Cowen Group, Inc.
Form 10-K
March 13, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

Annual Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the fiscal year ended: **December 31, 2007** Commission file number: **000-52048**

Cowen Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**84-1702964**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

1221 Avenue of the Americas
New York, New York 10020
(646) 562-1000

(Address, including zip code, and telephone number, including area code, of registrant's principal executive office)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Exchange on Which Registered
Common Stock, par value $0.01 per share	The Nasdaq Global Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No ý

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No ý

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 ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Annual Report on Form 10-K or any amendment to the Annual Report on Form 10-K. 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 definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer ý Non-accelerated filer o Smaller reporting company o

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

The aggregate market value of the common stock of the registrant held by non-affiliates of the registrant on June 30, 2007, the last business day of the registrant's most recently completed second fiscal quarter was: $284,498,075.

As of March 10, 2008 there were 14,593,478 shares of the registrant's common stock outstanding.

Documents incorporated by reference:

Part III of this Annual Report on Form 10-K incorporates by reference information (to the extent specific sections are referred to herein) from the Registrant's Proxy Statement for its 2008 Annual Meeting of Stockholders.

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Special Note Regarding Forward-Looking Statements

We have made statements in this Annual Report on Form 10-K (the "Annual Report") in, among other sections, Item 1 "Business," Item 1A "Risk Factors," Item 3 "Legal Proceedings," and Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" that are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. In some cases, you can identify these statements by forward-looking terms such as "may," "might," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential," "intend" or "continue," the negative of these terms and other comparable terminology. These forward-looking statements, which are subject to risks, uncertainties and assumptions about us, may include projections of our future financial performance, which in some cases may be based on our growth strategies and anticipated trends in our business. These statements are only predictions based on our current expectations and projections about future events. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from those expressed or implied by the forward-looking statements. In particular, you should consider the risks outlined under Item 1A "Risk Factors" in this Annual Report on Form 10-K.

Although we believe the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, level of activity, performance or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy or completeness of any of these forward-looking statements. You should not rely upon forward-looking statements as predictions of future events. We are under no duty to update any of these forward-looking statements after the date of this filing to conform our prior statements to actual results or revised expectations.

PART I

When we use the terms "we," "us," "our" and the "Company" we mean Cowen Group, Inc., a Delaware corporation, its consolidated subsidiaries and entities in which it has a controlling financial interest, taken as a whole, as well as any predecessor entities, unless the context otherwise indicates.

Item 1. Business

Overview

We are an investment bank dedicated to providing superior research, brokerage and investment banking services to companies and institutional investor clients primarily in the healthcare, technology, telecommunications, alternative energy, consumer and aerospace & defense sectors. As of December 31, 2007, our research and brokerage services were provided to over 1,000 domestic and international clients seeking to trade equity and equity-linked securities, principally in our target sectors. We focus our investment banking efforts, principally equity and equity-linked capital raising and strategic advisory services, on small and mid-capitalization public companies as well as private companies. We operate through a single reportable segment.

During 2007 we established Cowen Asset Management, LLC ("CAM US") and Cowen Asset Management Limited ("CAM UK") and hired portfolio management and client service teams in Boston and London. CAM US implements a growth-oriented investment style centered on small and mid-sized companies based primarily in North America. CAM UK provides traditional asset management products such as segregated funds to investors and provides listed fund products on the Irish Stock Exchange through Cowen Funds p.l.c., an entity in which we have a controlling financial interest.

In 2007, the Company established Cowen Healthcare Royalty Partners ("CHRP"), which manages an investment program that invests principally in commercial-stage biopharmaceutical products and companies. CHRP seeks to invest in companies and acquires royalty interests in end-user sales of commercial-stage, or near commercial-stage medical products such as pharmaceuticals, biotechnology products and medical devices.

The Company, through predecessor entities, was founded in 1918. In 1998, our firm was acquired by Société Générale ("SG"), one of the largest financial services firms in Europe. On July 12, 2006, following the transfer by SG's primary U.S. broker-dealer subsidiary, SG Americas Securities Holdings ("SGASH"), of all of its interest in Cowen and Company, LLC, our principal U.S. broker-dealer, and Cowen International Limited "(CIL"), a United Kingdom entity, to the Company in exchange for 12,899,900 shares of our stock, we completed an initial public offering ("IPO"). All of the shares sold in our IPO were previously held by SG Americas Securities Holdings. Cowen Group, Inc. was incorporated in Delaware in February 2006 in anticipation of the IPO.

Our principal executive offices are located at 1221 Avenue of the Americas, New York, New York 10020. Our telephone number is (646) 562-1000. We also have offices in Boston, Chicago, Cleveland, Dallas, San Francisco, London and Geneva. We maintain a website at www.cowen.com. The information contained on and connected to our website is not incorporated by reference into this report. We make available free of charge on or through our website our Annual Reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Act of 1934, and all other reports we file with the Securities Exchange Commission (the "SEC"), as soon as reasonably practicable after we electronically file these reports with the SEC. The Cowen and Company, LLC logo and the other trademarks, tradenames and service marks of Cowen and Company, LLC mentioned in this report, including Cowen and Company, LLC, are the property of Cowen Group, Inc.

Principal Business Lines

Research

As of December 31, 2007, we have a research team of 31 professionals providing research coverage on 414 companies. Within our coverage universe, approximately 36% are healthcare companies, 35% are technology companies, 14% are consumer companies, 7% are telecommunications companies, 6% are aerospace & defense companies and 2% are alternative energy companies. Our research analysts are located in New York City, Boston and San Francisco.

We highlight our investment research and provide significant investor access to corporate management teams through a number of annual conferences focused on our sectors and sub-sectors. We believe our conferences are differentiated by the quality of our research presented, the quality of our survey results presented and the quality of our expert panelist participants. Expert panelists who appear at our conferences are drawn from our extensive network of industry thought leaders that has been developed over the past 30 years. Our investor clients recognize that our networks, particularly in healthcare, are comprised of many of the leading professionals in their respective fields.

Our research franchise has been consistently characterized by teamwork and a desire to develop talent from within the organization. When we hire analysts from outside the organization, we prefer to hire technical professionals from the industry they will cover and to train them internally in our research approach. This approach ensures we attain the differentiated research products our clients expect while we maintain the key aspects of our culture.

Brokerage

Our team of brokerage professionals is focused on institutional investor clients in the U.S. and internationally. We primarily trade common stocks and listed options on behalf of our clients. In 2007, we had relationships with over 1,000 institutional investor clients. Our brokerage team is comprised of experienced professionals dedicated to our target sectors, which allows us to develop a level of knowledge and focus that differentiates our brokerage capabilities from those of many of our competitors. We believe our brokerage clients are becoming specialized in their evaluation of investment opportunities. As a result, the value they place on our focused, insightful, proprietary research and dedicated brokerage professionals is growing. Additionally, we tailor our account coverage to the unique needs of our clients. For example, as hedge funds have contributed an increasing percentage of our revenues in recent years, we have established a dedicated team of professionals to provide customized, value-added service to emerging firms in this important client segment. We have also established a dedicated team of professionals to focus on developing relationships with underserved middle market investor clients.

Our sales professionals also provide our institutional investor clients with access to the management of our investment banking clients outside the context of financing transactions. These meetings are commonly referred to as non-deal road shows. Non-deal road shows allow our investment banking clients to increase their visibility with the institutional investor community while providing our institutional investor clients with the opportunity to further educate themselves on companies and industries through meetings with management. We arranged 356 days of non-deal road show meetings for 165 companies in 2007. We believe our deep relationships with company management teams and our sector-focused approach provides us with strong access to management.

By specializing in the healthcare, technology, telecommunications, alternative energy, consumer and aerospace & defense sectors, our traders are able to provide superior execution because of their extensive knowledge of the interests of our institutional investor clients in specific companies in our target sectors. We also have a group of brokerage professionals focused on providing listed option strategies and execution for our institutional investor clients.

Our brokerage professionals are primarily located in New York City, Boston, San Francisco and London. We also have brokerage offices in Atlanta, Chicago, Cleveland, Dallas and Geneva.

Investment Banking

Our investment banking professionals are focused on providing strategic advisory and capital raising services to public and private companies in the healthcare, technology, telecommunications, alternative energy, consumer and aerospace & defense sectors. By focusing on our target sectors over a long period of time, we have developed a significant understanding of the unique challenges and demands with respect to public and private capital raising and strategic advice in these sectors. Our advisory and capital raising capabilities begin at the early stages of a private company's accelerated growth phase and continue through its evolution as a public company. A significant majority of our investment banking revenue is earned from high-growth public companies with a market capitalization below $2 billion. We believe the high level of expertise and client trust we have developed allow us to generate significant repeat business. In 2007, over 38% of our investment banking business was executed for clients that had utilized our services in the past. In addition, we believe the high level of lead-managed business reflects our expertise and the strength of our client relationships. We were lead manager on approximately 30% of our underwritten capital raising transactions executed in 2007.

Alternative Asset Management

In 2007, the Company established Cowen Healthcare Royalty Partners ("CHRP"), which manages an investment program that invests principally in commercial-stage biopharmaceutical products and companies. CHRP seeks to invest in companies and acquires royalty interests in end-user sales of commercial-stage, or near commercial-stage medical products such as pharmaceuticals, biotechnology products and medical devices.

In addition, the Company, through our indirect wholly-owned subsidiary, Cowen Capital Partners, manages a portfolio of merchant banking investments on behalf of SG and other third-party investors, as well as managing a portfolio of venture capital investments.

Asset Management

During 2007 we established CAM US and CAM UK and hired portfolio management and client service teams in London and Boston. CAM US focuses on a growth-oriented investment style centered on small and mid-sized companies based primarily in North America. CAM UK provides traditional asset management products such as segregated funds and has recently listed six fund products on the Irish Stock Exchange that present a range of portfolios focused on different geographical regions around the world.

Financial Information About Geographic Areas

We are principally engaged in providing investment banking and brokerage services to corporations and institutional investor clients in the United States. We also provide investment banking and brokerage services to companies and institutional investor clients in international jurisdictions, primarily in England and Europe. We conduct our international business primarily through CIL and CAM UK. See Note 19 to the Consolidated Financial Statements in Part IV, Item 15 of this Annual Report on Form 10-K for more information.

Competition

As an investment bank, all aspects of our business are intensely competitive. Our competitors are other investment banks, brokerage firms, merchant banks and financial advisory firms. We compete with some of our competitors nationally and with others on a regional, product or business line basis.

Many of our competitors have substantially greater capital and resources than we do and offer a broader range of financial products. We believe that the principal factors affecting competition in our business include client relationships, reputation, the quality and price of our products and services, market focus and the ability of our professionals. Competition is intense for the recruitment and retention of qualified professionals. Our ability to continue to compete effectively in our business will depend upon our continued ability to retain and motivate our existing professionals and attract new professionals. In recent years, there has been substantial consolidation and convergence among companies in the financial services industry, including among many of our former competitors. In particular, a number of large commercial banks have established or acquired broker-dealers or have merged with other financial institutions. Many of these firms have the ability to offer a wider range of products than we offer, including loans, deposit taking and insurance. Many of these firms also have more extensive investment banking services, which may enhance their competitive position. They also have the ability to support investment banking and securities products with commercial banking and other financial services revenue in an effort to gain market share, which could result in pricing pressure in our business. This trend toward consolidation and convergence has significantly increased the capital base and geographic reach of our competitors.

Seasonality

Our brokerage and investment banking businesses typically experience slowdowns during certain periods of the year. However, seasonality has not been a significant factor affecting our results.

Regulation

Our business, as well as the financial services industry generally, is subject to extensive regulation in the United States and elsewhere. As a matter of public policy, regulatory bodies in the United States and the rest of the world are charged with safeguarding the integrity of the securities and other financial markets and with protecting the interests of customers participating in those markets.

In the United States, the SEC is the federal agency responsible for the administration of the federal securities laws. Cowen and Company, LLC ("Cowen"), our wholly-owned subsidiary, is registered as a broker-dealer with the SEC and in all 50 states, the District of Columbia and Puerto Rico. Self-regulatory organizations, such as the Financial Industry Regulatory Authority ("FINRA") and the New York Stock Exchange, Inc. ("NYSE") adopt and enforce rules governing the conduct, and examine the activities, of its member firms, including Cowen. FINRA was formed in 2007 when the National Association of Securities Dealers ("NASD") and the NYSE merged their regulatory operations, although the NYSE continues to have oversight over NYSE-related market activities. Accordingly, Cowen is subject to regulation and oversight by the SEC, FINRA and the NYSE. FINRA and the NYSE are themselves subject to oversight by the SEC. State securities regulators also have regulatory or oversight authority over Cowen. Cowen is also a member of, and subject to regulation by, the Chicago Board Options Exchange, the Philadelphia Stock Exchange, the American Stock Exchange, the International Stock Exchange, the Nasdaq Stock Exchange, the Chicago Board of Trade and the New York Mercantile Exchange. CIL, our U.K. broker-dealer subsidiary, is subject to regulation by the Financial Services Authority ("FSA") in the U.K. Our business may also be subject to regulation by non-U.S. governmental and regulatory bodies and self-regulatory authorities in other countries where we operate.

Broker-dealers are subject to regulations that cover all aspects of the securities business, including sales methods, trade practices among broker-dealers, use and safekeeping of customers' funds and securities, capital structure, record-keeping, the financing of customers' purchases and the conduct and qualifications of directors, officers and employees. In particular, as a registered broker-dealer and member of various self-regulatory organizations, Cowen is subject to the SEC's uniform net capital rule, Rule 15c3-1. Rule 15c3-1 specifies the minimum level of net capital a broker-dealer must maintain and also requires that a significant part of a broker-dealer's assets be kept in relatively liquid form. The SEC and various self-regulatory organizations impose rules that require notification when net capital falls below certain predefined criteria, limit the ratio of subordinated debt to equity in the regulatory capital composition of a broker-dealer and constrain the ability of a broker-dealer to expand its business under certain circumstances. Additionally, the SEC's uniform net capital rule requires us to give prior notice to the SEC for certain withdrawals of capital. As a result, our ability to withdraw capital from our broker-dealer subsidiary may be limited.

The effort to combat money laundering and terrorist financing is a priority in governmental policy with respect to financial institutions. The Bank Secrecy Act, as amended by Title III of the USA PATRIOT Act of 2001 and its implementing regulations, requires broker-dealers and other financial services companies to maintain an anti-money laundering compliance program that includes written policies and procedures, designated compliance officer(s), appropriate training, independent review of the program, standards for verifying client identity at account opening, and obligations to report suspicious activities and certain other financial transactions. Through these and other provisions, the Bank Secrecy Act seeks to promote the identification of parties that may be involved in financing terrorism or money laundering. We must also comply with sanctions programs administered by the U.S. Department of Treasury's Office of Foreign Asset Control, which may include prohibitions on transactions with designated individuals and entities and with individuals and entities from certain countries.

Anti-money laundering laws outside the United States contain some similar provisions. The obligation of financial institutions, including us, to identify their customers, watch for and report suspicious transactions, respond to requests for information by regulatory authorities and law enforcement agencies, and share information with other financial institutions, has required the implementation and maintenance of internal practices, procedures and controls which have increased, and may continue to increase, our costs, and any failure with respect to our programs in this area could subject us to serious regulatory consequences, including substantial fines, and potentially other liabilities.

