# Consolidated Statement of Financial Condition

Piper Jaffray & Co. (A Wholly Owned Subsidiary of
Piper Jaffray Companies)
SEC File Number: 8-1-5204
Year Ended December 31, 2010
With Report of Independent Registered Public
Accounting Firm

Ernst & Young LLP

# Piper Jaffray & Co.
## (A Wholly Owned Subsidiary of Piper Jaffray Companies)
## Index to Consolidated Statement of Financial Condition
## Year Ended December 31, 2010


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# Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholder
Piper Jaffray & Co.

We have audited the accompanying consolidated statement of financial condition of Piper Jaffray & Co. (the Company) as of December 31, 2010. This consolidated statement of financial condition is the responsibility of the Company's management. Our responsibility is to express an opinion on this statement of financial condition based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statement of financial condition is free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated statement of financial condition. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall statement of financial condition presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated statement of financial condition referred to above presents fairly, in all material respects, the consolidated financial position of Piper Jaffray & Co. as of December 31, 2010, in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

Minneapolis, Minnesota
February 28, 2011

# Piper Jaffray & Co.
## (A Wholly Owned Subsidiary of Piper Jaffray Companies)
## Consolidated Statement of Financial Condition
## December 31, 2010

*(Amounts in thousands, except share data)*

| | | |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents | $ | 4,144 |
| Cash and cash equivalents segregated for regulatory purposes | | 27,006 |
| Receivables: | | |
| Customers | | 29,240 |
| Brokers, dealers and clearing organizations | | 188,777 |
| Securities purchased under agreements to resell | | 258,997 |
| Financial instruments and other inventory positions owned | | 329,003 |
| Financial instruments and other inventory positions owned and pledged as collateral | | 515,806 |
| Total financial instruments and other inventory positions owned | | 844,809 |
| Fixed assets (net of accumulated depreciation and amortization of $53,564) | | 17,110 |
| Goodwill | | 111,051 |
| Other receivables | | 32,695 |
| Other assets | | 80,341 |
| Total assets | $ | 1,594,170 |
| **Liabilities and Shareholder's Equity** | | |
| Short-term financing | $ | 193,589 |
| Payables: | | |
| Customers | | 41,816 |
| Brokers, dealers and clearing organizations | | 16,199 |
| Securities sold under agreements to repurchase | | 239,880 |
| Financial instruments and other inventory positions sold, but not yet purchased | | 365,747 |
| Accrued compensation | | 88,982 |
| Intercompany payable to affiliate | | 63,190 |
| Other liabilities and accrued expenses | | 51,898 |
| Total liabilities | | 1,061,301 |
| Shareholder's equity: | | |
| Preferred stock, $0.01 par value; 3,000 shares authorized, none issued and outstanding | | - |
| Common stock, $0.01 par value; 1,000 shares authorized, 459 issued and outstanding | | - |
| Additional paid-in capital | | 559,269 |
| Other comprehensive income | | 32 |
| Accumulated deficit | | (26,432) |
| Total shareholder's equity | | 532,869 |
| Total liabilities and shareholder's equity | $ | 1,594,170 |

*See Notes to Consolidated Statement of Financial Condition*

**Note 1** *Background*

Piper Jaffray & Co. (Piper Jaffray or the "Company") is a wholly owned subsidiary of Piper Jaffray Companies ("Parent Company"). The Parent Company is a public holding company incorporated in Delaware and traded on the New York Stock Exchange ("NYSE"). The Company is a self-clearing securities broker dealer and investment banking firm registered under the Securities and Exchange Act of 1934 and is a member of the Financial Industry Regulatory Authority ("FINRA"). As such, the Company trades and effects transactions in listed and unlisted equity and fixed income securities, underwrites equity and municipal debt offerings, acts as a broker of option contracts and provides various other financial services.

**Note 2** *Summary of Significant Accounting Policies*

**Principles of Consolidation**

The consolidated statement of financial condition includes the accounts of Piper Jaffray & Co. and all other entities in which the Company has a controlling financial interest. All material intercompany balances have been eliminated. The Company determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity ("VIE").

Voting interest entities are entities in which the total equity investment at risk is sufficient to enable each entity to finance itself independently and provides the equity holders with the obligation to absorb losses, the right to receive residual returns and the right or power to make decisions about or direct the entity's activities that most significantly impact the entity's economic performance. Voting interest entities, where the Company has a majority interest, are consolidated in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification Topic 810, "Consolidations" ("ASC 810"). ASC 810 states that the usual condition for a controlling financial interest in an entity is ownership of a majority voting interest. Accordingly, the Company consolidates voting interest entities in which it has all, or a majority of, the voting interests.

As defined in ASC 810, VIEs are entities that lack one or more of the characteristics of a voting interest entity described above. With the exception of entities eligible for the deferral codified in FASB Accounting Standards Update ("ASU") No. 2010-10, "Consolidation: Amendments for Certain Investment Funds" ("ASU 2010-10") (generally asset managers and investment companies), ASC 810 states that a controlling financial interest in an entity is present when an enterprise has a variable interest, or combination of variable interests, that have both the power to direct the activities of the entity that most significantly impact the entity's economic performance and the obligation to absorb losses of the entity or the rights to receive benefits from the entity that could potentially be significant to the entity. Accordingly, the Company consolidates VIEs in which the Company has a controlling financial interest. For more on ASC 810 and VIEs, please see "Consolidation of Variable Interest Entities" under Adoption of New Accounting Standards in Note 3 below.

Entities meeting the deferral provision defined by ASU 2010-10 (generally asset managers and investment companies) are evaluated under the historical VIE guidance. Under the historical guidance, a controlling financial interest in an entity is present when an enterprise has a variable interest, or combination of variable interests, that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both. The enterprise with a controlling financial interest, known as the primary beneficiary, consolidates the VIE. Accordingly, the Company consolidates VIEs subject to the deferral provisions defined by ASU 2010-10 in which the Company is deemed to be the primary beneficiary.

