and equity indices. Commodity price risks result from exposure to the changes in prices and volatilities of individual commodities, commodity baskets and commodity indices. We make dealer markets in equity securities, debt securities and commodities. We attempt to hedge our exposure to market risk by managing our net long or short positions. Due to imperfections in correlations, gains and losses can occur even for positions that are hedged. Position limits in trading and inventory accounts are established and monitored on an ongoing basis. Each day, consolidated position and exposure reports are prepared and distributed to various levels of management, which enable management to monitor inventory levels and results of the trading groups.

Credit Risk. Credit risk represents the loss that we would incur if a client, counterparty or issuer of financial instruments, such as securities and derivatives, held by us fails to perform its contractual obligations. We follow industry practices to reduce credit risk related to various trading, investing and financing activities by obtaining and maintaining collateral. We adjust margin requirements if we believe the risk exposure is not appropriate based on market conditions. Liabilities to other brokers and dealers related to unsettled transactions (i.e., securities failed-to-receive) are recorded at the amount for which the securities were purchased, and are paid upon receipt of the securities from other brokers or dealers. In the case of aged securities failed-to-receive, we may purchase the underlying security in the market and seek reimbursement for losses from the counterparty in accordance with standard industry practices.

Operational Risk. Operational risk generally refers to the risk of loss resulting from our operations, including, but not limited to, improper or unauthorized execution and processing of transactions, deficiencies in our operating systems, business disruptions and inadequacies or breaches in our internal control processes. Our businesses are highly dependent on our ability to process, on a daily basis, a large number of transactions across numerous and diverse markets in many currencies. In addition, the transactions we process have become increasingly complex. If any of our financial, accounting or other data processing systems do not operate properly or are disabled or if there are other shortcomings or failures in our internal processes, people or systems, we could suffer an impairment to our liquidity, financial loss, a disruption of our businesses, liability to clients, regulatory intervention or reputational damage. These systems may fail to operate properly or become disabled as a result of events that are wholly or partially beyond our control, including a disruption of electrical or communications services or our inability to occupy one or more of our buildings. The inability of our systems to accommodate an increasing volume of transactions could also constrain our ability to expand our businesses.

We also face the risk of operational failure or termination of any of the clearing agents, exchanges, clearing houses or other financial intermediaries we use to facilitate our securities transactions. Any such failure or termination could

adversely affect our ability to effect transactions and manage our exposure to risk.

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In addition, despite the contingency plans we have in place, our ability to conduct business may be adversely impacted by a disruption in the infrastructure that supports our businesses and the communities in which they are located. This may include a disruption involving electrical, communications, transportation or other services used by us or third parties with which we conduct business.

Our operations rely on the secure processing, storage and transmission of confidential and other information in our computer systems and networks. Although we take protective measures and endeavor to modify them as circumstances warrant, our computer systems, software and networks may be vulnerable to unauthorized access, computer viruses or other malicious code, and other events that could have a security impact. If one or more of such events occur, this potentially could jeopardize our or our clients or counterparties confidential and other information processed and stored in, and transmitted through, our computer systems and networks, or otherwise cause interruptions or malfunctions in our, our clients , our counterparties or third parties operations. We may be required to expend significant additional resources to modify our protective measures or to investigate and remediate vulnerabilities or other exposures, and we may be subject to litigation and financial losses that are either not insured against or not fully covered through any insurance maintained by us.

Legal and Compliance Risk. Legal and compliance risk includes the risk of non-compliance with applicable legal and regulatory requirements. We are subject to extensive regulation in the different jurisdictions in which we conduct our business. We have various procedures addressing issues such as regulatory capital requirements, sales and trading practices, use of and safekeeping of customer funds, credit granting, collection activities, anti-money laundering and record keeping. We also maintain an anonymous hotline for employees or others to report suspected inappropriate actions by us or by our employees or agents.

New Business Risk. New business risk refers to the risks of entering into a new line of business or offering a new product. By entering a new line of business or offering a new product, we may face risks that we are unaccustomed to dealing with and may increase the magnitude of the risks we currently face. We review proposals for new businesses and new products to determine if we are prepared to handle the additional or increased risks associated with entering into such activities.

Reputational Risk. We recognize that maintaining our reputation among clients, investors, regulators and the general public is an important aspect of minimizing legal and operational risks. Maintaining our reputation depends on a large number of factors, including the selection of our clients and the conduct of our business activities. We seek to maintain our reputation by screening potential clients and by conducting our business activities in accordance with high ethical standards.