Certain of our businesses are subject to compliance with laws and regulations of United States federal and state governments, non-United States governments, their respective agencies and/or various self-regulatory organizations or exchanges relating to the privacy of client information, and any failure to comply with these regulations could expose us to liability and/or reputational damage. Additional legislation, changes in rules promulgated by the SEC and self-regulatory organizations or changes in the interpretation or enforcement of existing laws and rules, either in the United States or elsewhere, may directly affect the mode of our operation and profitability. The United States and non-United States government agencies and self-regulatory organizations, as well as state securities commissions in the United States, are empowered to conduct administrative proceedings that can result in censure, fine, the issuance of cease-and-desist orders or the suspension or expulsion of a broker-dealer or its directors, officers or employees. Occasionally, we have been subject to investigations and proceedings, and sanctions have been imposed for infractions of various regulations relating to our activities.

Employees

As of February 29, 2008, we had 527 employees.

Item 1A. Risk Factors

Risks Related to Our Business

We focus principally on specific sectors of the economy, and deterioration in the business environment in these sectors or a decline in the market for securities of companies within these sectors could materially adversely affect our business.

We focus principally on the healthcare, technology, telecommunications, alternative energy, consumer and aerospace & defense sectors of the economy. Therefore, volatility in the business environment in these sectors or in the market for securities of companies within these sectors could substantially affect our financial results and the market value of our common stock. The business environment for companies in these sectors has been subject to substantial volatility, and our financial results have consequently been subject to significant variations from year to year. The market for securities in each of our target sectors may also be subject to industry-specific risks. For example, changes in policies of the United States Food and Drug Administration, along with changes in Medicare and government reimbursement policies, may affect the market for securities of healthcare companies.

As an investment bank focused principally on specific growth sectors of the economy, we also depend significantly on private company transactions for sources of revenues and potential business opportunities. Most of these private company clients are initially funded and controlled by private equity firms. To the extent the pace of these private company transactions slows or the average size declines due to a decrease in private equity financings, difficult market conditions in our target sectors or other factors, our business and results of operations may be adversely affected.

Our financial results may fluctuate substantially from period to period, which may impair our stock price.

We have experienced, and expect to experience in the future, significant periodic variations in our revenues and results of operations. These variations may be attributed in part to the fact that our investment banking revenues are typically earned upon the successful completion of a transaction, the timing of which is uncertain and beyond our control. In most cases, we receive little or no payment for investment banking engagements that do not result in the successful completion of a transaction. As a result, our business is highly dependent on market conditions as well as the decisions and actions of our clients and interested third parties. For example, a client's acquisition transaction may be delayed or terminated because of a failure to agree upon final terms with the counterparty, failure to obtain necessary regulatory consents or board or stockholder approvals, failure to secure necessary financing, adverse market conditions or unexpected financial or other problems in the client's or counterparty's business. If the parties fail to complete a transaction on which we are advising or an offering in which we are participating, we will earn little or no revenue from the transaction. This risk may be intensified by our focus on growth companies in the healthcare, technology, telecommunications, alternative energy, consumer and aerospace & defense sectors as the market for securities of these companies has experienced significant variations in the number and size of equity offerings. Many companies initiating the process of an IPO are simultaneously exploring merger and acquisition exit opportunities. Our investment banking revenues would be adversely affected in the event that an IPO for which we are acting as an underwriter is preempted by the company's sale if we are not also engaged as a strategic advisor in such sale. As a result, we are unlikely to achieve steady and predictable earnings on a quarterly basis, which could in turn adversely affect our stock price.

Our ability to retain our senior professionals is critical to the success of our business, and our failure to do so may materially adversely affect our reputation, business and results of operations.

Our people are our most valuable resource. Our ability to obtain and successfully execute the business mandates that generate a significant portion of our revenues depends upon the reputation, judgment, business generation capabilities and project execution skills of our senior professionals. Our employees' reputations and relationships with our clients are critical elements in obtaining and executing client engagements. We encounter intense competition for qualified employees from other companies in the investment banking industry as well as from businesses outside the investment banking industry, such as hedge funds and private equity funds. From time to time, we have experienced departures of investment banking, brokerage, research and other professionals. Losses of key personnel have occurred and may occur in the future. In addition, if any of our bankers or executive officers were to join an existing competitor or form a competing company, some of our clients could choose to use the services of that competitor instead of our services.

Pricing and other competitive pressures may impair the revenues of our brokerage business.

We derive a significant portion of our revenues from our brokerage business, which accounted for approximately 61% of our revenues in 2007. Along with other firms, we have experienced intense price competition in this business in recent years. In particular, the ability to execute trades electronically and through alternative trading systems has increased the pressure on trading commissions and spreads. We expect pricing pressures in the business to continue. Decimalization in securities trading has also reduced revenues and lowered margins within the equity brokerage divisions of many firms, including ours. We believe we may experience competitive pressures in these and other areas in the future as some of our competitors seek to obtain market share by competing on the basis of price or use their own capital to facilitate client trading activities. In addition, we face pressure from our larger competitors, which may be better able to offer a broader range of complementary products and services to clients in order to win their trading business. As we are committed to maintaining and improving our comprehensive research coverage in our target sectors to support our brokerage business, we may be required to make substantial investments in our research capabilities. If we are unable to compete effectively in these areas, the revenues of our brokerage business may decline, and our business and results of operations may be adversely affected.

We face strong competition from larger firms.

The research, brokerage and investment banking industries are intensely competitive, and we expect them to remain so. We compete on the basis of a number of factors, including client relationships, reputation, the abilities of our professionals, market focus and the relative quality and price of our services and products. We have experienced intense price competition in some of our businesses, including trading commissions and spreads in our brokerage business. In addition, pricing and other competitive pressures in investment banking, including the trends toward multiple bookrunners, co-managers and financial advisors, could adversely affect our revenues.

We are a relatively small investment bank. Many of our competitors in the research, brokerage and investment banking industries have a broader range of products and services, greater financial resources, larger customer bases, greater name recognition and marketing resources, a larger number of senior professionals to serve their clients' needs, greater global reach and more established relationships with clients than we have. These larger and better capitalized competitors may be better able to respond to changes in the research, brokerage and investment banking industries, to compete for skilled professionals, to finance acquisitions, to fund internal growth and to compete for market share generally.

The scale of our competitors has increased in recent years as a result of substantial consolidation among companies in the research, brokerage and investment banking industries. In addition, a number of large commercial banks and other broad-based financial services firms have established or acquired underwriting or financial advisory practices and broker-dealers or have merged with other financial institutions. These firms have the ability to offer a wider range of products than we do which may enhance their competitive position. They also have the ability to support their investment banking groups with commercial banking and other financial services in an effort to gain market share, which has resulted, and could further result, in pricing pressure in our businesses. In particular, the ability to provide debt financing has become an important advantage for some of our larger competitors. We do not provide debt financing and are just beginning to develop debt arrangement capabilities, and therefore we may be unable to compete as effectively for clients in a significant part of the investment banking market. If we are unable to compete effectively with our competitors, our business and results of operations will be adversely affected.

We have incurred losses in recent periods and may incur losses in the future.

We have incurred losses in several recent periods and also recorded net losses in certain quarters within other fiscal years. We may incur losses in any of our future periods. If we are unable to raise funds to finance future losses, those losses may have a significant effect on our liquidity as well as our ability to operate.

In addition, we may incur significant expenses in connection with any expansion, strategic acquisition or investment. Accordingly, we will need to increase our revenues at a rate greater than our expenses to achieve and maintain profitability. If our revenues do not increase sufficiently, or even if our revenues increase but we are unable to manage our expenses, we will not achieve and maintain profitability in future periods.

In the event we require additional capital for our business or to fund losses, we will need to seek such capital through the sale of additional common stock, the issuance of debt securities, or through other debt financings.

Our capital markets and strategic advisory engagements are singular in nature and do not generally provide for subsequent engagements.

Our investment banking clients generally retain us on a short-term, engagement-by-engagement basis in connection with specific capital markets or mergers and acquisitions transactions, rather than on a recurring basis under long-term contracts. As these transactions are typically singular in nature and our engagements with these clients may not recur, we must seek out new engagements when our current engagements are successfully completed or are terminated. As a result, high activity levels in any period are not necessarily indicative of continued high levels of activity in any subsequent period. If we are unable to generate a substantial number of new engagements that generate fees from new or existing clients, our business and results of operations would likely be adversely affected.

Larger and more frequent capital commitments in our trading and underwriting businesses increase the potential for significant losses.

There is a trend toward larger and more frequent commitments of capital by financial services firms in many of their activities. For example, in order to compete for certain transactions, investment banks are increasingly committing to purchase large blocks of stock from publicly traded issuers or significant stockholders, instead of the more traditional marketed underwriting process in which marketing is typically completed before an investment bank commits to purchase securities for resale. We anticipate participating in this trend and, as a result, we will be subject to increased risk as we commit capital to facilitate business. Furthermore, we may suffer losses as a result of the positions taken in these transactions even when economic and market conditions are generally favorable for others in the industry.

We may enter into large transactions in which we commit our own capital as part of our trading business to facilitate client trading activities. The number and size of these large transactions may materially affect our results of operations in a given period. Market fluctuations may also cause us to incur significant losses from our trading activities. To the extent that we own assets, *i.e.*, have long positions, a downturn in the value of those assets or in the markets in which those assets are traded could result in losses. Conversely, to the extent that we have sold assets we do not own, *i.e.*, have short positions, in any of those markets, an upturn in those markets could expose us to potentially large losses as we attempt to cover our short positions by acquiring assets in a rising market.

Limitations on our access to capital could impair our liquidity and our ability to conduct our businesses.

Liquidity, or ready access to funds, is essential to financial services firms. Failures of financial institutions have often been attributable in large part to insufficient liquidity. Liquidity is of particular importance to our trading business and perceived liquidity issues may affect our clients' and counterparties' willingness to engage in brokerage transactions with us. Our liquidity could be impaired due to circumstances that we may be unable to control, such as a general market disruption or an operational problem that affects our trading clients, third parties or us. Further, our ability to sell assets may be impaired if other market participants are seeking to sell similar assets at the same time.

We are a holding company and depend on dividends from Cowen, our broker-dealer subsidiary, to fund our obligations, including our share repurchase program. Cowen is subject to the net capital requirements of the SEC and various self-regulatory organizations of which it is a member. These requirements typically specify the minimum level of net capital a broker-dealer must maintain and also mandate that a significant part of its assets be kept in relatively liquid form. CIL, our registered broker-dealer subsidiary, and CAM UK are subject to the capital requirements of the U.K. FSA. Any failure to comply with these capital requirements could impair our ability to conduct our business.

Our operations and infrastructure may malfunction or fail.

Our businesses are highly dependent on our ability to process, on a daily basis, a large number of transactions across diverse markets, and the transactions we process have become increasingly complex. The inability of our systems to accommodate an increasing volume of transactions could also constrain our ability to expand our businesses. If any of these 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 impairments, financial loss, a disruption of our businesses, liability to clients, regulatory intervention or reputational damage.

We have outsourced certain aspects of our technology infrastructure including data centers and wide area networks, as well as some trading applications. We are dependent on our technology providers to manage and monitor those functions. A disruption of any of the outsourced services would be out of our control and could negatively impact our business. We have experienced disruptions on occasion, none of which has been material to our operations and results. However, there can be no guarantee that future material disruptions with these providers will not occur.

We also face the risk of operational failure of or termination of relations with 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 to manage our exposure to risk.

In addition, our ability to conduct business may be adversely impacted by a disruption in the infrastructure that supports our businesses and the communities in which we are located. This may affect, among other things, our financial, accounting or other data processing systems. This may include a disruption involving electrical, communications, transportation or other services used by us or third parties with which we conduct business, whether due to fire, other natural disaster, power or communications failure, act of terrorism or war or otherwise. Nearly all of our employees in our primary locations in New York, Boston, San Francisco and London work in close proximity to each other. Although we have a formal disaster recovery plan in place, if a disruption occurs in one location and our employees in that location are unable to communicate with or travel to other locations, our ability to service and interact with our clients may suffer, and we may not be able to implement successfully contingency plans that depend on communication or travel.

Our operations also 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 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, to investigate and remediate vulnerabilities or other exposures or to make required notifications, 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.

Strategic investments or acquisitions and joint ventures, or our entry into new business areas, may result in additional risks and uncertainties in our business.

We have grown and intend to continue to grow our core businesses both through internal expansion and through strategic investments, acquisitions or joint ventures. When we make strategic investments or acquisitions or enter into joint ventures, we expect to face numerous risks and uncertainties in combining or integrating the relevant businesses and systems, including the need to combine accounting and data processing systems and management controls and to integrate relationships with customers and business partners. In addition, future acquisitions or joint ventures may involve the issuance of additional shares of our common stock, which may dilute our stockholders' ownership of our firm. Furthermore, any future acquisitions of businesses or facilities could entail a number of risks, including:

- problems with the effective integration of operations;
- inability to maintain key pre-acquisition business relationships;
- increased operating costs;
- exposure to unanticipated liabilities; and
- difficulties in realizing projected efficiencies, synergies and cost savings.

During 2007 we established Cowen Asset Management and expanded our Alternative Asset Management platform with the formation of CHRP. Our expansion into these areas will require significant resources and/or may result in significant unanticipated losses, costs or liabilities. In addition, expansions, acquisitions or joint ventures may require significant managerial attention, which may be diverted from our other operations. These capital, equity and managerial commitments may impair the operation of our businesses.

Risks Related to Our Industry

Difficult market conditions could adversely affect our business in many ways.

Difficult market and economic conditions and geopolitical uncertainties have in the past adversely affected and may in the future adversely affect our business and profitability in many ways. Weakness in equity markets and diminished trading volume of securities could adversely impact our brokerage business, from which we have historically generated a significant portion of our revenues. Industry-wide declines in the size and number of underwritings and mergers and acquisitions also would likely have an adverse effect on our revenues. In addition, reductions in the trading prices for equity securities also tend to reduce the dollar value of investment banking transactions, such as underwriting and mergers and acquisitions transactions, which in turn may reduce the fees we earn from these transactions. As we may be unable to reduce expenses correspondingly, our profits and profit margins may decline.

Increases in regulation of the capital markets may have an adverse impact on our business.

Highly publicized financial scandals in recent years have led to investor concerns over the integrity of the U.S. financial markets, and have prompted Congress, the SEC, FINRA and the NYSE to significantly expand corporate governance and public disclosure requirements. To the extent that private companies, in order to avoid becoming subject to these new requirements, decide to forgo IPOs, our equity underwriting business may be adversely affected. In addition, provisions of the Sarbanes-Oxley Act and the corporate governance rules imposed by self-regulatory organizations may divert companies' attention away from capital markets transactions. In particular, companies that are or are planning to become publicly traded are incurring significant expenses and are allocating significant resources in order to comply with the SEC standards relating to internal controls over financial reporting, and companies that disclose material weaknesses in such controls under the new standards may have greater difficulty accessing the capital markets. These factors, in addition to potential future accounting and disclosure changes, may have an adverse effect on our business.

Financial services firms have been subject to increased scrutiny over the last several years, increasing the risk of financial liability and reputational harm resulting from adverse regulatory actions.