When the Company does not have a controlling financial interest in an entity but exerts significant influence over the entity's operating and financial policies (generally defined as owning a voting or economic interest of between 20% to 50%), the Company accounts for its investment in accordance with the equity method of accounting prescribed by FASB Accounting Standards Codification Topic 323, "Investments – Equity Method and Joint Ventures" ("ASC 323"). If the Company does not have a controlling financial interest in, or exert significant influence over, an entity, the Company accounts for its investment at cost.

**Use of Estimates**

The preparation of the statement of financial condition and related disclosures in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the statement of financial condition. Actual results could differ from those estimates.

**Cash and Cash Equivalents**

Cash and cash equivalents consist of cash and highly liquid investments with maturities of 90 days or less at the date of origination.

In accordance with Rule 15c3-3 of the Securities Exchange Act of 1934, Piper Jaffray, as a registered broker dealer carrying customer accounts, is subject to requirements related to maintaining cash or qualified securities in a segregated reserve account for the exclusive benefit of its customers.

**Collateralized Securities Transactions**

Securities purchased under agreements to resell and securities sold under agreements to repurchase are carried at the contractual amounts at which the securities will be subsequently resold or repurchased, including accrued interest. It is the Company's policy to take possession or control of securities purchased under agreements to resell at the time these agreements are entered into. The counterparties to these agreements typically are primary dealers of U.S. government securities and major financial institutions. Collateral is valued daily, and additional collateral is obtained from or refunded to counterparties when appropriate.

Securities borrowed and loaned result from transactions with other broker dealers or financial institutions and are recorded at the amount of cash collateral advanced or received. These amounts are included in receivables from and payable to brokers, dealers and clearing organizations on the consolidated statement of financial condition. Securities borrowed transactions require the Company to deposit cash or other collateral with the lender. Securities loaned transactions require the borrower to deposit cash with the Company. The Company monitors the market value of securities borrowed and loaned on a daily basis, with additional collateral obtained or refunded as necessary.

Interest is accrued on securities borrowed and loaned transactions and is included in other receivables and other liabilities and accrued expenses on the consolidated statement of financial condition.

**Customer Transactions**

Customer securities transactions are recorded on a settlement date basis. Customer receivables and payables include amounts related to both cash and margin transactions. Securities owned by customers, including those that collateralize margin or other similar transactions, are not reflected on the consolidated statement of financial condition.

**Fair Value of Financial Instruments**

Financial instruments and other inventory positions owned and financial instruments and other inventory positions sold, but not yet purchased on the Company's consolidated statement of financial condition consist of financial instruments recorded at fair value. Securities (both long and short) are recognized on a trade-date basis. Additionally, certain of the Company's investments recorded in other assets on the consolidated statement of financial condition are recorded at fair value, as required by accounting guidance.

*Fair Value Hierarchy* - FASB Accounting Standards Codification Topic 820, "Fair Value Measurements and Disclosures" ("ASC 820"), provides a definition of fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the inputs used to measure fair value and enhances disclosure requirements for fair value measurements. ASC 820 maximizes the use of observable inputs and minimizes 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 management's assumptions that market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the transparency of inputs as follows:

> Level I - Quoted prices (unadjusted) are available in active markets for identical assets or liabilities as of the report date. A quoted price for an identical asset or liability in an active market provides the most reliable fair value measurement because it is directly observable to the market. The type of financial instruments included in Level I are highly liquid instruments with quoted prices such as equities listed in active markets, U.S. treasury bonds, money market securities and certain exchange traded firm investments.
>
> Level II - Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the report date. The nature of these financial instruments include instruments for which quoted prices are available but traded less frequently, 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. Instruments which are generally included in this category are certain non-exchange traded equities, U.S. government agency securities, certain corporate bonds, certain municipal securities, certain asset-backed securities and certain convertible securities.
>
> Level III - Instruments that have little to no pricing observability as of the report date. These financial instruments may not have two-way markets and 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. Instruments included in this category generally include certain non-exchange traded equities, certain asset-backed securities, certain municipal securities, certain firm investments, certain convertible securities and certain corporate bonds.

*Valuation Of Financial Instruments* - The fair value of a financial instrument is the amount at which the instrument could be exchanged in an orderly transaction between market participants at the measurement date (the exit price). When available, the Company values financial instruments at observable market prices, observable market parameters, or broker or dealer prices (bid and ask prices). In the case of financial instruments transacted on recognized exchanges, the observable market prices represent quotations for completed transactions from the exchange on which the financial instrument is principally traded.

A substantial percentage of the fair value of the Company's financial instruments and other inventory positions owned and financial instruments and other inventory positions sold, but not yet purchased, are based on observable market prices, observable market parameters, or derived from broker or dealer prices. The availability of observable market prices and pricing parameters can vary from product to product. Where available, observable market prices and pricing or market parameters in a product may be used to derive a price without requiring significant judgment. In certain markets, observable market prices or market parameters are not available for all products, and fair value is determined using techniques appropriate for each particular product. These techniques involve some degree of judgment. Results from valuation models and other techniques in one period may not be indicative of future period fair value measurement.

For investments in illiquid or privately held securities that do not have readily determinable fair values, the determination of fair value requires the Company to estimate the value of the securities using the best information available. Among the factors considered by the Company in determining the fair value of such financial instruments are the cost, terms and liquidity of the investment, the financial condition and operating results of the issuer, the quoted market price of publicly traded securities with similar quality and yield, and other factors generally pertinent to the valuation of investments. In instances where a security is subject to transfer restrictions, the value of the security is based primarily on the quoted price of a similar security without restriction but may be reduced by an amount estimated to reflect such restrictions. In addition, even where the value of a security is derived from an independent source, certain assumptions may be required to determine the security's fair value. For instance, the Company assumes that the size of positions in securities that the Company holds would not be large enough to affect the quoted price of the securities if the firm sells them, and that any such sale would happen in an orderly manner. The actual value realized upon disposition could be different from the currently estimated fair value.