Other Risk. Other risks encountered by us include political, regulatory and tax risks. These risks reflect the potential impact that changes in local and international laws and tax statutes have on the economics and viability of current or future transactions. In an effort to mitigate these risks, we continuously review new and pending regulations and legislation and participate in various industry interest groups.

Accounting and Developments

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

Earnings per Share

We adopted accounting described in ASC 260, Earnings per Share Topic, on January 1, 2009 which addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, are included in the earnings allocation in computing earnings per share under the two-class method described in ASC 260. Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of EPS pursuant to the two-class method. Accordingly, All prior-period EPS data presented has been adjusted to comply with the provisions of ASC 260. The adoption of accounting changes described in ASC 260 did not have an effect on previously reported Basic

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and Diluted EPS of $(0.18) for the three months ended September 30, 2008 and reduced previously reported Basic and Diluted EPS from a loss of $0.60 to a loss of $0.64 for the nine months ended September 30, 2008.

Debt

We apply the provisions of accounting updates described in ASC 470, Debt Topic, effective January 1, 2009, which clarifies that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) were not previously addressed ASC 470 and specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity s nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. This is effective for fiscal years and interim periods beginning after December 31, 2008. Adoption of this accounting update did not affect our financial condition, results of operations or cash flows.

Business Combinations

We apply the provisions of accounting described in ASC 805, Business Combinations Topic, to business combinations occurring after January 1, 2009. This requires an entity to recognize the assets acquired, liabilities assumed, contractual contingencies and contingent consideration measured at their fair value at the acquisition date for any business combination consummated after the effective date. It further requires that acquisition-related costs are to be recognized separately from the acquisition and expensed as incurred. Adoption of this accounting change did not affect our financial condition, results of operations or cash flows, but may have an effect on accounting for future business combinations.

Consolidation

We adopted the provisions of accounting described in ASC 810, Consolidation Topic, on January 1, 2009, which requires an entity to clearly identify and present ownership interests in subsidiaries held by parties other than the entity in the consolidated financial statements within the equity section but separate from the entity s equity. It also requires the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income; changes in ownership interest be accounted for similarly, as equity transactions; and when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary and the gain or loss on the deconsolidation of the subsidiary be measured at fair value. Refer to Note 10 for further discussion on the adoption of the changes described in ASC 810.

We will adopt further accounting changes described in ASC 810, Consolidation Topic, as of January 1, 2010, which require that the party who has the power to direct the activities of a variable interest entity that most significantly impact the entity s economic performance and who has an obligation to absorb losses of the entity or a right to receive benefits from the entity that could potentially be significant to the entity consolidate the variable interest entity. The changes to ASC 810, effective as of January 1, 2010, eliminate the quantitative approach previously applied to assessing the consolidation of a variable interest entity and require ongoing reassessments for consolidation. We are currently evaluating the impact on our consolidated financial statements.

Derivatives and Hedging

We adopted certain accounting disclosures described in ASC 815, Derivative and Hedging Topic, for our year end consolidated financial statements as of December 31, 2008. This requires enhanced disclosures by sellers of credit derivatives, including credit derivatives embedded in a hybrid instrument, and require additional disclosure about the current status of the payment/performance risk of a guarantee. The adoption did not have an effect on our financial condition, results of operations or cash flows.

We adopted accounting changes described in ASC 815, Derivative and Hedging Topic, effective January 1, 2009, requiring qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair values and amounts of gains and losses on derivative contracts and disclosures about credit-risk-related contingent features in derivative agreements. Since changes required as of January 1, 2009 required only additional disclosures concerning derivatives and hedging activities, adoption did not affect our financial condition, results of operations or cash flows.

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Fair Value Measurements and Disclosures

We adopted accounting updates included in ASC 820, Fair Value Measurements and Disclosures Topic, as of April 1, 2009, which provide additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. ASC 820 also includes guidance on identifying circumstances that indicate a transaction is not orderly. The adoption of these updates did not have a material effect on our financial condition, results of operations and cash flows.

In August 2009, the FASB issued accounting updates to ASC 820, Fair Value Measurements and Disclosures Topic Measuring Liabilities at Fair Value, which provides clarifying guidance for determining the fair value of a liability. We will adopt this accounting update on October 1, 2009 and do not expect this update to have a material effect on our financial condition, results of operations or cash flows.