Firms in the financial services industry have been subject to an increasingly regulated environment. The industry has experienced increased scrutiny from a variety of regulators, including the SEC, FINRA, the NYSE and state attorneys general. Penalties and fines sought by regulatory authorities have increased substantially over the last several years. This regulatory and enforcement environment has created uncertainty with respect to a number of transactions that historically had been entered into by financial services firms and that were generally believed to be permissible and appropriate. We may be adversely affected by changes in the interpretation or enforcement of existing laws and rules by these governmental authorities and self-regulatory organizations. We also may be adversely affected as a result of new or revised legislation or regulations imposed by the SEC, other United States or foreign governmental regulatory authorities or self-regulatory organizations that supervise the financial markets. Among other things, we could be fined, prohibited from engaging in some of our business activities or subjected to limitations or conditions on our business activities. In addition, we could incur significant expense associated with compliance with any such legislation or regulations or the regulatory and enforcement environment generally. Substantial legal liability or significant regulatory action against us could have material adverse financial effects or cause significant reputational harm to us, which could seriously affect our business prospects.

In addition, financial services firms are subject to numerous conflicts of interest or perceived conflicts, which have drawn scrutiny from the SEC and other federal and state regulators. For example, the research areas of investment banks have been and remain the subject of heightened regulatory scrutiny, which has led to increased restrictions on the interaction between equity research analysts and investment banking personnel at securities firms. While we have adopted various policies, controls and procedures to address or limit actual or perceived conflicts and regularly seek to review and update our policies, controls and procedures, appropriately dealing with conflicts of interest is complex and difficult, and our reputation could be damaged if we fail, or appear to fail, to deal appropriately with conflicts of interest. Our policies and procedures to address or limit actual or perceived conflicts may also result in increased costs, additional operational personnel and increased regulatory risk. Failure to adhere to these policies and procedures may result in regulatory sanctions or client litigation.

Our exposure to legal liability is significant, and damages that we may be required to pay and the reputational harm that could result from legal action against us could materially adversely affect our businesses.

As an investment banking firm, we depend to a large extent on our reputation for integrity and high-caliber professional services to attract and retain clients. As a result, if a client is not satisfied with our services, it may be more damaging in our business than in other businesses. Moreover, our role as advisor to our clients on important underwriting or mergers and acquisitions transactions involves complex analysis and the exercise of professional judgment, including rendering "fairness opinions" in connection with mergers and other transactions. Therefore, our activities may subject us to the risk of significant legal liabilities to our clients and aggrieved third parties, including stockholders of our clients who could bring securities class actions against us. Although our investment banking engagements typically include broad indemnities from our clients and provisions to limit our exposure to legal claims relating to our services, these provisions may not protect us or may not be enforceable in all cases. As a result, we may incur significant legal and other expenses in defending against litigation and may be required to pay substantial damages for settlements and/or adverse judgments. Substantial legal liability or significant regulatory action against us could have a material adverse effect on our results of operations or cause significant reputational harm to us, which could seriously harm our business and prospects.

In connection with our IPO, we entered into an Indemnification Agreement with SG, wherein, among other things, SG agreed to indemnify us for all liability arising out of all known, pending or threatened litigation (including the cost of such litigation) and arbitrations and certain known regulatory matters, in each case, that existed prior to the date of our IPO. SG, however, will not indemnify us, and we will instead indemnify SG, for most litigation, arbitration and regulatory matters that may occur in the future but were unknown at the time of our IPO and certain known regulatory matters. See Item 3 "Legal Proceedings" for a discussion of the matters covered by these indemnification provisions.

Employee misconduct could harm us and is difficult to detect and deter.

It is not always possible to deter employee misconduct. The precautions we take to detect and prevent this activity may not be effective in all cases, and we may suffer significant reputational harm for any misconduct by our employees. The potential harm to our reputation and to our business caused by such matters is impossible to quantify.

Risks Related to Our Shares

Provisions of our organizational documents may discourage an acquisition of us.

Our organizational documents contain provisions that impede the removal of directors and may discourage a third party from making a proposal to acquire us. Our board is classified, and directors may only be able to be removed for cause and by the affirmative vote of at least 80% of our then-outstanding capital stock entitled to vote. Our board has the ability to take defensive measures that could impede or thwart a takeover such as, under certain circumstances, adopting a poison pill, or causing us to issue preferred stock that has greater voting rights than the common stock. If a change of control or change in management that stockholders might otherwise consider to be favorable is prevented or delayed, the market price of our common stock could decline.

Our directors, executive officers and other employees have significant influence over matters requiring stockholder approval, which could delay or prevent a change of control.

Our directors, executive officers and other employees beneficially own approximately 25% (29% on a fully diluted basis) of our common stock as of March 5, 2008. These percentages include the effect of the items discussed in Note 21 "Subsequent Events" to the Consolidated Financial Statements in

Part IV, Item 15 of this Annual Report on Form 10-K. In addition, we will continue to use equity as a component of our compensation program, which will result in our employees owning a greater percentage of our outstanding common stock. Consequently, our directors, executive officers and other employees, to the extent their interests are aligned, collectively may be able to significantly influence matters submitted for stockholder action, including the election of our board of directors and approval of significant corporate transactions, including business combinations, consolidations and mergers and the determination of our day-to-day corporate and management policies. This concentration of ownership of our common stock could delay or prevent proxy contests, mergers, tender offers, open-market purchase programs or other purchases of our common stock that might otherwise give you the opportunity to realize a premium over the then-prevailing market price of our common stock. In addition, these stockholders could exercise their influence in a manner that is not in the best interest of our other stockholders.

Future sales of our common stock could cause our stock price to decline.

Sales of substantial amounts of common stock by our employees and other stockholders, or the possibility of such sales, may adversely affect the price of our common stock and impede our ability to raise capital through the issuance of equity securities. In 2007 we filed a registration statement on behalf of SG, whereby SG may sell all or a portion of the 1,382,608 shares that they hold at any time. A significant sale by SG may adversely affect the price of our common stock.

We do not expect to pay any cash dividends in the foreseeable future.

We intend to retain any future earnings to fund the development and growth of our business. We, therefore, do not anticipate paying cash dividends in the foreseeable future. Accordingly, you must rely on sales of your shares of common stock after price appreciation, which may never occur, as the only way to realize any future gains on your investment.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our main offices, all of which are leased, are located in New York City, Boston, San Francisco and London. Our headquarters are located at 1221 Avenue of the Americas, New York, New York, and comprise approximately 109,619 square feet of leased space, pursuant to a sublease agreement expiring in 2013. We also lease approximately 38,217 square feet of space at Two International Place in Boston pursuant to a lease agreement expiring in 2014. In San Francisco, we lease approximately 29,072 square feet of space at 555 California Street, pursuant to a lease agreement expiring in 2015. Our London office is located at Broadgate West Phase II, 1 Snowden Street, and is subject to a lease agreement expiring in 2017. We believe that all of our properties and facilities are well maintained. We do not anticipate a need for additional office space in the near term.

Item 3. Legal Proceedings

We face significant legal risks in our businesses and, in recent years, the volume of claims and amount of damages sought in litigation and regulatory proceedings against financial institutions have been increasing. These risks include potential liability under federal securities and other laws in connection with securities offerings and other transactions, as well as advice and opinions we provide concerning strategic transactions. In addition, like most financial institutions, we are often the subject of claims made by current and former employees arising out of their employment or termination of employment with us. We are involved in a number of judicial, regulatory and arbitration matters arising in connection with our business including those described below.

Pursuant to Statement of Financial Accounting Standard ("SFAS") No. 5, "Accounting for Contingencies," we review the need for any loss contingency reserves, and we have established reserves for certain of these matters that we believe are adequate where, in the opinion of management, the likelihood of liability is probable and the extent of such liability is reasonably estimable. In addition, in connection with our IPO, we entered into an Indemnification Agreement with SG (the "Indemnification Agreement"), wherein SG agreed to indemnify us for all liability arising out of all known, pending or threatened litigation and arbitrations and certain specified regulatory matters that existed at the time of our IPO. The Indemnification Agreement provides that SG will indemnify us for all known or unknown liabilities, including litigation and related matters, arising from any business conducted by SG or previously conducted by us to the extent that such business is not part of the businesses currently conducted by us. The liabilities for which SG will indemnify us include the costs of legal fees and related expenses incurred in connection with the indemnified matters as well as any settlements or awards. Under the Indemnification Agreement, we have agreed to indemnify SG for all claims made after our IPO to the extent they relate to the businesses currently conducted by us and were not known or threatened at the time of our IPO. All of our material pending legal proceedings are described below. Certain of these material proceedings, along with certain other immaterial known, pending or threatened litigations and arbitrations, are subject to indemnification by SG under the Indemnification Agreement.

Gruttadauria Matters

In January 2002, we learned that Frank Gruttadauria ("Gruttadauria"), a former employee of SG Cowen Securities Corporation's ("SGCSC's") retail brokerage business that was sold in October 2000, had defrauded numerous customers and misappropriated their assets at various firms that had employed him, including us. Following the discovery of Gruttadauria's fraud, numerous former customers commenced or threatened to commence lawsuits and arbitrations against us arising out of Gruttadauria's actions. In addition, government and regulatory authorities initiated investigations of the matter. We cooperated fully with all of the governmental and regulatory investigations and all known regulatory matters arising out of Gruttadauria's conduct were resolved in 2003. To date, we have either settled or arbitrated all known customer claims or actions, except one. To the extent that we incur additional legal fees or pay any fine or monetary sanction in connection with Gruttadauria's actions, we will be indemnified by SG.

Lernout & Hauspie Litigation

We are one of several defendants named in lawsuits involving Lernout & Hauspie Speech Products, N.V. ("L&H"):

> *In Rocker Management, L.L.C., et al. v. Lernout & Hauspie Speech Products, N.V., et al.*, Civil Action No. 00-CV-5965 (D.N.J.) filed in the United States District Court for the District of New Jersey, on December 8, 2000, short-sellers of L&H stock allege that we violated federal securities laws and state common law by participating in a scheme to artificially inflate L&H's stock price through our role as underwriter and adviser for L&H on several acquisitions and through our published research on L&H. On April 3, 2001, we filed a motion to dismiss which was denied by the Court and we subsequently filed an answer denying liability. On November 10, 2006, we filed a motion for summary judgment seeking dismissal of all claims. That same day the plaintiffs filed a motion for spoliation sanctions against us in which they sought, alternatively, the striking of our answer or an adverse jury instruction. On July 12, 2007, the Court denied plaintiffs' motion for spoliation sanctions. On September 24, 2007, the Court denied our summary judgment motion but granted an interlocutory appeal on certain issues. The parties filed petitions with the United States Court of Appeals for the Third Circuit seeking permission to appeal different aspects of the Court's prior rulings, both of which have now been denied. Discovery in the case is continuing and no definitive trial date has been set. To the extent that we incur additional legal fees or pay any fine or monetary sanction, we will be indemnified by SG.

In re: Initial Public Offering Securities Litigation

We are one of many financial institutions named as defendants in a number of putative securities class actions entitled *In re: Initial Public Offering Securities Litigation*, filed in the United States District Court for the Southern District of New York ("SDNY") relating to numerous initial and other public offerings of common stock from approximately 1998 through 2000. The various complaints allege that the underwriters of certain IPOs, including us, made material misrepresentations and omissions to purchasers of the stock sold in the IPOs, thereby inflating the value of the stock. Specifically, the plaintiffs allege that the defendants failed to disclose, among other things, the purported existence of improper tie-in and compensation arrangements they had with certain purchasers of the stock and alleged conflicts of interest relating to research published by the underwriters, all in violation of federal securities laws. The district court granted plaintiffs' motion to certify six "focus" cases as class actions. We are a named defendant in four of these "focus" cases. We appealed the class certification decision to the Second Circuit Court of Appeals (the "Second Circuit") and on December 4, 2006, the Second Circuit reversed the SDNY's decision and remanded the matter for reconsideration in light of the Second Circuit's opinion. Plaintiffs petitioned for rehearing and rehearing en banc by the Second Circuit. On December 14, 2006, the SDNY stayed discovery in the consolidated banc. On April 6, 2007, the Second Circuit denied plaintiffs' petition for rehearing en banc. Plaintiffs have amended their complaints and revised their class definitions in an attempt to comply with the Second Circuit's December 4, 2006 decision. Defendants in the six focus cases, including us, have moved to dismiss the amended complaints in each case. Briefing on that motion was completed on January 28, 2008. Defendants in the six focus cases, including us, also have opposed plaintiffs' motion for class certification in each of the six focus cases. Briefing on that motion is scheduled to be completed on April 22, 2008. To date, no new classes have been certified. To the extent that we incur additional legal fees or pay any fine or monetary sanction, we will be indemnified by SG.

IPO Antitrust Actions

We and other underwriters are defendants in two separate, but related, antitrust actions alleging that the underwriter defendants conspired to fix IPO underwriting fees at 7%. On February 11, 1999, the SDNY consolidated three actions brought by purchasers of securities in IPOs under the caption *In re Public Offering Fee Antitrust Litigation*, 98 Civ. 7890 (LMM). In that action, plaintiffs' damages claims were dismissed by the SDNY, but their claims for injunctive relief remain pending. In a related case, on April 10, 2001, the SDNY consolidated several actions filed by certain issuers of IPOs under the caption *In re Issuer Plaintiff Initial Public Offering Antitrust Litigation*, No. 00 Civ. 7804 (LMM). In this action, the damages are unspecified and the SDNY denied the defendants' motion to dismiss. On April 18, 2006, the SDNY denied the issuer plaintiffs' motion for class certification and ordered further briefing on the investor plaintiffs' motion for class certification. The plaintiffs have also filed a joint motion for summary judgment on liability and the issuers have filed a motion for leave to amend their Consolidated Class Action Complaint. The SDNY proceedings in both actions were stayed pending resolution of the issuers' motion for class certification, which was on appeal. On September 11, 2007, the Second Circuit reversed the SDNY's decision and remanded for further proceedings to determine whether or not certification of an issuer class is appropriate, including whether factual questions relevant to antitrust injury are common to the class or are individual to each class member, whether common questions predominate, and whether certification of part of the case may be appropriate as to particular issues. All other SDNY proceedings remain stayed pending further briefing and the SDNY's determination of the class certification issues. To the extent that we incur additional legal fees or pay any fine or monetary sanction, we will be indemnified by SG.

Adelphia Communications Corp. Litigation

We are a named defendant in several litigations relating to Adelphia Communications, a cable company that filed for bankruptcy in June 2002. The complaints generally allege that the Rigas family, who controlled Adelphia, took advantage of Adelphia's assets, including through the use of certain loans, or "co-borrowing facilities," that allowed the family to take more than $3 billion for their private use. We have been named as a defendant in four actions arising out of certain offerings of Adelphia securities in which we participated as a member of the underwriting syndicate. All four actions are pending before the SDNY. The complaints in each of these actions raise a variety of claims arising out of the sale of Adelphia securities, including claims under the federal securities laws.