**Fixed Assets**

Fixed assets include furniture and equipment, software and leasehold improvements. Depreciation of furniture and equipment and software is provided using the straight-line method over estimated useful lives of three to ten years. Leasehold improvements are amortized over their estimated useful life or the life of the lease, whichever is shorter. Additionally, certain costs incurred in connection with internal-use software projects are capitalized and amortized over the expected useful life of the asset, generally three to seven years.

**Leases**

The Company leases its corporate headquarters and other offices under various non-cancelable leases. The leases require payment of real estate taxes, insurance and common area maintenance, in addition to rent. The terms of the Company's lease agreements generally range up to 10 years. Some of the leases contain renewal options, escalation clauses, rent-free holidays and operating cost adjustments.

For leases that contain escalations and rent-free holidays, the Company recognizes the related rent expense on a straight-line basis from the date the Company takes possession of the property to the end of the initial lease term. The Company records any difference between the straight-line rent amounts and amounts payable under the leases as part of other liabilities and accrued expenses.

Cash or lease incentives received upon entering into certain leases are recognized on a straight-line basis as a reduction of rent expense from the date the Company takes possession of the property or receives the cash to the end of the initial lease term. The Company records the unamortized portion of lease incentives as part of other liabilities and accrued expenses.

**Goodwill**

Goodwill represents the fair value of the consideration transferred in excess of the fair value of identifiable net assets at the acquisition date. The recoverability of goodwill is evaluated annually, at a minimum, or on an interim basis if events or circumstances indicate a possible inability to realize the carrying amount. The evaluation includes assessing the estimated fair value of the Company's reporting unit based on market prices for similar assets, where available, the Parent Company's market capitalization and the present value of the estimated future cash flows associated with the reporting unit. The Company completed its annual assessment of goodwill as of November 30, 2010, and no impairment was identified.

**Other Receivables**

Other receivables include management fees receivable, accrued interest and loans made to revenue-producing employees, typically in connection with their recruitment. Employee loans are forgiven based on continued employment and are amortized using the straight-line method over the respective terms of the loans, which generally range up to three years.

**Other Assets**

Other assets include net deferred tax assets, prepaid expenses and proprietary investments. The Company's investments include direct equity investments in public companies, investments in private companies and partnerships, warrants of public or private companies, private company debt and investments to fund deferred compensation liabilities. The Company's direct equity investments in public companies are valued based on quoted prices on active markets. Investments in private companies or partnerships are accounted for on the equity method or at cost, as appropriate. Company-owned warrants with a cashless exercise option are valued at fair value, while warrants without a cashless exercise option are valued at cost. Private company debt investments are recorded at amortized cost, net of any unamortized premium or discount.

**Income Taxes**

The Company files a consolidated U.S. federal income tax return with the Parent Company on a calendar year basis, combined returns for state tax purposes where required, and separate state income tax returns where required. The Company determines and records income taxes based upon the provisions of a tax sharing arrangement with the Parent Company and U.S. affiliated entities. Deferred tax assets and liabilities are determined based on the difference between the financial statement carrying amounts and tax bases of assets and liabilities using enacted tax rates expected to apply to taxable income in the periods in which the deferred tax asset or liability is expected to be settled or realized. Uncertain tax positions are recognized if they are more likely than not to be sustained upon examination, based on the technical merits of the position. The amount of tax benefit recognized is the largest amount of benefit that is greater than 50% likely of being realized upon settlement. The Company recognizes interest and penalties, if any, related to income tax matters as part of the provision for income taxes on the statement of income.

**Note 3** *Recent Accounting Pronouncements*

**Adoption of New Accounting Standards**

*Accounting for Transfers of Financial Assets*

In June 2009 the FASB issued guidance amending the Accounting Standards Codification Topic 860, "Transfers and Servicing" ("ASC 860"), designed to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its statement of financial condition about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. Additionally, the new guidance eliminates the qualifying special-purpose entity ("QSPE") concept. The updates were effective for the Company January 1, 2010. The recognition and measurement provisions were effective for prospective transfers with the exception of existing QSPEs which must be evaluated at the time of adoption. The disclosures required by ASC 860 are applied to both retrospective and prospective transfers. The adoption of ASC 860 did not have an impact on the Company's consolidated statement of financial condition.

*Consolidation of Variable Interest Entities*

In June 2009, the FASB updated the accounting standard related to the consolidation of VIEs. The standard requires, among other things, a qualitative rather than quantitative analysis to determine the primary beneficiary ("PB") of the VIE, continuous assessments of whether the entity is the PB of the VIE, and enhanced disclosures about involvement with VIEs. This standard was effective for the Company January 1, 2010, and is applicable to all entities with which the enterprise has involvement, regardless of when that involvement arose. The adoption of the new standard did not have an impact on the Company's consolidated statement of financial condition.

In February 2010, the FASB issued ASU 2010-10, which addresses the application of the amendments to the VIE consolidation described above for reporting entities in the asset management industry by deferring the effective date of the standard's new recognition and measurement requirements for certain investment funds. However, the standard's new disclosure requirements will continue to apply to all entities. ASU 2010-10 was effective January 1, 2010. The Company did not have any investment funds within the scope of ASU 2010-10 that qualified for deferral.