In September 2009, the FASB issued accounting updates to ASC 820, Fair Value Measurements and Disclosures Topic Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent). The accounting updates in this topic permit an investment that has the characteristics of an investment company and has no readily determinable fair value to be measured based on the net asset value per share of the investment. The accounting updates also require disclosure by major category of investment about the attributes of the investment, the nature of any redemption restrictions on the investment, any unfunded commitments we have pertaining to the investment and the investment strategies of the underlying investees. We will adopt the provisions contained in the accounting update in the fourth quarter of 2009 and do not expect there to be a material effect on our financial condition, results of operations or cash flows.

Subsequent Events

We adopted accounting described in ASC 855, Subsequent Events Topic, as of our financial period ended June 30, 2009, requiring that management evaluate events and transactions that may occur for potential recognition or disclosure in the financial statements after the balance sheet date through the date the financial statements are issued and determining the circumstances under which such events or transactions must be recognized in the financial statements. The adoption did not have an effect on our financial condition, results of operations or cash flows.

Transfers and Servicing

We adopted accounting updates included in ASC 860, Transfers and Servicing Topic, effective January 1, 2009, which require an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously or in contemplation of the initial transfer to be evaluated as a linked transaction unless certain criteria are met. The updates to ASC 860 are to be applied prospectively for new transactions entered into after the adoption date. The adoption did not have a material effect on financial condition, cash flows or results of operations.

We will adopt further accounting changes described in ASC 860, Transfers and Servicing Topic, as of January 1, 2010, which eliminate the concept of a qualifying special purpose entity, require that a transferor consider all arrangements made contemporaneously with, or in contemplation of, a transfer of assets when determining whether derecognition of a financial asset is appropriate, clarify the requirement that a transferred financial asset be legally isolated from the transferor and any of its consolidated affiliates, stipulate that constraints on a transferee s ability to freely pledge or exchange transferred assets causes the transfer to fail sale accounting, and define participating interests and provides guidance on derecognizing participating interests. We are currently evaluating the impact on our consolidated financial statements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We use a number of quantitative tools to manage our exposure to market risk. These tools include:

inventory position and exposure limits, on a gross and net basis;

scenario analyses, stress tests and other analytical tools that measure the potential effects on our trading net revenues of various market events, including, but not limited to, a large widening of credit spreads, a substantial decline in equities markets and significant moves in selected emerging markets; and

risk limits based on a summary measure of risk exposure referred to as Value-at-Risk.

Value-at Risk

Jefferies estimates Value-at-Risk (VaR) using a model that simulates revenue and loss distributions on all financial instruments by applying historical market changes to the current portfolio. Using the results of this simulation, VaR measures potential loss of trading revenues at a given confidence level over a specified time horizon. We calculate VaR over a one day holding period measured at a 95% confidence level which implies that, on average, we expect to realize a loss of daily trading revenue at least as large as the VaR amount on one out of every twenty trading days. VaR is one measurement of potential loss in trading revenues that may result from adverse market movements over a specified period of time with a selected likelihood of occurrence. As with all measures of VaR, our estimate has substantial limitations due to our reliance on historical performance, which is not necessarily a predictor of the future. Consequently, this VaR estimate is only one of a number of tools we use in our daily risk management activities. VaR is a model that predicts the future risk based on historical data. We could incur losses greater than the reported VaR because the historical market prices and rates changes may not be an accurate measure of future market events and conditions. In addition, the VaR model measures the risk of a current static position over a one-day horizon and might not predict the future position. When comparing our VaR numbers to those of other firms, it is important to remember that different methodologies could produce significantly different results.

The VaR numbers below are shown separately for interest rate, equity, currency and commodity products, as well as for our overall trading positions, excluding corporate investments in asset management positions, using a historical simulation approach. The aggregated VaR presented here is less than the sum of the individual components (i.e., interest rate risk, foreign exchange rate risk, equity risk and commodity price risk) due to the benefit of diversification among the risk categories. Diversification benefit equals the difference between aggregated VaR and the sum of VaRs for the four risk categories. The following table illustrates the VaR for each component of market risk.