These actions are generally referred to as the "Adelphia Securities Class Action", "W.R. Huff Asset Management", "Appaloosa", and "Stocke." The SDNY granted our motion to dismiss all federal securities claims brought against us in the Adelphia Class Action. Thereafter, the financial institution defendants reached a settlement with the plaintiffs. On June 15, 2006, the SDNY preliminarily approved the settlement. A fairness hearing was held on November 10, 2006, and the settlement was approved on November 20, 2006. Our share of the settlement is approximately $1.7 million plus interest at 4.37% beginning December 1, 2006 (all of which is covered by the Indemnification Agreement). In November 2006, this amount was placed in an attorneys' escrow account bearing the required rate of interest. On December 8, 2006, a group of class members appealed the order approving the settlement agreement with the class plaintiffs to the Second Circuit. Oral argument was held on the appeal on November 30, 2007. If approval of the settlement is upheld on appeal or otherwise becomes final, claims made by all class members who did not opt out (including plaintiffs in Stocke) will be dismissed and released. The SDNY also has granted in part, and denied in part, certain motions to dismiss filed by various defendants, including us, in Huff, Appaloosa and Stocke, but has not ruled on other potential bases for dismissal set forth in our motions in Huff and Stocke. In addition, in August 2005, the SDNY denied our motion to dismiss based on Huff's lack of standing, and subsequently granted leave to file an interlocutory appeal to the Second Circuit of that ruling. The Second Circuit granted our petition to appeal under 28 U.S.C. § 1292. Oral argument was held on the appeal on November 7, 2007, and that appeal is pending. In addition to the cases in which we have been named as a defendant, we may also face potential liability pursuant to the applicable master agreements among underwriters for any judgments or settlements in other cases involving the Adelphia securities offerings in which we participated. To the extent that we incur additional legal fees or pay any fine or monetary sanction, we will be indemnified by SG.

We are also one of many defendants in two related adversary proceedings pending before the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court"). These adversary proceedings were filed originally by the Official Committee of Unsecured Creditors (the "Creditors' Committee") and the Official Committee of Equity Security Holders (the "Committees"). Both of these cases raised a variety of common law and federal claims, which are generally similar to the claims asserted in the Adelphia cases described above. With respect to us and other investment banks, the complaints taken together originally set forth claims for violation of the Bank Holding Company Act, equitable disallowance or equitable subordination, breach of fiduciary duty, aiding and abetting breach of fiduciary duty, aiding and abetting fraud, gross negligence and breach of contract, among others. We filed motions to dismiss the claims asserted by the Committees, which were ultimately denied in part, and granted in part, by the Bankruptcy Court in two decisions issued on June 11, 2007 and August 17, 2007, respectively. We appealed those portions of the Bankruptcy Court's June 11, 2007 decision that denied our motion to dismiss the claims asserted against us by the Creditors' Committee. On January 17, 2008, the SDNY denied our appeal and affirmed, in part, the June 11, 2007 decision, but dismissed the Bank Holding Company Act claim against us and the other investment banks.

As part of the bankruptcy plan confirmation process, claims by both Committees were assigned to a litigation trust, which in October 2007, filed an amended complaint against us in which it repleaded the following claims: aiding and abetting fraud; fraudulent concealment; fraud; equitable disallowance; equitable subordination; and violation of the Bank Holding Company Act (which was dismissed on appeal to the SDNY). On January 4, 2008, we filed an Answer to the Amended Complaint and a joinder to a Motion filed by certain Investment Banks seeking a dismissal of several counts in the Amended Complaint. To the extent that we incur additional legal fees or pay any fine or monetary sanction, we will be indemnified by SG.

In re: HealthSouth Corporation Bondholder Litigation

We have been named as a defendant in a purported class action filed in the United States District Court for the Northern District of Alabama on January 8, 2004 as a result of our predecessor's involvement as one of the initial purchasers in a March 1998 private placement of debt securities issued by HealthSouth Corporation, which were subsequently exchanged for materially identical registered securities. The complaint alleges that the offering materials for the private placement and the registration statement in the associated offering violated federal securities laws by failing to disclose HealthSouth's subsequently revealed accounting irregularities. On June 8, 2006, the District Court, among other things, dismissed the claims arising out of the March 1998 private placement (the only claims against us). On August 21, 2006, following plaintiffs' subsequent submission of amendments to the complaint, the District Court so-ordered a stipulation and order dismissing all amended counts against us. The dismissal is not yet a "final" judgment from which an appeal may be taken by plaintiffs. To the extent that we incur additional legal fees or pay any fine or monetary sanction, we will be indemnified by SG.

Crossroads Systems, Inc. Litigation

We are one of three underwriter defendants in a lawsuit filed in the District Court of Travis County, Texas, on May 24, 2006 by Crossroads Systems, Inc., a company that designs, develops, and manufactures computer storage devices. The lawsuit alleges that the underwriters of Crossroads' 1999 IPO, lead-managed by us, purposely underpriced the IPO for their own improper purposes. Specifically, Crossroads alleges that the underwriter defendants allocated stock to favored clients who shared their profits with the underwriters either directly or indirectly through excessive trading commissions in connection with the IPO stock and/or unrelated securities trading. Crossroads sets forth causes of action for breach of fiduciary duty, fraud, and unjust enrichment. The damages are unspecified. In July 2006, we filed an answer denying the allegations of the complaint. On October 4, 2007, we filed and argued a motion for summary judgment, which was denied after the close of argument. On October 17, 2007, two former Crossroads executives who personally sold shares to the underwriting syndicate in connection with the IPO, petitioned to intervene, making allegations substantially similar to those of Crossroads and asserting claims for breach of fiduciary duty, fraud, statutory fraud and unjust enrichment. Their damages also are unspecified. Discovery in the case continues and a trial date has been set for June 2008. To the extent that we incur additional legal fees or pay any fine or monetary sanction, we will be indemnified by SG.

Madden Litigation

On June 28, 2006, a group of approximately 60 medical doctors filed a lawsuit against us in San Francisco Superior Court. Plaintiffs allege that we negligently rendered a fairness opinion in 1998 in connection with the acquisition of Orange Coast Managed Care Services and St. Joseph Medical Corporation by FPA Medical Management, Inc. ("FPA"). According to the complaint, plaintiffs received restricted FPA stock as consideration in the sale and, shortly after the acquisition, FPA went bankrupt, rendering the stock worthless. On August 14, 2006, we removed the case to the United States District

Court for the Northern District of California. On August 17, 2006 we filed a motion to dismiss the complaint. Plaintiffs sought a remand to state court. On March 18, 2007, the Court granted our motion to dismiss, with leave to replead, and denied plaintiffs' move to remand. By stipulation and order dated April 20, 2007, the Court directed entry of a final judgment dismissing the complaint with prejudice. On May 17, 2007, plaintiffs filed with the United States Court of Appeals for the Ninth Circuit, a Notice of Appeal of the District Court's dismissal. The appeal has been fully briefed by us and plaintiffs. The Ninth Circuit has not yet scheduled oral argument. To the extent that we incur additional legal fees or pay any fine or monetary sanction, we will be indemnified by SG.

Stanton Litigation

On June 6, 2005, SGC Partners I LLC, SGC Partners II LLC, SG Merchant Banking Fund, SG Capital Partners LLC and former employees of SGCSC were served with a First Amended Complaint in a case entitled *Janice E. Stanton v. SGC Partners I, LLC*, Case No. 02-40208, Adv. No. 05-40145 ("Stanton I"). The action was brought in connection with the bankruptcy proceeding filed by House of Lloyd ("HOL") pending in that court. The Trustee seeks damages based on claims of breach of fiduciary duty, corporate waste, fraudulent transfers, insider preferences and illegal distributions. On December 29, 2006, the Trustee filed a separate complaint against us, Cowen Capital Partners, LLC, and SG Americas Securities, LLC ("SGAS") in a case entitled *Janice E. Stanton v. Cowen and Company, LLC* et al., Case No. 02-40208, Adv. No. 06-04283 based on virtually identical facts alleged in Stanton I arising out of the HOL bankruptcy. The complaint further alleges that we owned and controlled the Defendants in Stanton I and/or that we are the successor of the defendants in Stanton I. The two cases have been consolidated. Both we and the Trustee have filed separate motions for summary judgment and a trial date has been scheduled for April 22, 2008. To the extent that we incur additional legal fees or pay any fine or monetary sanction, we will be indemnified by SG.

WorldSpace Litigation

We are named as an underwriter defendant in several putative securities class actions brought in the SDNY in 2007. In all of the cases brought to date, plaintiffs seek to recover for losses allegedly caused by misrepresentations and omissions in connection with the August 4, 2005 IPO of WorldSpace, Inc., a satellite-radio provider. The complaints allege that the WorldSpace prospectus referenced a subscriber count that improperly included subscribers who had stopped paying for the service and failed to disclose that WorldSpace lacked the internal systems necessary to accurately determine the number of subscribers to its service. On June 21, 2007, the SDNY issued an order consolidating the actions and appointing a lead plaintiff. The consolidated amended complaint was filed on August 9, 2007. On October 9, 2007, we filed a motion to dismiss the consolidated amended complaint and that motion is now fully briefed.

China Sunergy Litigation

We are named as one of several underwriter defendants in two cases filed in the SDNYin 2007. Plaintiffs in both cases seek to recover for losses allegedly caused by misrepresentations and omissions in the May 17, 2007 IPO of China Sunergy Co. Ltd ("China Sunergy"). Principally, the complaints allege that China Sunergy's prospectus failed to disclose that China Sunergy was having difficulty obtaining sufficient raw materials to achieve its revenue objectives, and also failed to disclose that China Sunergy would likely face a loss in the second quarter of 2007. The court has yet to appoint a lead Plaintiff.

BigBand Litigation

We are one of five underwriter defendants named in putative securities class actions filed in the United States District Court for the Northern District of California ("Federal Securities Actions") and the Superior Court for the State of California, County of San Francisco ("State Securities Action") during 2007 relating to the March 15, 2007 IPO of BigBand Networks, Inc ("BigBand"). The complaints in each of these actions allege claims under the federal securities laws and generally allege, among other things, that BigBand's Registration Statement and Prospectus contained material misrepresentations or omissions with respect to BigBand's growth plan, projections and internal controls. Defendants removed the State Securities Action to the United States District Court for the Northern District of California, pursuant to a notice of removal filed on January 2, 2008. Plaintiffs have moved to remand that action back to state court. The Federal Securities Actions have been consolidated and a lead Plaintiff has been appointed.

Regulatory Inquiries and Investigations

In addition to the litigation matters described above, we are also involved in a number of regulatory inquiries and investigations, which, except as noted below, are not covered by the Indemnification Agreement. The most significant regulatory matters are as follows:

The SEC commenced an investigation arising out of the proprietary trading activities of Guillaume Pollet, a former Managing Director and proprietary trader in the former equity derivatives division of SGCSC (which is now part of SGAS, a former affiliate), who was terminated by us in 2001 for violating firm policy and misleading the firm's management about certain of his trading activity. The trading activity at issue involved private placements in public equity ("PIPEs"). We received a Wells Notice in July 2004, and submitted a response in August 2004. In July 2007, SGAS informed us that it will agree to be the named corporate respondent under the terms of a proposed settlement that SGAS is currently discussing with the staff of the SEC. To the extent that we incur additional legal fees or pay any fine or monetary sanction, we will be indemnified by SG.

We have provided various data and information to the NASD (now known as FINRA) in response to its request for information as part of an industry-wide "sweep" relating to gifts, gratuities and entertainment policies, practices, and procedures. In addition, we have also received a subpoena for documents and information from the SEC, and additional requests for information from FINRA, seeking information concerning, among other things, gifts, gratuities and entertainment and the use of one of our error accounts primarily involving an unaffiliated mutual fund company. In the fourth quarter of 2007, FINRA requested additional documentation, including emails, from us, took sworn testimony from certain of our current and former employees, and engaged us in discussions regarding the scope and conduct of the investigation relating to the use of error accounts. We are cooperating fully with these continuing investigations.

We received requests for documents and information from the SEC's Office of Compliance Inspections and Examinations seeking documents and certain financial and other information concerning, among other things, our various trading desks, institutional sales team and internal accounts, including error accounts, and related compliance procedures. We are cooperating fully with this inquiry.

In October 2004, we received a request from the NYSE (now known as FINRA), as part of an industry-wide "sweep," for data and information relating to our compliance with provisions of the federal securities laws, and related rules and regulations, concerning delivery of prospectuses and/or product descriptions in connection with customer purchases of, among other things, new issue securities, mutual funds and exchange-traded funds. We have provided periodic reports to FINRA concerning our progress in responding to their request and will continue to cooperate fully with this continuing inquiry. We will be indemnified by SG in part against any liabilities, including legal fees that arise out of any future litigation or the pending regulatory investigation relating to this matter.

In December 2007, we, along with 18 other firms, reached a settlement with FINRA with respect to overstatement of advertised trade volume in certain securities. We did not admit or deny the charges and agreed to pay a fine and revise our written supervisory procedures.

Item 4. Submission of Matters to a Vote of Security Holders

None.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Stock Price Information and Stockholders

The principal market on which the Company's common stock is traded is the Nasdaq Global Market under the symbol "COWN." The following table sets forth the quarterly high and low sales price of our common stock for 2007 and 2006. The information presented for 2006 includes the third quarter from the date of our IPO and the fourth quarter. As of March 11, 2008 there were 18 registered holders of our common stock. This number does not include stockholders for whom shares were held in "nominee" or "street" name.

	Sales Price	
	High	**Low**
Fiscal 2007		
Fourth Quarter	$ 14.90	$ 8.81
Third Quarter	$ 18.82	$ 11.29
Second Quarter	$ 19.91	$ 15.90
First Quarter	$ 21.48	$ 16.54
Fiscal 2006		
Fourth Quarter	$ 21.40	$ 14.45
July 13, 2006 to September 30, 2006	$ 16.73	$ 13.40

Dividends

The Company has not declared or paid any cash dividends on our common stock. Our board of directors does not anticipate authorizing the payment of cash dividends in the foreseeable future and intends to retain all available funds and any future earnings to fund the development and growth of our business. Any determination to pay dividends to holders of our common stock in the future will be at the discretion of our board of directors and will depend on many factors, including our financial condition, results of operations, general business conditions and any other factors our board of directors deems relevant.

Recent Sales of Unregistered Securities

None.

Issuer Purchases of Equity Securities

On November 7, 2007, the Company's Board of Directors authorized a share buyback program to repurchase up to 2.0 million shares that meet certain pricing criteria. The Board approved the Company's decision to permanently retire the repurchased shares effective November 8, 2007. For the period ended December 31, 2007, the Company repurchased 1.4 million of its own shares in the open market which have been permanently retired. Subsequent to December 31, 2007, the Company repurchased and permanently retired an additional 0.5 million shares at an average cost per share of $9.29 per share. The repurchase program is funded through the return of capital to the Company from Cowen. For more information about the repurchase program see Note 17 to the Consolidated Financial Statements in Part IV, Item 15, in this Annual Report Form 10-K.

The table below sets forth the information with respect to purchases made by or on the behalf of the Company or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934, as amended), of our common stock during the quarter ended December 31, 2007.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
Month 1 (November 7 November 30, 2007)				
Common stock repurchases(1)	684,300	$ 10.30	684,300	1,315,700
Month 2 (December 1, 2007 December 31, 2007)				
Common stock repurchases(1)	732,500	$ 10.26	732,500	583,200
Total (November 7, 2007 December 31, 2007)	1,416,800	$ 10.28	1,416,800	583,200

(1) The Company has an ongoing common stock repurchase program, pursuant to which the Company repurchases shares in the open market. As announced in November 2007 the Company's Board of Directors authorized the repurchase, subject to market conditions, of up to 2.0 million shares of the Company's outstanding common stock.