*Fair Value Measurements*

In January 2010, the FASB issued ASU No. 2010-06, "Improving Disclosures about Fair Value Measurements," ("ASU 2010-06"), amending ASC 820. The amended guidance requires entities to disclose additional information regarding assets and liabilities that are transferred between levels of the fair value hierarchy and to disclose information in the Level III rollforward about purchases, sales, issuances and settlements on a gross basis. ASU 2010-06 also further clarifies existing guidance pertaining to the level of disaggregation at which fair value disclosures should be made and the requirements to disclose information about the valuation techniques and inputs used in estimating Level II and Level III fair value measurements. The guidance in ASU 2010-06 was effective for the Company January 1, 2010, except for the requirement to separately disclose purchases, sales, issuances, and settlements on a gross basis in the Level III rollforward, which becomes effective for fiscal years (and for interim periods within those fiscal years) beginning after December 15, 2010. While the adoption of ASU 2010-06 did not change accounting requirements, it did impact the Company's disclosures about fair value measurements.

**Note 4** *Financial Instruments and Other Inventory Positions Owned and Financial Instruments and Other Inventory Positions Sold, but Not Yet Purchased*

Financial instruments and other inventory positions owned and financial instruments and other inventory positions sold, but not yet purchased at December 31, 2010 were as follows:

| | | |
|---|---|---|
| *(Dollars in thousands)* | | |
| Financial instruments and other inventory positions owned: | | |
| Corporate securities: | | |
| Equity securities | $ | 18,089 |
| Convertible securities | | 37,290 |
| Fixed income securities | | 58,591 |
| Municipal securities: | | |
| Taxable securities | | 295,439 |
| Tax-exempt securities | | 137,340 |
| Short-term securities | | 48,830 |
| Asset-backed securities | | 88,922 |
| U.S. government agency securities | | 153,739 |
| U.S. government securities | | 6,569 |
| | $ | 844,809 |
| | | |
| Financial instruments and other inventory positions sold, but not yet purchased: | | |
| Corporate securities: | | |
| Equity securities | $ | 23,651 |
| Convertible securities | | 8,320 |
| Fixed income securities | | 17,965 |
| Asset-backed securities | | 12,425 |
| U.S. government agency securities | | 52,934 |
| U.S. government securities | | 250,452 |
| | $ | 365,747 |

At December 31, 2010, financial instruments and other inventory positions owned in the amount of $515.8 million had been pledged as collateral for the Company's repurchase agreements, secured borrowings and securities loaned.

Inventory positions sold, but not yet purchased represent obligations of the Company to deliver the specified security at the contracted price, thereby creating a liability to purchase the security in the market at prevailing prices. The Company is obligated to acquire the securities sold short at prevailing market prices, which may exceed the amount reflected on the consolidated statement of financial condition. The Company economically hedges changes in market value of its financial instruments and other inventory positions owned utilizing inventory positions sold, but not yet purchased, futures and exchange-traded options.

**Note 5** *Fair Value of Financial Instruments*

The Company records financial instruments and other inventory positions owned and financial instruments and other inventory positions sold, but not yet purchased at fair value on the consolidated statement of financial condition.

The degree of judgment used in measuring the fair value of financial instruments generally correlates to the level of pricing observability. Pricing observability is impacted by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established and other characteristics specific to the instrument. Financial instruments with readily available active quoted prices for which fair value can be measured generally will have a higher degree of pricing observability and a lesser degree of judgment used in measuring fair value. Conversely, financial instruments rarely traded or not quoted will generally have less, or no, pricing observability and a higher degree of judgment used in measuring fair value.

The following is a description of the valuation techniques used to measure fair value.

**Financial Instruments and Other Inventory Positions Owned**

*Equity securities* – Exchange traded equity securities are valued based on quoted prices from the exchange for identical assets or liabilities as of the period-end date. To the extent these securities are actively traded and valuation adjustments are not applied, they are categorized as Level I. Non-exchange traded equity securities are measured primarily using broker quotations, pricing service data from external providers and prices observed for recently executed market transactions and are categorized within Level II of the fair value hierarchy. Where such information is not available, non-exchange traded equity securities are categorized as Level III financial instruments and measured using valuation techniques involving quoted prices of, or market data for, comparable companies. When using pricing data of comparable companies, judgment must be applied to adjust the pricing data to account for differences between the measured security and the comparable security (e.g., issuer market capitalization, yield, dividend rate and geographical concentration).

*Convertible securities* – Convertible securities are valued based on observable trades, when available. Accordingly, these convertible securities are categorized as Level II. When observable price quotations are not available, fair value is determined based upon model-based valuation techniques with observable market inputs, such as specific company stock price and volatility and unobservable inputs such as option adjusted spreads. These instruments are categorized as Level III.

*Corporate fixed income securities* – Fixed income securities include corporate bonds which are valued based on recently executed market transactions of comparable size, pricing service data from external providers when available, or broker quotations. Accordingly, these corporate bonds are categorized as Level II. When observable price quotations are not available, fair value is determined using model-based valuation techniques with observable inputs such as specific security contractual terms and yield curves and unobservable inputs such as credit spreads. Corporate bonds measured using model-based valuation techniques are categorized as Level III.

*Taxable municipal securities* – Taxable municipal securities are valued using recently executed observable trades or market price quotations and therefore are generally categorized as Level II.

*Tax-exempt municipal securities* – Tax-exempt municipal securities are valued using recently executed observable trades or market price quotations and therefore are generally categorized as Level II. Certain illiquid tax-exempt municipal securities are valued using similar securities (maturity and sector) and management judgment to infer an appropriate current yield and are categorized as Level III.

*Short-term municipal securities* – Short-term municipal securities include auction rate securities, variable rate demand notes, and other short-term municipal securities. Auction rate securities were historically traded and valued as floating rate notes, priced at par due to the auction mechanism. Beginning in 2008, the auction rate securities market experienced dislocation due to uncertainties in the credit markets. During 2009, certain areas of the auction rate market began to function; however, lower credit issuers remain illiquid. Accordingly, auction rate securities with limited liquidity were valued based upon internal models with observable inputs such as specific security contractual terms and yield curves and unobservable inputs such as liquidity discounts. These instruments were categorized as Level III. Variable rate demand notes and other short-term municipal securities are valued using recently executed observable trades or market price quotations and therefore are generally categorized as Level II.