Daily VaR [(1)]
(In Millions)
Value-at-Risk in trading portfolios

	VaR at			**Average VaR 3 Months Ended**		
Risk Categories	**9/30/09**	**6/30/09**	**3/31/09**	**9/30/09**	**6/30/09**	**3/31/09**
Interest Rates	$4.07	$5.95	$2.99	$6.39	$5.64	$3.96
Equity Prices	$8.08	$2.61	$3.59	$4.86	$3.20	$2.28
Currency Rates	$0.79	$1.09	$0.20	$0.70	$0.32	$0.24
Commodity Prices	$1.35	$1.16	$0.87	$1.44	$0.95	$0.68
Diversification Effect[2]	-$4.82	-$4.40	-$3.31	-$5.88	-$3.94	-$2.71
Firmwide	$9.47	$6.41	$4.34	$7.51	$6.17	$4.45

JEFFERIES GROUP, INC. AND SUBSIDIARIES

	Daily VaR [1] (In Millions) Value-at-Risk Highs and Lows for Three Months Ended					
	9/30/09		6/30/09		3/31/09	
Risk Categories	High	Low	High	Low	High	Low
Interest Rates	$10.55	$3.52	$7.68	$4.00	$5.79	$2.51
Equity Prices	$10.69	$2.16	$7.54	$1.71	$5.20	$1.13
Currency Rates	$ 1.52	$0.18	$1.09	$0.06	$0.46	$0.06
Commodity Prices	$ 3.50	$0.80	$1.68	$0.40	$1.36	$0.29
Firmwide	$11.54	$5.12	$8.26	$4.15	$6.43	$3.48

(1) VaR is the potential loss in value of our trading positions due to adverse market movements over a defined time horizon with a specific confidence level. For the VaR numbers reported above, a one-day time horizon and 95% confidence level were used.

(2) Equals the difference between firmwide VaR and the sum of the VaRs by risk categories. This effect is due to the market categories not being perfectly correlated.

Average VaR of $7.51 million during the third quarter of 2009 increased from the $6.17 million average during the second quarter of 2009 due mainly to an increase in exposure to equity prices and interest rates, given the expansion of our fixed income businesses.

The following table presents our daily VaR over the last four quarters:

Daily VaR Trend

VaR Back-Testing

The comparison of daily actual revenue fluctuations with the daily VaR estimate is the primary method used to test the efficacy of the VaR model. Back testing is performed at various levels of the trading portfolio, from the holding company level down to specific business lines. A back-testing exception occurs when the daily loss exceeds the daily VaR estimate. Results of the process at the aggregate level demonstrated no outliers when comparing the 95% one-day VaR with the back-testing profit and loss in the third quarter of 2009. A 95% confidence one-day VaR model usually should not have more than twelve (1 out of 20 days) back-testing exceptions on an annual basis. Back-testing profit and loss is a subset of actual trading revenue, excluding fees, commissions, and certain provisions. We compare the trading revenue with VaR for back-testing purposes because VaR assesses only the potential change in position value due to overnight movements in financial market variables such as prices, interest rates and volatilities under normal market conditions. The graph below illustrates the relationship between daily back-testing trading profit and loss and daily VaR for us in the third quarter of 2009.

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Daily Trading Net Revenue
($ in millions)

Trading revenue used in the histogram below entitled Third Quarter 2009 vs. Third Quarter 2008 Distribution of Daily Trading Revenue is the actual daily trading revenue which is excluding fees, commissions and certain provisions. The histogram below shows the distribution of daily trading revenue for substantially all of our trading activities.

During the quarter ended September 30, 2009, we changed the groupings of the Daily Trading Revenue histogram. Previously, daily trading revenue was grouped in $1 million increments ranging from $(2) million to $4 million. As of September 30, 2009, the grouping is presented in $2 million increments ranging from $(4) million to $10 million. This presentation provides more information across the distribution by reducing the maximum number of days in any single bucket.

JEFFERIES GROUP, INC. AND SUBSIDIARIES

Item 4. Controls and Procedures

We, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2009. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of September 30, 2009 are functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding disclosure. A controls system cannot provide absolute assurance, however, that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

No change in our internal control over financial reporting occurred during the quarter ended September 30, 2009 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Many aspects of our business involve substantial risks of legal liability. In the normal course of business, we have been named as defendants or co-defendants in lawsuits involving primarily claims for damages. We are also involved in a number of judicial and regulatory matters arising out of the conduct of our business. Based on currently available information, we do not believe that any matter will have a material adverse effect on our financial condition, although, depending on our results for a particular period, an adverse determination could be material for a particular period.