Item 6. Selected Financial Data

The following table sets forth our selected consolidated financial and other data for the years ended December 31, 2007, 2006, 2005, 2004 and 2003. The selected Consolidated Statements of Financial Condition data and Consolidated Statements of Operations data as of and for the years ended December 31, 2007, 2006, 2005, and 2004 have been derived from our audited consolidated financial statements. The selected Consolidated Statements of Operations data as of and for the year ended December 31, 2003 was derived from our audited consolidated financial statements, whereas the selected Consolidated Statement of Financial Condition data for that same period was derived from our unaudited financial statements. Our selected consolidated financial data is only a summary and should be read in conjunction with the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and with our audited consolidated financial statements and related notes included elsewhere in this Annual Statement on Form 10-K.

	Year Ended December 31,				
	2007	2006	2005	2004	2003
	(in thousands)				
Consolidated Statements of Operations Data:					
Revenues					
Investment banking	$ 90,520	$ 164,342	$ 126,253	$ 113,795	$ 104,863
Brokerage	158,720	159,879	145,700	164,188	174,382
Interest and dividend income	8,284	17,766	16,990	9,504	12,302
Other	4,045	2,980	5,348	5,574	1,412
Total revenues	261,569	344,967	294,291	293,061	292,959
Expenses					
Employee compensation and benefits	177,948	215,707	172,128	170,546	156,202

	Year Ended December 31,				
Non-compensation expense[1]	103,226	112,644	109,848	63,533[2]	210,976[3]
Total expenses	281,174	328,351	281,976	234,079	367,178
Operating (loss) income	(19,605)	16,616	12,315	58,982	(74,219)
Gain (loss) on exchange memberships	1,775	25,843	918	(1,993)	(1,195)
(Loss) income before income taxes	(17,830)	42,459	13,233	56,989	(75,414)
(Benefit) provision for income taxes	(6,509)	4,548	1,152	1,877	(1,040)
Net (loss) income	$ (11,321)	$ 37,911	$ 12,081	$ 55,112	$ (74,374)

Earnings (loss) per share:					
Weighted average common shares outstanding:					
Basic	12,805	12,903	12,900	12,900	12,900
Diluted	12,805	12,966	12,900	12,900	12,900
Earnings (loss) per share:					
Basic	$ (0.88)	$ 2.94	$ 0.94	$ 4.27	$ (5.77)
Diluted	$ (0.88)	$ 2.92	$ 0.94	$ 4.27	$ (5.77)

(1) Includes floor brokerage and trade execution, net service fees, communications, occupancy and equipment, marketing and business development, depreciation and amortization, interest and other expenses.

(2) Includes a net benefit of $46.9 million related to accruals for insurance recoveries and the net reversal of previously accrued reserves in 2004.

(3) Includes a charge of $71.7 million related to loss contingency reserves established in 2003.

	As of December 31,				
	2007	2006	2005	2004	2003
					(unaudited)
	(in thousands)				
Consolidated Statements of Financial Condition Data:					
Total assets	$ 349,038	$ 684,438	$ 785,339	$ 820,350	$ 717,980
Total liabilities	140,383	466,310	411,388	466,872	455,037
Total stockholders' equity (2007 and 2006) and group equity (2005-2003)	$ 208,655	$ 218,128	$ 373,951	$ 353,478	$ 262,943

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

The following discussion should be read in conjunction with our audited consolidated financial statements and the related notes that appear elsewhere in this Annual Report. In addition to historical information, this discussion includes forward-looking information that involves risks and assumptions, which could cause actual results to differ materially from management's expectations. See "Special Note Regarding Forward-Looking Statements" included elsewhere in this Annual Report on Form 10-K.

Overview

We are an investment bank dedicated to providing superior research, brokerage and investment banking services to companies and institutional investor clients primarily in the healthcare, technology, telecommunications, alternative energy, consumer and aerospace & defense sectors. As of December 31, 2007 our research and brokerage services were provided to over 1,000 domestic and international clients seeking to trade equity, and equity-linked securities, principally in our target sectors. We focus our investment banking efforts, principally equity and equity-linked capital raising and strategic advisory services, on small and mid-capitalization public companies as well as private companies. We operate through a single reportable segment.

The securities business is a human capital business; accordingly, compensation and benefits comprise the largest component of our expenses, and our performance is dependent upon our ability to attract, develop and retain highly skilled employees who are motivated and committed to provide the highest quality of service and guidance to our clients.

During 2007, we executed on the following initiatives in connection with our growth strategy:

- We expanded our target sectors to include aerospace & defense and telecommunications investment banking;

We expanded our alternative asset management platform by establishing CHRP, which manages an investment program that invests principally in commercial-stage biopharmaceutical and med-tech products and companies;

We established our asset management business through the formation of CAM US and CAM UK. CAM US focuses on a growth-oriented investment style centered on small and mid-sized companies based primarily in North America whose stocks are listed on the major exchanges. CAM US also serves as the investment manager for an equity long-short hedge fund. CAM UK provides traditional asset management products, focusing on a global equity strategy.

We plan to continue to focus on the growth of our investment banking, brokerage and asset management businesses. Our growth initiatives will require investments in personnel and other expenses, which may have a short-term negative impact on our profitability as it may take time to develop meaningful revenues from our growth initiatives. Our ability to successfully execute on our growth plans is dependent upon favorable market conditions.

External Factors Impacting Our Business

Many external factors affect our revenues and profitability, including economic and market conditions, the level and volatility of interest rates, inflation, political events, investor sentiment, legislative and regulatory developments and competition. A favorable business environment is characterized by many factors, including a stable geopolitical climate, transparent financial markets, low inflation, low interest rates, low unemployment, strong business profitability and high business and investor confidence. These factors influence levels of equity security issuance and merger and acquisition activity generally and in our target sectors, which affect our investment banking business. The same factors also affect trading volumes and valuations in secondary financial markets, which affect our brokerage business. Commission rates, market volatility and other factors also affect our brokerage revenues and may cause these revenues to vary from period to period. Because these business environment issues are unpredictable and beyond our control, our earnings may fluctuate significantly from period to period. We are also subject to various legal and regulatory actions that impact our business and financial results.

The second half of 2007 provided a challenging market environment. While not directly exposed to the mortgage and credit crises, financial services firms generally were negatively impacted, as we were, in the form of fewer and smaller investment banking and capital-raising transactions. However, our brokerage business benefited from increased volatility during 2007, and remains well-positioned in an increasingly competitive market.

In addition, our business focuses primarily on small to mid-capitalization and private companies in specific industry sectors. These sectors may experience growth or downturns independently of general economic and market conditions, or may face market conditions that are disproportionately better or worse than those impacting the economy and markets generally. Therefore, our business could be affected differently than overall market trends.

Recent Developments

Management Changes

Effective March 4, 2008, Kim S. Fennebresque, formerly Chairman, President and Chief Executive Officer of the Company, retired as President and Chief Executive Officer. Mr. Fennebresque will remain employed as a Senior Advisor to the Company and will serve as Non-Executive Chairman of the Company's Board of Directors. David M. Malcolm, formerly Executive Vice Chairman of the Company, was appointed President and Chief Executive Officer, effective as of the same date. Mr. Malcolm was also appointed to the Board of Directors.

In connection with Mr. Fennebresque's retirement, he forfeited, in its entirety, the equity award of 975,000 restricted shares he received in connection with the Company's IPO (the "IPO Award"). Mr. Fennebresque will continue to vest in the equity awards he received as part of his 2006 and 2007 annual compensation.

The Company expects to record an adjustment of approximately $5.1 million in the first quarter of 2008 to reverse amounts previously expensed in 2006 and 2007 associated with the IPO Award. This adjustment will be partially offset by the reversal of associated income tax benefits of approximately $2.2 million. As a result of the forfeiture of the IPO Award, the future estimated annual expense associated with the initial grant of equity to the Company's senior employees in connection with the Company's IPO will decrease by approximately $3.5 million in the years 2008, 2009, and 2010, respectively. In addition, the remaining $0.8 million expense associated with the equity awards Mr. Fennebresque received as part of his 2006 and 2007 annual compensation will be expensed in the first quarter of 2008, as there is no longer a service period requirement relating to these awards.

Acquisition of Latitude Holdings Limited

On March 7, 2008, the Company announced that it has signed a definitive agreement with the stockholders of Latitude Holdings Limited ("LHL") to acquire 100% of LHL. LHL, through its wholly-owned subsidiaries, operates Latitude Capital Group, a boutique investment bank headquartered in Hong Kong with offices in mainland China. Subject to customary closing conditions and Hong Kong SFC approval, the transaction is expected to close in the second quarter of 2008. The anticipated consideration to be paid by the Company at closing is not expected to be material.

Basis of Presentation

Our consolidated financial statements for periods prior to July 13, 2006 include the carve-out accounts of Cowen and the carve-out accounts of SG London Branch, the predecessor of CIL, in each case using the historical basis of accounting for the results of operations, assets and liabilities of the businesses that currently constitute Cowen and CIL. The consolidated financial information included herein, for periods prior to July 13, 2006, may not necessarily be indicative of our results of operations, financial condition and cash flows in the future or what our results of operations, financial condition and cash flows would have been had we been a stand-alone company during the entire periods presented.

The Consolidated Statements of Operations do not include litigation expenses incurred by us in connection with certain litigation and other legal matters that are indemnified by SG through the Indemnification Agreement. The legal reserves related to these indemnified matters are included in legal reserves and legal expenses payable in the Consolidated Statements of Financial Condition. Before becoming a public company, payments related to these matters were included in the Consolidated Statements of Cash Flows as financing activities because we were a wholly-owned subsidiary of SG. Since we became a public company, these payments have been included as operating activities. The effect of this indemnification on our consolidated results of operations is that when a future increase to a loss contingency reserve that is related to litigation covered by the Indemnification Agreement is recorded, the litigation cost and the indemnification recovery will be reflected as an increase in litigation and related expense and the indemnification recovery will be recorded as a reduction to our litigation and related expense. See Note 10 of the Notes to the Consolidated Financial Statements, "Commitments, Contingencies and Guarantees" and Note 11 of the Notes to the Consolidated Financial Statements, "Separation from Société Générale and Other Related Matters" for further discussion.

The consolidated financial statements include the accounts of the Company, its subsidiaries and entities in which it has a controlling financial interest. All intercompany accounts and transactions have been eliminated upon consolidation. Certain reclassifications have been made to conform prior-period amounts to the current-period presentation, including (i) the reclassification of $7.0 million and $5.6 million from communications expense to floor brokerage and trade execution expense in the Consolidated Statements of Operations for the years ended December 31, 2006 and 2005, respectively, (ii) litigation and related expenses of $4.4 million and $6.9 million have been reclassified to other expense in the Consolidated Statements of Operations for the years ended December 31, 2006 and 2005, respectively, (iii) commissions of $93.3 million and $93.5 million for the years ended December 31, 2006 and 2005, respectively and principal transactions of $64.4 million and $52.3 million for the years ended December 31, 2006 and 2005, respectively, have been combined for those years into a new revenue line named brokerage in the Consolidated Statements of Operations and (iv) the reclassification of $2.2 million related to fees paid to us for equity research from other revenue to the new revenue line called brokerage in the Consolidated Statements of Operations for the year ended December 31, 2006.

Revenues

We operate our business as a single segment; however, we derive the vast majority of our revenues from two primary sources, investment banking and brokerage.

Investment Banking

We earn investment banking revenue primarily from fees associated with underwriting and privately placing securities and from providing strategic advisory services in mergers and acquisitions and similar transactions. Our investment banking revenues are derived primarily from small and mid-capitalization companies within our target sectors of healthcare, technology, telecommunications, alternative energy, consumer, and aerospace & defense.

Underwriting fees. We earn underwriting revenues in securities offerings in which we act as an underwriter, such as IPOs, follow-on equity offerings and convertible security offerings. Our underwriting revenues include management fees, selling concessions and underwriting fees. Fee revenue relating to underwriting commitments is recorded when all significant items relating to the underwriting cycle have been completed and the amount of the underwriting revenue has been determined. This generally is the point at which all of the following have occurred: (i) the issuer's registration statement has become effective with the SEC, or the other offering documents are finalized, (ii) the Company has made a firm commitment for the purchase of shares from the issuer, and (iii) the Company has been informed of the number of shares that it has been allotted. As co-manager for registered equity underwriting transactions, management must estimate the Company's share of transaction related expenses incurred by the lead manager in order to recognize revenue. Transaction related expenses are deducted from the underwriting fee and therefore reduce the revenue the Company recognizes as co-manager. Such amounts are adjusted to reflect actual expenses in the period in which the Company receives the final settlement, typically within 90 days following the closing of the transaction.

Private placement fees. We earn agency placement fees in non-underwritten transactions such as private placements, PIPEs and Registered Direct transactions ("RDs"). We record private placement revenues when the services for the transactions are completed under the terms of each assignment or engagement and collection is reasonably assured. Expenses associated with such transactions are deferred until the related revenue is recognized or the engagement is otherwise concluded.

Strategic/financial advisory fees. Our strategic advisory revenues include success fees earned in connection with advising companies, both buyers and sellers, principally in mergers and acquisitions. We also earn fees for related advisory work such as providing fairness opinions. We record strategic advisory revenues when the services for the transactions are completed under the terms of each assignment or engagement and collection is reasonably assured. Expenses associated with such transactions are deferred until the related revenue is recognized or the engagement is otherwise concluded.

Since our investment banking revenues are generally recognized at the time of completion of each transaction or the services to be performed, these revenues typically vary between periods and may be considerably affected by the timing of the closing of significant transactions.

Brokerage

Our brokerage revenues consist of commissions, principal transactions and fees paid to us for equity research. Our management reviews brokerage revenue on a combined basis as the vast majority of the revenue is derived from the same group of clients. In addition, the majority of our trading gains and losses are a result of activities that support the facilitation of client orders in both listed and over-the-counter securities, although all trading gains and losses are recorded in brokerage. We derive our brokerage revenue primarily from trading equity and equity-linked securities on behalf of institutional investors.

Commissions. Our brokerage business generates commission revenue from securities trading commissions paid by institutional investor clients. Commissions are recognized on a trade date basis. The Company permits 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. Commissions on soft dollar brokerage are recorded net of the related expenditures on an accrual basis.

Principal transactions. Our brokerage revenues also include net trading gains and losses from principal transactions, which primarily include acting as a market-maker in over-the-counter equity securities, listed options trading, trading of convertible securities, and from trading gains and losses on firm inventory positions, which include warrants previously received as part of investment banking transactions. In certain cases, we commit our own capital to provide liquidity to clients buying or selling blocks of shares of listed stocks without previously identifying the other side of the trade at execution, which subjects us to market risk. These positions are typically held for a very short duration.

Equity research fees. Our brokerage revenues also include fees paid to us for providing equity research. These fees are recognized as revenue when they are earned.

Interest and Dividend Income

Interest and dividend income primarily consists of interest earned on our interest bearing assets and interest and dividends on securities maintained in trading accounts related to our brokerage business.

Other

Other revenue includes fees for managing assets and investments for private equity, asset management and alternative asset management funds, fees for managing a portfolio of merchant banking investments on behalf of SG and other third party investors, and miscellaneous income such as fees for managing venture capital investments. Management fees are recognized in the periods during which the related services are performed and the amounts have been contractually earned.

Expenses

A significant portion of our expense base is variable, including employee compensation and benefits, brokerage and clearance, communications, and marketing and business development expenses.

Certain of our expenses are largely fixed in nature, the most significant of which include expenses associated with rent and occupancy, outsourced services such as information technology infrastructure, presentation center, copy center and library services.