*Asset-backed securities* – Asset-backed securities are valued using observable trades, when available. Certain asset-backed securities are valued using models where inputs to the model are directly observable in the market, or can be derived principally from or corroborated by observable market data. These asset-backed securities are categorized as Level II. Other asset-backed securities, which are principally collateralized by residential mortgages or aircraft, have experienced low volumes of executed transactions that results in less observable transaction data. Asset-backed securities collateralized by residential mortgages are valued using cash flow models that utilize unobservable inputs, including credit default rates ranging from 2% to 12%, prepayment rates ranging from 4% to 8% of CPR, severity ranging from 50% to 80% and valuation yields ranging from 5.5% to 8.5%. Asset-backed securities collateralized by aircraft are valued using cash flow models that utilize unobservable inputs including airplane lease rates, aircraft valuation, trust costs, and other factors impacting security cash flows. The Company's aircraft asset-backed securities had a weighted average yield of 10.5% at December 31, 2010. As judgment is used to determine the range of these inputs, these asset-backed securities are categorized as Level III.

*U.S. government agency securities* – U.S. government agency securities include agency debt bonds and mortgage bonds. Agency debt bonds are valued by using either direct price quotes or price quotes for comparable bond securities and thus, are categorized as Level II. Mortgage bonds include mortgage bonds, mortgage pass-through securities and agency collateralized mortgage-obligations ("CMO"). Mortgage pass-through securities and CMO securities are valued using recently executed observable trades or other observable inputs, such as prepayment speeds and therefore, generally are categorized as Level II. Mortgage bonds are valued using observable market inputs, such as market yields ranging from 85 to 155 basis point spreads to treasury securities, or models based upon prepayment expectations ranging from 200 to 420 Public Securities Association ("PSA") prepayment levels. These securities are categorized as Level II.

*U.S. government securities* – U.S. government securities include highly liquid U.S. treasury securities which are generally valued using quoted market prices and therefore categorized as Level I.

**Investments**

The Company's investments valued at fair value include investments in public companies, warrants of public or private companies and investments in certain illiquid municipal bonds. Exchange traded direct equity investments in public companies are valued based on quoted prices on active markets and reported in Level I. Company-owned warrants, which have a cashless exercise option, are valued based upon the Black-Scholes option-pricing model that uses discount rates and stock volatility factors of comparable companies as inputs. These inputs are subject to management judgment to account for differences between the measured investment and comparable companies. Company-owned warrants are reported as Level III assets. Investments in certain illiquid municipal bonds that the Company is holding for investment are measured using valuation techniques involving significant management judgment and are reported as Level III assets.

The following table summarizes the valuation of the Company's financial instruments by pricing observability levels defined in ASC 820 as of December 31, 2010:

| *(Dollars in thousands)* | Level I | Level II | Level III | Total |
|---|---|---|---|---|
| **Assets:** | | | | |
| Financial instruments and other inventory positions owned: | | | | |
| Corporate securities: | | | | |
| Equity securities | $ 14,509 | $ 2,240 | $ 1,340 | $ 18,089 |
| Convertible securities | - | 34,405 | 2,885 | 37,290 |
| Fixed income securities | - | 52,323 | 6,268 | 58,591 |
| Municipal securities: | | | | |
| Taxable securities | - | 295,439 | - | 295,439 |
| Tax-exempt securities | - | 131,222 | 6,118 | 137,340 |
| Short-term securities | - | 48,705 | 125 | 48,830 |
| Asset-backed securities | - | 43,752 | 45,170 | 88,922 |
| U.S. government agency securities | - | 153,739 | - | 153,739 |
| U.S. government securities | 6,569 | - | - | 6,569 |
| Total financial instruments and other inventory positions owned | 21,078 | 761,825 | 61,906 | 844,809 |
| Investments | 1,078 | - | 2,668 | 3,746 |
| Total assets | $ 22,156 | $ 761,825 | $ 64,574 | $ 848,555 |
| **Liabilities:** | | | | |
| Financial instruments and other inventory positions sold, but not yet purchased: | | | | |
| Corporate securities: | | | | |
| Equity securities | $ 23,651 | $ - | $ - | $ 23,651 |
| Convertible securities | - | 6,543 | 1,777 | 8,320 |
| Fixed income securities | - | 15,642 | 2,323 | 17,965 |
| Asset-backed securities | - | 10,310 | 2,115 | 12,425 |
| U.S. government agency securities | - | 52,934 | - | 52,934 |
| U.S. government securities | 250,452 | - | - | 250,452 |
| Total financial instruments and other inventory positions sold, but not yet purchased | 274,103 | 85,429 | 6,215 | 365,747 |
| Investments | - | - | 1 | 1 |
| Total liabilities | $ 274,103 | $ 85,429 | $ 6,216 | $ 365,748 |

The Company's Level III assets were $64.6 million, or 7.6% of financial instruments measured at fair value at December 31, 2010. At December 31, 2010, the Company's Level II and Level III equities securities increased due to the purchase of non-exchange traded equities securities. Historically, the Company did not hold this type of security for trading purposes.

Some of the Company's financial instruments are not measured at fair value on a recurring basis, but are recorded at amounts that approximate fair value due to their liquid or short-term nature. Such financial assets and financial liabilities include cash, securities either purchased or sold under agreements to resell, receivables and payables either from or to customers and brokers, dealers and clearing organizations and short-term financings.

**Note 6** *Variable Interest Entities*

In the normal course of business, the Company periodically creates or transacts with entities that are investment vehicles organized as limited partnerships or limited liability companies. These entities were established for the purpose of investing in equity and debt securities of public and private companies and were initially financed through the capital commitments of the members. The Company has investments in and/or acts as the managing partner of these entities. At December 31, 2010, the Company's aggregate net investment in these investment vehicles totaled $9.6 million and are recorded in other assets on the consolidated statement of financial condition. The Company's remaining capital commitments to these entities was $0.2 million at December 31, 2010.