Prior to February 2008, we bought and sold auction rate securities (ARS) for PCS clients and institutional customers that used our cash management desk. We did not underwrite or act as an auction agent for any issuer of auction rate securities. A number of firms that underwrote ARS have entered into settlements with various regulators to, among other measures, purchase at par ARS sold to retail customers. We have provided information on our ARS transactions to the New York Attorney General, SEC and FINRA. FINRA is currently conducting an investigation of our activities relating to ARS.

The enforcement division of FINRA has advised us that it has made a preliminary determination to bring an enforcement action against us alleging a number of violations of FINRA and SEC rules relating to our activities in ARS. In accordance with FINRA procedures, we have an opportunity to explain why we believe an action is not appropriate. If we are unable to explain why no such action should be brought or otherwise to reach a satisfactory resolution with FINRA, we intend to vigorously defend our position.

Item 1A. Risk Factors

Information regarding our risk factors appears in Part I, Item 1A. of our annual report on Form 10-K for the fiscal year ended December 31, 2008 filed with the SEC on February 27, 2009. These risk factors describe some of the assumptions, risks, uncertainties and other factors that could adversely affect our business or that could otherwise result in changes that differ materially from our expectations. There have been no material changes from the risk factors previously disclosed in our annual report on Form 10-K.

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

Period	(a) Total Number of Shares Purchased (1)	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(2)(3)	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
July 1 July 31, 2009	7,188	$21.16		10,416,304
August 1 August 31, 2009	2,022,701	$22.55	1,961,000	8,455,304
September 1 September 30, 2009	1,501,804	$23.73	1,500,304	6,955,000
Total	3,531,693		3,461,304	

(1) We repurchased an aggregate of 70,389 shares other than as part of a publicly announced plan or program. We repurchased these securities in connection with our share-based compensation plans which allow participants to use shares to pay the exercise price of options exercised and to use shares to satisfy tax liabilities arising from the exercise of options or the vesting of restricted stock.

The number above does not include unvested shares forfeited back to us pursuant to the terms of our share-based compensation plans.

(2) On July 26, 2005, we issued a press release announcing the authorization by our Board of Directors to repurchase, from time to time, up to an aggregate of 3,000,000 shares of our common stock. After giving effect to the 2-for-1 stock split effected as a stock dividend on May 15, 2006, this authorization increased to 6,000,000 shares.

(3) On January 23, 2008, we issued a press release announcing the authorization by our Board of Directors to repurchase, from time to time, up to an additional 15,000,000 shares of our common stock

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JEFFERIES GROUP, INC. AND SUBSIDIARIES
Item 6. Exhibits

Exhibits

3.1 Amended and Restated Certificate of Incorporation of Jefferies Group, Inc. is incorporated herein by reference to Exhibit 3 of the Registrant s Form 8-K filed on May 26, 2004.

3.2 Certificate of Designations of 3.25% Series A Cumulative Convertible Preferred Stock is incorporated herein by reference to Exhibit 3.1 of the Registrant s Form 8-K filed on February 21, 2006.

3.3 By-Laws of Jefferies Group, Inc are incorporated herein by reference to Exhibit 3 of Registrant s Form 8-K filed on December 4, 2007.

10.1 Purchase Agreement, dated September 22, 2009, by and among Jefferies Group, Inc., Jefferies & Company, Inc., Citigroup Global Markets Inc., J.P. Morgan Securities Inc., BNY Mellon Capital Markets, Inc., Banc of America Securities LLC, BNP Paribas Securities Corp., Deutsche Bank Securities Inc., and Keefe, Bruyette & Woods, Inc. is incorporated herein by reference to Exhibit 10.1 of the Registrant s Form 8-K filed on September 24, 2009.

31.1* Rule 13a-14(a)/15d-14(a) Certification by the Chief Financial Officer.

31.2* Rule 13a-14(a)/15d-14(a) Certification by the Chief Executive Officer.

32* Rule 13a-14(b)/15d-14(b) and Section 1350 of Title 18 U.S.C. Certification by the Chief Executive Officer and Chief Financial Officer.

* Filed herewith.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

JEFFERIES GROUP, INC.

(Registrant)

Date: November 5, 2009 By: /s/ Peregrine C. Broadbent

Peregrine C. Broadbent
Chief Financial Officer
(duly authorized officer)