Compensation Expense

Our ongoing compensation expense includes salaries, employee benefits, amortization of equity compensation awards and cash bonuses. The annual base salary for each individual employee is based on their experience and position, but generally does not exceed $250 thousand. Amortization expense of equity awards relates to both the compensation expense associated with the initial grant of equity to our senior employees (as described below) in connection with our IPO and the expense associated with awards under our ongoing equity and incentive plans. A significant portion of our equity awards are granted as a component of annual employee compensation. As such, employees who earn total compensation above a designated level will have a specified percentage of their compensation paid with restricted equity awards in lieu of cash. The amount of restricted equity awards paid to an employee is determined using a pre-determined formula such that higher levels of compensation will be more heavily weighted toward equity awards. As is typical in our industry, variable bonuses represent the most significant component of compensation expense.

We seek to incur employee compensation and benefits expense equal to between 58% and 60% of total revenues, plus, through 2011, the compensation expense associated with the initial grant of equity to our senior employees in connection with our IPO. For 2007, we accrued employee compensation and benefits expense above our range as we believe that it was in the best interest of the Company and its shareholders to take reasonable steps to provide competitive compensation for our employees. We may change our target percentages at any time.

The annual expense associated with the initial grant of equity to our senior employees in connection with our IPO was $7.9 million in 2007 and is estimated to be $0.2 million, $2.4 million, $1.1 million, and $0.3 million in the years 2008, 2009, 2010, and 2011, respectively. The expense in 2007 associated with the grant of equity to our senior employees in connection with our IPO included a reversal of $1.9 million, representing the cumulative catch-up adjustment for the change in estimated forfeitures. The estimated future expense amounts include the effect of the forfeiture of shares associated with the resignation of the Company's former Chairman and CEO. See Note 21 "Subsequent Events" of the Notes to the Consolidated Financial Statements included in this Annual Report on Form 10-K.

The annual expense may be adjusted again in the future based on actual forfeiture rates. We have accounted for our equity awards in accordance with SFAS 123(R), *Share-Based Payment* ("SFAS 123R"). Compensation and benefit expense in 2006 included $10.6 million of expense associated with deferred compensation plans that were terminated as a result of our separation from SG.

Non-compensation Expense

Floor brokerage and trade execution. These expenses include floor brokerage and trade execution costs that fluctuate depending on the volume of trades we complete. We entered into a commercial clearing agreement with a new clearing firm and commenced operating under the agreement on January 26, 2007.

Service fees, net. These expenses include fees for outsourcing services, including certain support functions such as information technology infrastructure, management and support, net of fees earned related to presentation center and library services provided by the Company to SG during the years ended December 31, 2006 and 2005, prior to the IPO.

Communications. These expenses include costs for telecommunication and data communication, primarily consisting of expenses for obtaining third-party market data.

Occupancy and equipment. These expenses include rent and utilities associated with our various offices, occupancy and premises taxes, support for software applications and other fixed asset service fees.

Marketing and business development. These expenses include costs such as business travel and entertainment, expenses related to holding conferences and advertising costs.

Depreciation and amortization. We incur depreciation and amortization expense related to capital assets, such as investments in technology and leasehold improvements.

Other. Other expenses include consulting fees, professional fees, legal and related costs, implementation costs related to outsourcing and other projects, insurance premiums, exchange membership fees (net), research delivery costs and other related expenses.

Gain (Loss) on Exchange Memberships

These realized gains or losses are recognized upon the sale, exchange or other disposition of the membership interests or the other-than-temporary impairment of the membership interests.

Provision for Income Taxes

The taxable results of our U.S. operations are included in the consolidated income tax returns of the Company as well as stand alone state and local returns. The U.K. operations tax results are reported by CIL and CAM UK separately in their respective U.K. tax filings. If applicable, CIL and CAM UK share tax losses to the extent permitted by local law.

Historically, the taxable results of our U.S. operations were included in the consolidated income tax returns of SGAI through the IPO date. The tax results of our U.K. operations were historically included in the tax returns of SG London Branch through April 30, 2006. For the period May 1, 2006 through December 31, 2006, the U.K. operations are included in CIL's U.K. tax filing. The U.S. impact of CIL's operations is included in the SGAI consolidated tax returns for the period May 1, 2006 through the IPO date and in the Company's tax filings post-IPO.

The income tax provision reflected in this Annual Report on Form 10-K is presented as if we operated on a stand-alone basis, consistent with the liability method prescribed by SFAS No. 109, *Accounting for Income Taxes*. Under the liability method, deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial statement and income tax purposes, as determined under applicable tax laws and rates. A valuation allowance is provided for deferred tax assets when it is more likely than not that the benefits of net deductible temporary differences and net operating loss carryforwards will not be realized.

Our effective tax rates for the years ended December 31, 2007, 2006 and 2005 were 36.5%, 10.7% and 8.7%, respectively.

The effective tax rate in 2007 differs from the statutory rate of 35% due to the establishment of a valuation allowance against certain stock compensation deferred tax assets offset by a state and local tax benefit. The low effective tax rate in 2006 is primarily the result of a net reversal of valuation allowance due to payments of deferred compensation arrangements related to the IPO and pre-IPO amortization of goodwill. The low effective tax rates in 2005 are primarily attributable to continued net operating losses for tax purposes and a change in the valuation allowance.

The Company's future effective tax rate depends upon the results of the business. If the Company does not have sufficient income in the future, it will not realize future tax benefits, such as future compensation and legal reserve deductions and foreign tax credits. Additionally, if the Company experiences continued losses, deferred tax assets will be subject to impairment through the establishment of a valuation allowance. Moreover, a high concentration of the Company's deferred tax assets is attributable to share-based compensation. To the extent that share-based compensation vests at a share price less than the grant price, such shortfall will result in unfavorable permanent book-tax difference since the tax deduction will be less than the book amortization.

Results of Operations

Year Ended December 31, 2007 Compared with the Year Ended December 31, 2006

Overview

Total revenues decreased $83.4 million, or 24%, to $261.6 million for the year ended December 31, 2007 compared with $345.0 million in 2006. This decrease was primarily due to a decrease in investment banking revenues of $73.8 million and a decrease in interest and dividend income of $9.5 million.

Total expenses decreased $47.2 million, or 14%, to $281.2 million for the year ended December 31, 2007 compared with $328.4 million in 2006, primarily due to a decrease in compensation expense. Compensation expense decreased primarily as a result of the decrease in total revenues, partially offset by an increase of 7% in the accrual ratio of compensation and benefits expense from 58% in 2006 to 65% in 2007. The results in 2007 include $7.9 million of expense associated with the initial grant of equity to our employees in connection with the IPO compared to $5.2 million during 2006. In addition, compensation expense for the year ended December 31, 2006 included $10.6 million associated with the vesting of deferred compensation plans that were terminated as a result of our separation from SG.

Total non-compensation expenses decreased $9.4 million, or 8%, during the year ended December 31, 2007 compared with 2006, primarily due to a decrease in service fees as a result of our separation from SG and a decrease in floor brokerage and trade execution related expenses. These decreases were partially offset by an increase in marketing and development expenses, and depreciation and amortization expense related to leasehold improvements made during 2006 in certain of our offices.

We recorded a net loss of $11.3 million for the year ended December 31, 2007 compared with net income of $37.9 million for the year ended December 31, 2006. Net income for the year ended December 30, 2006 included a one-time gain on exchange memberships of $24.8 million realized upon the consummation of the merger of the NYSE and Archipelago Holdings, Inc. which occurred on March 7, 2006.

The following table provides a comparison of our revenues and expenses for the periods presented:

	Year Ended December 31,		Period-to-Period	
	2007	2006	$ Change	% Change
	(in thousands)			
Revenues				
Investment banking	$ 90,520	$ 164,342	$ (73,822)	(44.9)%
Brokerage	158,720	159,879	(1,159)	(0.7)
Interest and dividend income	8,284	17,766	(9,482)	(53.4)
Other	4,045	2,980	1,065	35.7
Total revenues	261,569	344,967	(83,398)	(24.2)
Expenses				
Employee compensation and benefits	177,948	215,707	(37,759)	(17.5)
Floor brokerage and trade execution	11,879	18,811	(6,932)	(36.9)
Service fees, net	15,337	16,961	(1,624)	(9.6)
Communications	16,292	17,316	(1,024)	(5.9)
Occupancy and equipment	17,237	17,772	(535)	(3.0)
Marketing and business development	12,792	12,581	211	1.7
Depreciation and amortization	3,168	2,369	799	33.7
Interest	509	980	(471)	(48.1)
Other	26,012	25,854	158	0.6
Total expenses	281,174	328,351	(47,177)	(14.4)
Operating (loss) income	(19,605)	16,616	(36,221)	NM
Gain on exchange memberships	1,775	25,843	(24,068)	(93.1)
(Loss) income before income taxes	(17,830)	42,459	(60,289)	NM
(Benefit) provision for income taxes	(6,509)	4,548	(11,057)	NM
Net (loss) income	$ (11,321)	$ 37,911	$ (49,232)	NM%

NM indicates not meaningful.

Revenues

Investment Banking

Investment banking revenues decreased $73.8 million, or 45%, to $90.5 million for the year ended December 31, 2007 compared with $164.3 million in 2006. Our underwriting revenues decreased $35.2 million, or 44%, to $45.0 million for the year ended December 31, 2007 compared with $80.2 million the prior year. The decrease in underwriting revenues was the result of a decrease in both the number of transactions completed and average revenue per transaction, due in part to the depressed capital markets environment in the second half of 2007, and, we believe, employee dislocation within our investment banking department in 2007. We lead managed 30% and 39% of our underwritten transactions during 2007 and 2006, respectively. Our private placement revenues decreased $49.1 million, or 74%, to $16.8 million for the year ended December 31, 2007 compared with $65.9 million in 2006. The decrease in private placement revenues was primarily attributable to a decrease in both the number of transactions completed and the average revenues per transaction during 2007 compared to 2006. The decrease in capital raising revenues was partially offset by an increase of $10.5 million, or 58%, in strategic advisory fees to $28.7 million for the year ended December 31, 2007 compared with $18.2 million during the prior year. The increase in strategic advisory fees was primarily due to an increase in the size of transactions completed during 2007 compared to 2006, which more than offset the slight decrease in transaction volume during 2007 compared to 2006.

Brokerage

Our brokerage revenues include (i) commissions paid by customers from brokerage transactions in equity securities, (ii) trading gains and losses on firm inventory positions, which include warrants previously received as part of investment banking transactions, and trading gains and losses which result primarily from market making activities and from our commitment of capital related to the facilitation of customer transactions, and (iii) fees paid to us for equity research.

Brokerage revenue decreased $1.2 million, or 1%, to $158.7 million for the year ended December 31, 2007 compared with $159.9 million in 2006. Our traditional secondary equity business remained relatively stable. The decrease in revenues is associated with a reduction of our convertible inventory which was partially offset by increases in revenues related to our options activities and gains on warrants previously received as part of our investment banking transactions.

Interest and Dividend Income

Interest and dividend income decreased $9.5 million, or 53%, to $8.3 million for the year ended December 31, 2007 compared with $17.8 million in 2006. This decrease was primarily the result of lower average interest bearing assets during 2007 compared to 2006. In conjunction with our IPO, we made a payment of $180.3 million, representing a return of capital, to SGASH. The level of our interest bearing assets was significantly reduced as a result of this capital distribution which resulted in a meaningful reduction in our interest income in 2007.

Other

Other revenues increased $1.0 million, or 36%, to $4.0 million for the year ended December 31, 2007 compared with $3.0 million in 2006. This increase was attributable to an increase in fees for managing the assets and investments of certain private equity, asset management and alternative asset management funds.

Expenses

Employee Compensation and Benefits

Employee compensation and benefits expense decreased $37.8 million, or 17%, to $177.9 million for the year ended December 31, 2007 compared with $215.7 million in 2006. This decrease was primarily attributable to our compensation and benefits expense to revenue ratio being applied to lower total revenues, partially offset by an increase of 7% in the accrual ratio of compensation and benefits expense from 58% in 2006 to 65% in 2007. In addition, 2007 includes $7.9 million of expense associated with the initial grant of equity to our employees in connection with the IPO compared with $5.2 million during 2006. The $7.9 million expense in 2007 includes a reversal of $1.9 million for a cumulative adjustment related to a change in estimated forfeitures. Lastly, 2006 included a vesting expense of $10.6 million related to deferred compensation plans that were terminated as a result of our separation from SG. Excluding the compensation expense associated with the initial grant of equity and the terminated deferred compensation plans, employee compensation and benefits expense as a percentage of total revenues was 65% and 58% for the years ended December 31, 2007 and 2006, respectively.

Floor Brokerage and Trade Execution

Floor brokerage and trade execution fees decreased $6.9 million, or 37%, to $11.9 million for the year ended December 31, 2007 compared with $18.8 million in 2006. This decrease was primarily attributable to more favorable pricing under our new clearing agreement.

Service Fees, net

Net service fees decreased $1.6 million, or 10%, to $15.3 million for the year ended December 31, 2007 compared with $16.9 million in 2006. This decrease was primarily attributable to the termination of various service level agreements with SG for certain support functions as a result of the IPO, partially offset by additional services related to the outsourcing of our information technology infrastructure.

Communications

Communications expense decreased $1.0 million, or 6%, to $16.3 million for the year ended December 31, 2007 compared with $17.3 million in 2006. This decrease was primarily attributable to decreased costs associated with third-party market data services fees.

Occupancy and Equipment

Occupancy and equipment expense decreased $0.5 million, or 3%, to $17.2 million for the year ended December 31, 2007 compared with $17.7 million in 2006. This decrease was primarily attributable to moving expenses associated with relocating certain employees within our New York office and relocating our San Francisco office during 2006.

Marketing and Business Development

Marketing and business development expense increased $0.2 million, or 2%, to $12.8 million for the year ended December 31, 2007 compared with $12.6 million in 2006. This increase was primarily due to an increase in conference related costs, partially offset by a decrease in travel and entertainment related expenses.

Depreciation and Amortization

Depreciation and amortization expense increased $0.8 million, or 34%, to $3.2 million for the year ended December 31, 2007 compared with $2.4 million in 2006. This increase was primarily attributable to the amortization of additional network hardware and additional leasehold improvements placed into service during 2006. In addition, there was accelerated amortization expense on certain retired software.

Other

Other expenses increased $0.1 million, or 1%, to $26.0 million for the year ended December 31, 2007 compared with $25.9 million in 2006. An increase in legal related expenses due to broken transactions and new business initiatives was partially offset by reductions in insurance premiums and exchange dues.

Gain on Exchange Memberships

Gain on exchange memberships decreased $24.0 million to $1.8 million for the year ended December 31, 2007 compared to $25.8 million in 2006. This decrease was primarily attributable to a $24.8 million one-time gain realized upon the consummation of the merger of the NYSE and Archipelago Holdings, Inc. which occurred on March 7, 2006. NYSE members were entitled to receive cash and shares of NYSE Group common stock for each NYSE membership seat. We held seven NYSE membership seats at the date of the merger. The Company directed its interests from the merger to SGASH. The remaining gain last year occurred on November 16, 2006, as a result of the demutualization of the New York Mercantile Exchange ("NYMEX"). The Company exchanged its seats at the Commodity Exchange ("COMEX") for 16,800 shares of restricted NYMEX common stock and two trading rights in the restructured COMEX. The NYMEX shares and the trading rights were recognized at fair value at the date of exchange, and the Company recognized a gain of approximately $1.0 million representing the difference between the previous carrying value of the seats and the fair value of the shares that were received from the exchange at the time of demutualization. During the first quarter of 2007, we sold our seat on the Chicago Board Options Exchange for a one-time gain of $1.8 million.