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. The determination as to whether an entity is a VIE is based on the amount and nature of the members' equity investment in the entity. The Company also considers other characteristics such as the power through voting rights or similar rights to direct the activities of an entity that most significantly impact the entity's economic performance. For those entities that meet the deferral provisions defined by ASU 2010-10, the Company considers characteristics such as the ability to influence the decision making about the entity's activities and how the entity is financed. The Company has identified certain of the entities described above as VIEs. These VIEs had net assets approximating $212.4 million at December 31, 2010. The Company's exposure to loss from these VIEs is $5.8 million, which is the carrying value of its capital contributions recorded in other assets on the consolidated statement of financial condition at December 31, 2010. The Company had no liabilities related to these VIEs at December 31, 2010.

The Company is required to consolidate all VIEs for which it is considered to be the primary beneficiary. The determination as to whether the Company is considered to be the primary beneficiary is based on whether the Company has both the power to direct the activities of the VIE that most significantly impact the entity's economic performance and the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. It was determined the Company is not the primary beneficiary of the VIEs and accordingly does not consolidate them.

The Company has not provided financial or other support to the VIEs that it was not previously contractually required to provide as of December 31, 2010.

**Note 7** *Receivables from and Payables to Brokers, Dealers and Clearing Organizations*

Amounts receivable from brokers, dealers and clearing organizations as of December 31, 2010 included:

| *(Dollars in thousands)* | |
|---|---|
| Receivable arising from unsettled securities transactions, net | $ 65,923 |
| Deposits paid for securities borrowed | 62,720 |
| Receivable from clearing organizations | 19,153 |
| Deposits with clearing organizations | 24,794 |
| Securities failed to deliver | 1,361 |
| Other | 14,826 |
| Total receivables | $ 188,777 |

Amounts payable to brokers, dealers and clearing organizations as of December 31, 2010 included:

| *(Dollars in thousands)* | |
|---|---|
| Securities failed to receive | $ 499 |
| Other | 15,700 |
| Total payables | $ 16,199 |

**Note 8** *Receivables from and Payables to Customers*

Amounts receivable from customers as of December 31, 2010 included:

| *(Dollars in thousands)* | | |
|---|---|---|
| Cash accounts | $ | 4,762 |
| Margin accounts | | 24,478 |
| Total receivables | $ | 29,240 |

Securities owned by customers are held as collateral for margin loan receivables. This collateral is not reflected on the consolidated statement of financial condition. Margin loan receivables earn interest at floating interest rates based on prime rates.

Amounts payable to customers as of December 31, 2010 included:

| *(Dollars in thousands)* | | |
|---|---|---|
| Cash accounts | $ | 15,013 |
| Margin accounts | | 26,803 |
| Total payables | $ | 41,816 |

Payables to customers primarily comprise certain cash balances in customer accounts consisting of customer funds pending settlement of securities transactions and customer funds on deposit. Except for amounts arising from customer short sales, all amounts payable to customers are subject to withdrawal by customers upon their request.

**Note 9** *Collateralized Securities Transactions*

The Company's financing and customer securities activities involve the Company using securities as collateral. In the event that the counterparty does not meet its contractual obligation to return securities used as collateral, or customers do not deposit additional securities or cash for margin when required, the Company may be exposed to the risk of reacquiring the securities or selling the securities at unfavorable market prices in order to satisfy its obligations to its customers or counterparties. The Company seeks to control this risk by monitoring the market value of securities pledged or used as collateral on a daily basis and requiring adjustments in the event of excess market exposure.

In the normal course of business, the Company obtains securities purchased under agreements to resell, securities borrowed and margin agreements on terms that permit it to repledge or resell the securities to others. The Company obtained securities with a fair value of approximately $351.7 million at December 31, 2010, of which $309.9 million had been either pledged or otherwise transferred to others in connection with the Company's financing activities or to satisfy its commitments under financial instruments and other inventory positions sold, but not yet purchased.

At December 31, 2010, the Company's securities sold under agreements to repurchase ("Repurchase Liabilities") exceeded 10% of total assets. The following is a summary of Repurchase Liabilities and the fair market value of related collateral pledged as of December 31, 2010:

| *(Dollars in thousands)* | Fair Market Value | Repurchase Liabilities | Interest Rates |
|---|---|---|---|
| **Overnight maturities:** | | | |
| Corporate securities: | | | |
| Fixed income securities | $ 4,012 | $ 3,196 | 1.25% |
| Municipal securities: | | | |
| Taxable securities | 117,232 | 94,584 | 1.25% |
| Tax-exempt securities | 54,479 | 44,988 | 1.25% |
| Short-term securities | 8,763 | 7,232 | 1.25% |
| **On demand maturities:** | | | |
| Corporate securities: | | | |
| Fixed income securities | 9,071 | 8,581 | 0.65 - 0.95% |
| U.S. government agency securities | 82,468 | 75,872 | 0.40 - 0.75% |
| U.S. government securities | 5,455 | 5,427 | 0.30% |
| | $ 281,480 | $ 239,880 | |

**Note 10** *Other Assets*

Other assets include net deferred tax assets, prepaid expenses and proprietary investments. The Company's investments include direct equity investments in public companies, investments in private companies and partnerships, warrants of public or private companies, private company debt and investments to fund deferred compensation liabilities.