Provision for Income Taxes

We reported a tax benefit of $6.5 million for the year ended December 31, 2007, which reflects an effective tax rate of 36.5%, compared to a tax provision of $4.5 million in 2006, which reflects an effective tax rate of 10.7%. The 2007 effective tax rate differs from the statutory tax rate of 35% primarily due to the establishment of a valuation allowance against certain stock compensation deferred tax assets offset by a state and local tax benefit. The 2006 low effective rate is primarily the result of a net reversal of valuation allowance due to payments of deferred compensation arrangements related to the IPO and pre-IPO amortization of goodwill.

Year Ended December 31, 2006 Compared with the Year Ended December 31, 2005

Overview

Total revenues increased $50.7 million, or 17%, to $345.0 million for the year ended December 31, 2006 compared with $294.3 million in 2005. This increase was primarily due to an increase in investment banking revenues of $38.1 million and an increase in brokerage revenues of $14.2 million.

Total expenses increased $46.4 million, or 16%, to $328.4 million for the year ended December 31, 2006 compared with $282.0 million in 2005, primarily due to an increase in compensation expense. Compensation expense increased for a number of reasons including; the increase in total revenues, 58% of which were used for compensation, expense associated with the accelerated vesting of deferred compensation plans that were terminated as a result of our separation from SG and expense associated with the initial grant of equity to our employees in connection with our IPO.

Total non-compensation expenses increased $2.8 million, or 3%, during the year ended December 31, 2006 compared with 2005, primarily due to an increase in occupancy related expenses as a result of our new sublease in New York, our new office in London, an increase in floor brokerage and trade execution related expenses due to increased volumes and increased pricing under our clearing agreement with SGAS. These increases were partially offset by a decrease in certain allocated costs which terminated after our separation from SG and litigation and related costs.

We recorded net income of $37.9 million for the year ended December 31, 2006 compared with $12.1 million in 2005. Net income for the year ended December 31, 2006 included one-time gains on exchange memberships, including $24.8 million realized upon the consummation of the merger of the

NYSE and Archipelago Holdings, Inc. which occurred on March 7, 2006. The Company directed its interests from the merger to SGASH.

The following table provides a comparison of our revenues and expenses for the periods presented:

	Year Ended December 31,		Period-to-Period	
	2006	2005	$ Change	% Change
	(in thousands)			
Revenues				
Investment banking	$ 164,342	$ 126,253	$ 38,089	30.2%
Brokerage	159,879	145,700	14,179	9.7
Interest and dividend income	17,766	16,990	776	4.6
Other	2,980	5,348	(2,368)	(44.3)
Total revenues	344,967	294,291	50,676	17.2
Expenses				
Employee compensation and benefits	215,707	172,128	43,579	25.3
Floor brokerage and trade execution	18,811	15,598	3,213	20.6
Service fees, net	16,961	18,446	(1,485)	(8.1)
Communications	17,316	17,412	(96)	(0.6)
Occupancy and equipment	17,772	15,071	2,701	17.9
Marketing and business development	12,581	12,382	199	1.6
Depreciation and amortization	2,369	2,140	229	10.7
Interest	980	1,178	(198)	(16.8)
Other	25,854	27,621	(1,767)	(6.4)
Total expenses	328,351	281,976	46,375	16.4
Operating income	16,616	12,315	4,301	34.9
Gain on exchange memberships	25,843	918	24,925	2,715
Income before income taxes	42,459	13,233	29,226	220.9
Provision for income taxes	4,548	1,152	3,396	294.8
Net income	$ 37,911	$ 12,081	$ 25,830	213.8%

Revenues

Investment Banking

Investment banking revenues increased $38.1 million, or 30%, to $164.3 million for the year ended December 31, 2006 compared with $126.2 million in 2005. The increase reflects improved results in our capital raising activities. Our underwriting revenues increased $25.1 million, or 45%, to $80.2 million for the year ended December 31, 2006 compared with $55.1 million during the same period in the prior year. The increase in underwriting revenues was the result of increased transaction volume, which increased by 32%, and an increase in our average revenues per transaction. We lead managed 39% of our underwritten transactions in 2006. Our private placement revenues increased $36.3 million, or 123%, to $65.9 million for the year ended December 31, 2006 compared with $29.6 million in 2005. The increase in private placement revenues was primarily attributable to an increase in both the number and median size of the transactions completed in 2006. The increase in capital raising revenues were partially offset by a decrease of $23.3 million, or 56%, in strategic advisory fees to $18.2 million for the year ended December 31, 2006 compared with $41.5 million in 2005. The decrease in strategic advisory fees was primarily the result of a decrease in the size of the transactions completed in 2006 and, to a lesser extent, the number of transactions closed.

Brokerage

Brokerage revenue increased $14.2 million, or 10%, to $159.9 million for the year ended December 31, 2006 compared with $145.7 million in 2005. This increase was primarily due to higher over-the-counter equity volumes as well as improved revenues related to our convertible bond business.

Interest and Dividend Income

Interest and dividend income increased $0.8 million, or 5%, to $17.8 million for the year ended December 31, 2006 compared with $17.0 million in 2005, resulting primarily from higher average interest rates during 2006, partially offset by lower average interest bearing assets in 2006 compared with 2005. In conjunction with our IPO, we made a payment of $180.3 million, representing a return of capital, to SGASH. The level of our interest bearing assets was significantly reduced as a result of this capital distribution which will result in a meaningful reduction in our interest income in the future.

Other

Other revenues decreased $2.3 million, or 44%, to $3.0 million for the year ended December 31, 2006 compared with $5.3 million in 2005. This decrease was primarily attributable to the decrease in fees for managing the portfolio of merchant banking assets and venture capital investments.

Expenses

Employee Compensation and Benefits

Employee compensation and benefits expense increased $43.6 million, or 25%, to $215.7 million for the year ended December 31, 2006 compared with $172.1 million in 2005. This increase was primarily attributable to the application of our target compensation and benefits expense to revenue ratio to the increased revenues during 2006 as compared to 2005. In addition, there was an accelerated vesting expense of $10.6 million related to deferred compensation plans that were terminated as a result of our separation from SG and $5.2 million of expense associated with the initial grant of equity to our employees in connection with the IPO. Excluding the compensation expense associated with the initial grant of equity and the terminated deferred compensation plans, employee compensation and benefits expense as a percentage of total revenues was 58.0% for the year ended December 31, 2006. Employee compensation and benefits expense as a percentage of total revenues was 58.5% for 2005.

Floor Brokerage and Trade Execution

Floor brokerage and trade execution fees increased $3.2 million, or 21%, to $18.8 million for the year ended December 31, 2006 compared with $15.6 million in 2005. This increase was primarily attributable to an increase in volumes and increased pricing under our clearing agreement with SGAS.

Service Fees, net

Net service fees decreased $1.5 million, or 8%, to $17.0 million for the year ended December 31, 2006 compared with $18.5 million in 2005. This decrease was primarily attributable to the termination of various service level agreements with SG for certain support functions as a result of the IPO, partially offset by the full year effect of the outsourcing of our information technology infrastructure.

Occupancy and Equipment

Occupancy and equipment expense increased $2.7 million, or 18%, to $17.8 million for the year ended December 31, 2006 compared with $15.1 million in 2005. This increase was primarily attributable to an increase in rent expense under our new sublease for our New York office space, new London office space and an increase in certain software license fees.

Marketing and Business Development

Marketing and business development expense increased $0.2 million, or 2%, to $12.6 million for the year ended December 31, 2006 compared with $12.4 million in 2005. This increase was primarily due to an increase in conference related costs, partially offset by a decrease in travel and entertainment related expenses.

Depreciation and Amortization

Depreciation and amortization expense increased $0.2 million, or 11%, to $2.4 million for the year ended December 31, 2006 compared with $2.2 million in 2005. This increase was primarily attributable to the amortization of additional network hardware and additional leasehold improvements placed into service during 2006.

Other

Other expenses decreased $1.8 million, or 6%, to $25.8 million for the year ended December 31, 2006 compared with $27.6 million in 2005. This decrease was primarily attributable to elimination of certain litigation and related costs expenses which are now covered under the Indemnification Agreement with SG.

Gain on Exchange Memberships

Gain on exchange memberships increased $24.9 million to $25.8 million for the year ended December 31, 2006 compared to $0.9 million in the prior year. This increase was primarily attributable to a $24.8 million one-time gain realized upon the consummation of the merger of the NYSE and Archipelago Holdings, Inc. which occurred on March 7, 2006. NYSE members were entitled to receive cash and shares of NYSE Group common stock for each NYSE membership seat. We held seven NYSE membership seats at the date of the merger. The Company directed its interests from the merger to SGASH. The remaining gain occurred on November 16, 2006, as a result of the demutualization of the NYMEX. The Company exchanged its seats at the COMEX for 16,800 shares of restricted NYMEX common stock and two trading rights in the restructured COMEX. The NYMEX shares and the trading rights were recognized at fair value at the date of exchange, and the Company recognized a gain of approximately $1.0 million representing the difference between the previous carrying value of the seats and the fair value of the shares that were received from the exchange at the time of demutualization.

Provision for Income Taxes

We reported a tax provision of $4.5 million for the year ended December 31, 2006, which reflects an effective tax rate of 10.7%, compared to a tax provision of $1.2 million in 2005, which reflects an effective tax rate of 8.7%. The 2006 low effective rate is primarily the result of a net reversal of valuation allowance due to payments of deferred compensation arrangements related to the IPO and pre-IPO amortization of goodwill.

Liquidity and Capital Resources

Most of our assets consist of cash, cash equivalents and assets readily convertible into cash such as our securities held in inventory. Securities inventories are stated at fair value and are generally readily marketable. As of December 31, 2007, we had cash and cash equivalents of $139.9 million.

As part of our separation from SG, we made a payment to SGASH of $180.3 million in 2006. This distribution was the amount necessary to cause our stockholders' equity to be $207.0 million immediately after the IPO as agreed upon with SG. Under the terms of the Separation Agreement with

SG (the "Separation Agreement"), the amount of this distribution is subject to adjustment based on a final review of the Company's separation from SG. See Note 11 of the Notes to the Consolidated Financial Statements for further discussion of the Separation Agreement. While the final review has not yet been completed, we have accrued approximately $2.1 million as a capital distribution payable to SG related to this final review.

During 2007, the Company concluded that a receivable recorded on its Consolidated Statement of Financial Condition in the amount of $1.9 million owed to it from SG is in dispute. The receivable had been previously established on the Consolidated Statement of Financial Condition of the Company prior to the time of the IPO as a "Receivable from brokers, dealers and clearing brokers" and reported as such, and has since been reclassified to "Other assets". The Company has been informed that SG currently disputes its obligation to pay the receivable. The Company believes, based on current facts and circumstances and in consultation with counsel, that it holds a valid legal claim to the receivable. Based upon the validity of its legal claim, the Company believes the receivable is realizable. Therefore, no reserves have been established. The Company and SG are continuing to review the matter in an effort to reach a mutually acceptable resolution.

As a registered broker-dealer and member firm of the NYSE, Cowen is subject to the Uniform Net Capital Rule of the SEC. We have elected to use the alternative method permitted by the Uniform Net Capital Rule, which generally requires that we maintain minimum net capital of $1.0 million. The NYSE may prohibit a member firm from expanding its business or paying dividends if resulting net capital would be below the regulatory limit. We expect these limits will not impact our ability to meet current and future obligations.

At December 31, 2007, Cowen's net capital under the SEC's Uniform Net Capital Rule was $79.3 million, or $78.3 million in excess of the minimum required net capital.

CIL is subject to the capital requirements of the FSA of the U.K. Financial Resources, as defined, must exceed the Total Financial Resources requirement of the FSA. At December 31, 2007, CIL's Financial Resources of approximately $7.7 million exceeded the minimum requirement of $2.9 million by approximately $4.8 million.

CAM UK is subject to the capital requirements of the FSA of the U.K. Liquid Capital, as defined, must exceed the Total Capital requirement of the FSA, as defined. At December 31, 2007, CAM UK's Liquid Capital of approximately $3.0 million exceeded the minimum requirement of $0.8 million by approximately $2.2 million.

Cash Flows

Year Ended December 31, 2007. Cash decreased by $45.2 million for the year ended December 31, 2007, primarily as a result of cash used in operating activities and cash used in financing activities.

Our operating activities used $28.4 million of cash due to a decrease in cash from changes in operating liabilities of $325.7 million and a net loss of $11.3 million, partially offset by an increase in cash from changes in operating assets of $295.8 million and non-cash charges of $12.8 million.

The change in operating liabilities of $325.7 million was primarily due to a decrease in securities sold, not yet purchased, at fair value, of $225.9 million, a decrease in employee compensation and benefits payable of $42.9 million, a decrease in payable to brokers, dealers and clearing brokers of $29.5 million and a decrease in legal reserves and legal expenses payable of $27.7 million. The 2007 change in securities sold, not yet purchased, at fair value associated with our convertible trading inventory, caused cash to decrease by that amount. The decrease in employee compensation and benefits payable was due to the payment of 2006 bonus accruals in the first quarter of 2007, partially offset by lower 2007 bonus accruals at December 31, 2007. Legal reserves and expenses payable decreased due to settlement payments and a return of excess funds to SGASH. The decrease in payable to brokers, dealers and clearing brokers was primarily attributable to the reduction of our net convertible bond inventory.

The change in operating assets of $295.8 million was primarily due to a decrease in securities owned, at fair value of $234.3 million, a decrease in receivable from brokers, dealers and clearing brokers of $34.8 million and a decrease in restricted cash pursuant to the Escrow Agreement of $28.6 million. The decrease in securities owned, at fair value was due to a reduction of our convertible bond inventory. The decrease in receivable from brokers, dealers and clearing brokers was primarily due to collection on balances held at a previous clearing firm. The decrease in cash pursuant to escrow agreement was the result of settlement payments and a return of excess funds to SGASH. The non-cash charges primarily represent share-based compensation, deferred income taxes, and depreciation and amortization charges.

Our investing activities used $1.9 million of cash in 2007 due to purchases of fixed assets.

Our financing activities used $14.8 million of cash in 2007 in order to purchase shares under our stock repurchase program. For the period ended December 31, 2007, the Company repurchased 1.4 million of its own shares in the open market, at an average price of $10.28, which have been permanently retired. Subsequent to December 31, 2007, the Company repurchased and permanently retired an additional 0.5 million shares at an average cost per share of $9.29 per share. The repurchase program is funded through the return of capital to the Company from Cowen. For more information about the repurchase program see Note 17 to the Consolidated Financial Statements in Part IV, Item 15, in this Annual Report Form 10-K.

Year ended December 31, 2006. Cash increased by $182.9 million for the year ended December 31, 2006 from the prior year, primarily as a result of cash provided by operating activities, partially offset by cash used in financing activities. In conjunction with our separation from SG and our becoming a public company, we made a payment representing a return of capital to SGASH in the amount of $180.3 million. This distribution was the amount necessary to cause our stockholders' equity to be $207.0 million immediately after the IPO as agreed upon with SG. The increase in cash for the year ended December 31, 2006 and the cash used to distribute this $180.3 million payment to SGASH was primarily funded by the decrease in securities purchased under agreements to resell with related parties of $411.0 million.