Other assets at December 31, 2010 included:

| *(Dollars in thousands)* | |
|---|---|
| Deferred income tax assets | $ 60,442 |
| Investments at fair value | 3,746 |
| Investments at cost | 2,314 |
| Investments valued using equity method | 8,395 |
| Prepaid expenses | 4,978 |
| Other | 466 |
| Total other assets | $ 80,341 |

At December 31, 2010, the estimated fair market value of investments carried at cost totaled $2.3 million. The estimated fair value of investments carried at cost was measured using valuation techniques involving market data for comparable companies (e.g., multiples of revenue and earnings before income tax, depreciation and amortization (EBIDTA)). Valuation adjustments, based upon management's judgment, were made to account for differences between the measured security and comparable securities.

**Note 11** *Goodwill*

The following table presents the changes in the carrying value of goodwill for the year ended December 31, 2010:

| *(Dollars in thousands)* | |
|---|---|
| **Balance at December 31, 2009** | $ 111,051 |
| Goodwill acquired | - |
| Impairment losses | - |
| **Balance at December 31, 2010** | $ 111,051 |

The Company tests goodwill for impairment on an annual basis and on an interim basis when certain events or circumstances exist that could indicate possible impairment. The Company tests for impairment at the reporting unit level, which are generally one level below its operating segments. The Company has identified one reporting unit: capital markets. The goodwill impairment test is a two-step process. The first step of the process consists of comparing the estimated fair value of a reporting unit with its book value. If the estimated fair value is less than the carrying value, the second step is performed to compute the amount of impairment by determining an "implied fair value" of goodwill.

The Company completed its annual goodwill impairment testing as of November 30, 2010, and no impairment was identified.

**Note 12** *Fixed Assets*

The following is a summary of fixed assets as of December 31, 2010:

| *(Dollars in thousands)* | |
|---|---|
| Furniture and equipment | $ 33,774 |
| Leasehold improvements | 17,382 |
| Software | 19,162 |
| Projects in process | 356 |
| Total | 70,674 |
| Less accumulated depreciation and amortization | (53,564) |
| | $ 17,110 |

**Note 13** *Short-Term Financing*

The following is a summary of short-term financing and the weighted average interest rate on borrowings as of December 31, 2010:

| *(Dollars in thousands)* | **Outstanding Balance** | **Weighted Average Interest Rate** |
|---|---|---|
| Bank lines (secured) | $ 70,000 | 1.31% |
| Commercial paper (secured) | 123,589 | 1.28% |
| Total short-term financing | $ 193,589 | |

The Company has committed short-term bank line financing available on a secured basis and uncommitted short-term bank line financing available on both a secured and unsecured basis. The Company uses these credit facilities in the ordinary course of business to fund a portion of its daily operations and the amount borrowed under these credit facilities varies daily based on the Company's funding needs.

The Company's committed short-term bank line financing at December 31, 2010 consisted of a $250 million committed revolving credit facility with U.S. Bank, N.A., which was renewed in December 2010. Advances under this facility are secured by certain marketable securities. The facility includes a covenant that requires the Company to maintain a minimum net capital of $150 million, and the unpaid principal amount of all advances under this facility will be due on December 30, 2011. The Company pays a nonrefundable commitment fee on the unused portion of the facility on a quarterly basis.

The Company's uncommitted secured lines at December 31, 2010 totaled $275 million with three banks and are dependent on having appropriate collateral, as determined by the bank agreement, to secure an advance under the line. The availability of the Company's uncommitted lines are subject to approval by the individual banks each time an advance is requested and may be denied. In addition, the Company has established arrangements to obtain financing by another broker dealer at the end of each business day related specifically to its convertible inventory.

In 2009, the Company initiated a secured commercial paper program to fund a portion of its securities inventory. The senior secured commercial paper notes ("Series A CP Notes") are secured by the Company's securities inventory with maturities on the Series A CP Notes ranging from 28 days to 270 days from date of issuance. The Series A CP Notes are interest bearing or sold at a discount to par with an interest rate based on the London Interbank Offered Rate ("LIBOR") plus an applicable margin.

**Note 14** *Contingencies and Commitments*

**Legal Contingencies**

The Company has been named as a defendant in various legal actions, including complaints and litigation and arbitration claims, arising from its business activities. Such actions include claims related to securities brokerage and investment banking activities, and certain class actions that primarily allege violations of securities laws and seek unspecified damages, which could be substantial. Also, the Company is involved from time to time in investigations and proceedings by governmental agencies and self-regulatory organizations.

Given uncertainties regarding the timing, scope, volume and outcome of pending and potential legal actions, investigations and regulatory proceedings and other factors, the amounts of reserves are difficult to determine and of necessity subject to future revision. Subject to the foregoing, management of the Company believes, based on its current knowledge, after consultation with outside legal counsel and taking into account its established reserves, that pending legal actions, investigations and regulatory proceedings will be resolved with no material adverse effect on the consolidated financial condition of the Company.

The Company is a defendant in one potentially material legal proceeding as described below.

The U.S. Department of Justice ("DOJ"), Antitrust Division, the SEC and various state attorneys general are conducting broad investigations of numerous firms, including the Company, for possible antitrust and securities violations in connection with the bidding or sale of guaranteed investment contracts and derivatives to municipal issuers from the early 1990s to date. These investigations commenced in November 2006. In addition, several class action complaints have been brought on behalf of a purposed class of government entities that purchased municipal derivatives. The complaints allege antitrust violations and civil fraud and are pending in a U.S. District Court under the multi-district litigation rules. No loss contingency has been reflected in the Company's consolidated statement of financial condition as this contingency is neither probable nor reasonably estimable at this time. An estimate of the loss, or range of loss that is reasonably possible, cannot be made at this time.

**Operating Lease Commitments**

The Company leases office space throughout the United States and in a limited number of foreign countries where the Company's international operations reside. Aggregate minimum lease commitments under operating leases as of December 31, 2010 are as follows:

| *(Dollars in thousands)* | |
|---|---|
| 2011 | $ 13,576 |
| 2012 | 12,755 |
| 2013 | 12,521 |
| 2014 | 8,650 |
| 2015 | 5,620 |
| Thereafter | 21,684 |
| | $ 74,806 |

Total minimum rentals to be received from 2011 through 2016 under noncancelable subleases were $11.3 million at December 31, 2010.

**Fund Commitments**

As of December 31, 2010, the Company had commitments to invest approximately $0.2 million in limited partnerships that make investments in private equity and venture capital funds. The commitments are estimated to be funded, if called, through the end of the respective investment periods ranging from 2011 to 2016.

**Other Commitments**

The Company is a member of numerous exchanges and clearinghouses. Under the membership agreements with these entities, members generally are required to guarantee the performance of other members, and if a member becomes unable to satisfy its obligations to the clearinghouse, other members would be required to meet shortfalls. To mitigate these performance risks, the exchanges and clearinghouses often require members to post collateral. The Company's maximum potential liability under these arrangements cannot be quantified. However, management believes the likelihood that the Company would be required to make payments under these arrangements is remote. Accordingly, no liability is recorded in the consolidated statement of financial condition for these arrangements.

**Concentration of Credit Risk**

The Company provides investment, capital-raising and related services to a diverse group of domestic and foreign customers, including governments, corporations, and institutional and individual investors. The Company's exposure to credit risk associated with the non-performance of customers in fulfilling their contractual obligations pursuant to securities transactions can be directly impacted by volatile securities markets, credit markets and regulatory changes. This exposure is measured on an individual customer basis and on a group basis for customers that share similar attributes. To alleviate the potential for risk concentrations, counterparty credit limits have been implemented for certain products and are continually monitored in light of changing customer and market conditions.

**Note 15** *Employee Benefit Plans*

The Parent Company has various employee benefit plans, and substantially all Company employees are covered by at least one plan. The plans include a tax-qualified retirement plan, a post-retirement medical plan, and health and welfare plans.

**Note 16** *Parent Company Stock-Based Compensation Plan*

The Parent Company maintains a stock-based compensation plan, the Piper Jaffray Companies Amended and Restated 2003 Annual and Long-Term Incentive Plan (the "Incentive Plan"). The plan permits the grant of equity awards, including non-qualified stock options and restricted stock, to the Company's employees. The awards granted to employees have either three-year cliff vesting periods, vest ratably from 2011 through 2013 on the annual grant date anniversary or cliff vest upon meeting a specific performance-based metric prior to May 2013. The maximum term of the stock options granted to employees is 10 years. The plan provides for accelerated vesting of option and restricted stock awards if there is a change in control of the Parent Company (as defined in the plan), in the event of a participant's death, and at the discretion of the compensation committee of the Parent Company's board of directors.

**Note 17** *Net Capital Requirements and Other Regulatory Matters*

Piper Jaffray is registered as a securities broker dealer with the SEC and is a member of various self regulatory organizations ("SROs") and securities exchanges. FINRA serves as Piper Jaffray's primary SRO. Piper Jaffray is subject to the uniform net capital rule of the SEC and the net capital rule of FINRA. Piper Jaffray has elected to use the alternative method permitted by the SEC rule, which requires that it maintain minimum net capital of the greater of $1.0 million or 2% of aggregate debit balances arising from customer transactions, as such term is defined in the SEC rule. Under its rules, FINRA may prohibit a member firm from expanding its business or paying dividends if resulting net capital would be less than 5% of aggregate debit balances. Advances to affiliates, repayment of subordinated debt, dividend payments and other equity withdrawals by Piper Jaffray are subject to certain notification and other provisions of the SEC and FINRA rules. In addition, Piper Jaffray is subject to certain notification requirements related to withdrawals of excess net capital.

At December 31, 2010, net capital calculated under the SEC rule was $189.5 million, and exceeded the minimum net capital required under the SEC rule by $188.3 million.

The Company's short-term committed credit facility of $250 million includes a covenant requiring Piper Jaffray to maintain minimum net capital of $150 million. In addition, the Parent Company's three-year bank syndicated credit facility includes a similar covenant, requiring Piper Jaffray to maintain a minimum net capital of $160 million.

**Note 18** *Income Taxes*

Deferred income tax assets and liabilities reflect the tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for the same items for income tax reporting purposes. The net deferred tax asset included in other assets on the consolidated statement of financial condition consisted of the following items at December 31:

| *(Dollars in thousands)* | | |
|---|---|---|
| Deferred tax assets: | | |
| Deferred compensation | $ | 55,041 |
| Liabilities/accruals not currently deductible | | 3,206 |
| Other | | 6,403 |
| | | 64,650 |
| Deferred tax liabilities: | | |
| Firm investments | | 655 |
| Fixed assets | | 125 |
| Other | | 3,428 |
| | | 4,208 |
| Net deferred tax asset | $ | 60,442 |

The realization of deferred tax assets is assessed and a valuation allowance is recorded to the extent that it is more likely than not that any portion of the deferred tax asset will not be realized. The Company believes that its future tax profits will be sufficient to recognize its deferred tax assets.

**Note 19** *Related Party Transactions*

The Company has significant transactions with the Parent Company and the Parent Company's other subsidiaries. The Company arranges for the purchase or sale of securities, manages investments and markets derivative instruments for affiliates. Pursuant to shared services agreements, the Company records a portion of the revenues earned by affiliates in return for services provided to affiliates. The Company allocated investment banking revenue to affiliate companies for certain investment banking transactions where the affiliate company employees assisted in providing underwriting, management and/or advisory services to customers. Certain operating expenses, along with advances for certain investments, incurred by affiliates are initially paid by the Company and subsequently reimbursed by the affiliates. In addition, the Company may transact with the Parent Company for the financing of its operations. At December 31, 2010, payable to affiliates of $63.2 million was included in other liabilities and accrued expenses on the consolidated statement of financial condition, representing the amounts payable for related party transactions.

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