Our operating activities provided $388.6 million of cash due to net income of $37.9 million and cash provided by changes in operating assets of $286.9 million, including an increase in cash from changes in operating liabilities of $81.6 million and a decrease in non-cash revenue and expense items of $17.9 million. The change in operating liabilities of $81.6 million was primarily due to an increase in securities sold, not yet purchased, at fair value, of $108.4 million partially offset by a decrease in employee compensation and benefits payable of $40.9 million. The change in operating assets of $286.9 million primarily resulted from a decrease in securities purchased under agreements to resell with related parties of $411.0 million, which caused cash to increase by that amount, offset by an increase in restricted cash pursuant to an escrow agreement of $52.1 million and an increase of $57.7 million in receivable from brokers, dealers and clearing brokers. Net non-cash revenue and expense items consisted primarily of a million $24.8 million gain on exchange memberships.

Our investing activities consumed $11.8 million due to purchases of fixed assets. Net cash used in financing activities of $193.9 million was primarily attributable to a net capital distribution of $180.3 million to SG.

Year ended December 31, 2005. Cash increased $0.2 million in the year ended December 31, 2005 from the prior year, primarily due to positive operating cash flow, substantially offset by cash used in financing activities.

Our operating activities provided $44.9 million of cash due to net income of $12.1 million, including non-cash revenue and expense items of $3.5 million, and cash provided from the change in operating assets of $33.5 million, offset by a reduction in cash from the change in operating liabilities of $4.1 million. The non-cash items consist primarily of depreciation and amortization expense of $2.1 million and income tax expense of $1.2 million. Cash provided from the change in operating assets consisted primarily of $34.4 million from the reduction of securities purchased under agreements to resell, $23.2 million from the collection of insurance claims receivable and $10.6 million from the reduction of amounts due from affiliates, partially offset by an increase of $29.8 million in securities owned. Cash consumed by the decrease in operating liabilities was primarily attributable to $25.3 million related to the change in legal reserves and related payables, partially offset by an increase of $16.1 million in securities sold, not yet purchased.

We used $0.5 million in our investing activities, primarily in the purchase of fixed assets. Financing activities consisted of $1.4 million of net capital contributions from SG and $45.7 million in payments related to the retail brokerage business not conducted by us.

Credit Facilities

We have an irrevocable Letter of Credit for $5.0 million issued by The Bank of New York ("BONY"), expiring on July 12, 2008, supporting obligations under Cowen's Boston office lease. The Company also has two additional irrevocable Letters of Credit issued by BONY, the first of which is for $100 thousand, expiring on July 26, 2008, supporting Cowen's workers' compensation insurance with Safety National Casualty Corporation, and the second of which is for $57 thousand, expiring on November 14, 2008, supporting one of Cowen's lease obligations. To the extent any Letter of Credit is drawn upon, interest will be assessed at the prime commercial lending rate. As of December 31, 2007, there were no amounts due related to these letters of credit.

Contractual Obligations

The following table provides a summary of our contractual obligations as of December 31, 2007:

	Payments due by Period				
	Total	**2008**	**2009**	**2010-2011**	**2012 and thereafter**
	(in thousands)				
Operating lease obligations	$ 59,289	$ 9,482	$ 9,627	$ 19,471	$ 20,709
Other contractual obligations	26,955	12,107	10,465	4,383	
Total	$ 86,244	$ 21,589	$ 20,092	$ 23,854	$ 20,709

Operating lease obligations represent leases on the Company's office locations. Other contractual obligations represent agreements related to the outsourcing of certain information technology services.

Off-Balance Sheet Arrangements

We had no material off-balance sheet arrangements as of December 31, 2007; however, through indemnification provisions in our clearing agreement, customer activities may expose us to off-balance-sheet credit risk. Pursuant to the clearing agreement, we are required to reimburse our clearing broker, without limit, for any losses incurred due to a counterparty's failure to satisfy its contractual obligations. However, these transactions are collateralized by the underlying security, thereby reducing the associated risk to changes in the market value of the security through the settlement date. See Item 7A "Qualitative and Quantitative Disclosures About Market Risk Credit Risk."

We are a member of various securities exchanges. Under the standard membership agreement, members are required to guarantee the performance of other members and, accordingly, if another member becomes unable to satisfy its obligations to the exchange, all other members would be required to meet the shortfall. Our liability under these arrangements is not quantifiable and could exceed the cash and securities we have posted as collateral. However, management believes that the potential for us to be required to make payments under these arrangements is remote. Accordingly, no contingent liability is carried in the accompanying consolidated statements of financial condition for these arrangements.

Critical Accounting Policies and Estimates

The preparation of our consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and of revenues and expenses during the reporting periods. We base our estimates and assumptions on historical experience and on various other factors that we believe are reasonable under the circumstances. The use of different estimates and assumptions could produce materially different results. For example, if factors such as those described in Item 1A-"Risk Factors" cause actual events to differ from the assumptions we used in applying the accounting policies, our results of operations, financial condition and liquidity could be materially adversely affected.

Our significant accounting policies are summarized in Note 2 to our audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K. On an ongoing basis, we evaluate our estimates and assumptions, particularly as they relate to accounting policies that we believe are most important to the presentation of our financial condition and results of operations. We regard an accounting estimate or assumption to be most important to the presentation of our financial condition and results of operations where:

- the nature of the estimate or assumption is material due to the level of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and

- the impact of the estimate or assumption on our financial condition or operating performance is material.

Using these criteria, we believe the following to be our critical accounting policies:

Revenue Recognition

Investment banking revenues include underwriting fees, private placement fees, strategic advisory fees and financial advisory fees.

- **Underwriting fees.** We earn underwriting revenues in securities offerings in which we act as an underwriter, such as IPOs, follow-on equity offerings and convertible security offerings. Our underwriting revenues include management fees, selling concessions and underwriting fees. Fee revenue relating to underwriting commitments is recorded when all significant items relating to the underwriting cycle have been completed and the amount of the underwriting revenue has been determined. This generally is the point at which all of the following have occurred: (i) the issuer's registration statement has become effective with the SEC, or the other offering documents are finalized, (ii) the Company has made a firm commitment for the purchase of shares from the issuer, and (iii) the Company has been informed of the number of shares that it has been allotted. As co-manager for registered equity underwriting transactions, management must estimate the Company's share of transaction related expenses incurred by the lead manager in order to recognize revenue. Transaction related expenses are deducted from the underwriting fee and therefore reduce the revenue the Company recognizes as co-manager. Such amounts are adjusted to reflect actual expenses in the period in which the Company receives the final settlement, typically within 90 days following the closing of the transaction.

Private placement fees. We earn agency placement fees in non-underwritten transactions such as private placements, PIPEs and RDs. We record private placement revenues when the services for the transactions are completed under the terms of each assignment or engagement and collection is reasonably assured. Expenses associated with such transactions are deferred until the related revenue is recognized or the engagement is otherwise concluded.

Strategic / financial advisory fess. Our strategic advisory revenues include success fees earned in connection with advising companies, both buyers and sellers, principally in mergers and acquisitions. We also earn fees for related advisory work such as providing fairness opinions. We record strategic advisory revenues when the services for the transactions are completed under the terms of each assignment or engagement and collection is reasonably assured. Expenses associated with such transactions are deferred until the related revenue is recognized or the engagement is otherwise concluded.

Valuation of Financial Instruments

Substantially all of our financial instruments are recorded at fair value or contract amounts that approximate fair value. Securities owned and securities sold, not yet purchased and derivative financial instruments including options and warrant positions are stated at fair value, with related changes in unrealized appreciation or depreciation reflected in brokerage revenue in the Consolidated Statements of Operations. Financial instruments carried at contract amounts include amounts receivable from and payable to brokers, dealers and clearing brokers, securities purchased under agreements to resell and corporate finance and syndicate receivables.

Fair value is generally based on independent sources such as quoted market prices or dealer price quotations. To the extent certain financial instruments trade infrequently or are non-marketable securities and, therefore, do not have readily determinable fair values, primarily warrants, we estimate the fair value of these instruments using various pricing models and available information that management deems most relevant. Among the factors considered by us in determining the fair value of financial instruments are discounted anticipated cash flows, the cost, terms and liquidity of the instrument, the financial condition, operating results and credit ratings of the issuer or underlying company, the quoted market price of publicly traded securities with similar quality and yield, and other factors generally pertinent to the valuation of financial instruments.

Goodwill

Goodwill represents the excess of the purchase price of a business acquisition over the fair value of the net assets acquired. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* ("SFAS 142"), goodwill is not amortized. We monitor goodwill annually or more frequently if events or circumstances indicate a possible impairment.

A two-step test is used to determine whether goodwill is impaired. The first step is to compare the carrying value of the Company with the fair value of the Company. If the carrying value of the Company exceeds the fair value of the Company, the second step is applied. The second step is to compare the carrying amount of the goodwill with the implied fair value of the goodwill as determined in accordance with SFAS 142. Goodwill impairment is recognized if its carrying value exceeds its implied fair value. The determination of fair value includes considerations of projected cash flows, relevant trading multiples of comparable exchange listed corporations, and the trading price of the our common shares.

Goodwill impairment tests are subject to significant judgment in determining the estimation of future cash flows, discount rates and other assumptions. Changes in these estimates and assumptions could have a significant impact on the fair value and any resulting impairment of goodwill.

Legal and Regulatory Reserves

We are involved in a number of legal and regulatory matters that arise from time to time in connection with the conduct of our businesses. To the extent that we are indemnified by SG, indemnified legal expenses and liabilities will be paid out of escrow pursuant to our Escrow Agreement with SG. See Note 4 of the Notes to the Consolidated Financial Statements, "Restricted Cash Pursuant to Escrow Agreement and Related Indemnification Agreement with Société Générale" and Note 11 of the Notes to the Consolidated Financial Statements, "Separation from Société Générale and Other Related Matters" in Part I, Item I "Business", for further discussion of the Escrow Agreement and the Indemnification Agreement. To the extent that we are not indemnified by SG, we estimate potential losses that may arise out of these matters and record a reserve and take a charge to income when losses with respect to such matters are deemed probable and can be reasonably estimated, in accordance with SFAS 5. Such estimates, by their nature, are based on judgment and currently available information and involve a variety of factors, including, but not limited to, the type and nature of the litigation, claim or proceeding, the progress of the matter, the advice of legal counsel, our defenses and our experience in similar cases or proceedings as well as our assessment of matters, including settlements, involving other defendants in similar or related cases or proceedings. We may increase or decrease our legal reserves in the future, on a matter by matter basis, to account for developments in such matters. Any future increases to our loss contingency reserves or releases from these reserves may affect our results of operations. Historically, legal costs have significantly impacted our financial results.

Recently Issued Accounting Standards, Not Yet Adopted

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, ("SFAS 160"). SFAS 160 will significantly change financial accounting and reporting for noncontrolling (or minority) interests in consolidated financial statements. SFAS 160 is effective for the first annual reporting period beginning on or after December 15, 2008. Earlier application is prohibited. We are currently assessing the impact of SFAS 160 on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business combinations* ("SFAS 141R"), which replaces SFAS 141. SFAS 141R establishes principles and requirements for how an acquirer in a business combination (1) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest, (2) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase and (3) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for the first annual reporting period beginning on or after December 15, 2008. Earlier application is prohibited.

In February 2007, the FASB issued Statement of Financial Accounting Standard No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS 159"). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We do not expect the adoption of SFAS 159 to have a material impact on our consolidated financial statements.

In September, 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurement. This statement shall be effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The provisions of this statement should be applied prospectively as of the beginning of the fiscal year in which this statement is initially applied, except in some circumstances where the statement shall be applied retrospectively. We do not expect the adoption of SFAS 157 to have a material impact on our consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Market Risk

Market risk represents the risk of loss that may result from the change in value of a financial instrument due to fluctuations in its market price. Market risk may be exacerbated in times of trading illiquidity when market participants refrain from transacting in normal quantities and/or at normal bid-offer spreads. Our exposure to market risk is primarily related to our role as a financial intermediary in customer trading and to our market making and investment activities. Market risk is inherent in financial instruments. We trade in equity securities as an active participant in both listed and over the counter markets. We typically maintain securities in inventory to facilitate our market making activities and customer order flow. We may use a variety of risk management techniques and hedging strategies in the ordinary course of our trading business to manage our exposures. In connection with our trading business, management also reviews reports appropriate to the risk profile of specific trading activities. Typically, market conditions are evaluated and transaction details and securities positions are reviewed. These activities seek to ensure that trading strategies are within acceptable risk tolerance parameters, particularly when we commit our own capital to facilitate client trading. Activities include price verification procedures, position reconciliations and reviews of transaction booking. We believe these procedures, which stress timely communications between traders, trading management and senior management, are important elements of the risk management process.

Interest Rate Risk

Interest rate risk represents the potential loss from adverse changes in market interest rates. As we may hold interest sensitive liabilities from time to time, we are exposed to interest rate risk arising from changes in the level and volatility of interest rates and in the shape of the yield curve. Interest rate risk is primarily managed through the use of U.S. Treasury futures, options and short positions in corporate debt securities.

Credit Risk

We engage in various securities underwriting, trading and brokerage activities servicing a diverse group of domestic and foreign corporations and institutional investor clients. A substantial portion of our transactions are collateralized and are executed with or on behalf of institutions including other brokers or dealers, commercial banks and other financial institutions. Our exposure to credit risk associated with the nonperformance of these counterparties in fulfilling their contractual obligations pursuant to securities transactions can be directly impacted by volatile trading markets which may impair the client's ability to satisfy its obligations to us. Our principal activities are also subject to the risk of counterparty nonperformance. Pursuant to our clearing agreement, we are required to reimburse our clearing broker without limit for any losses incurred due to a counterparty's failure to satisfy its contractual obligations. However, as noted above, these transactions are collateralized by the underlying security, thereby reducing the associated risk to changes in the market value of the security through the settlement date. We also seek to mitigate the risks associated with brokerage services through active customer screening and selection procedures and through requirements that clients maintain collateral in appropriate amounts where required or deemed necessary.

Inflation Risk

Because our assets are, to a large extent, liquid in nature, they are not significantly affected by inflation. However, the rate of inflation affects such expenses as employee compensation and communications charges, which may not be readily recoverable in the prices of services we offer. To the extent inflation results in rising interest rates and has other adverse effects on the securities markets, it may adversely affect our financial condition and results of operations in certain businesses.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. We are focused on maintaining our overall operational risk management framework and minimizing or mitigating these risks through continual assessment, reporting and monitoring of potential operational risks.

Item 8. Financial Statements and Supplementary Data

The financial statements and supplementary data required by this item are listed in Item 15 "Exhibits and Financial Statement Schedules" of this Annual Report on Form 10-K. "Supplemental Information Quarterly Information" is included after Note 21 Subsequent Events.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Our management, with the participation of the Chief Executive Officer and the Chief Financial Officer (the principal executive officer and principal financial officer, respectively), evaluated our disclosure controls and procedures as of the end of the fiscal year covered by this Report.

Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that, as of the end of the fiscal year covered by this Report, our disclosure controls and procedures are effective to provide a reasonable assurance that information required to be disclosed by the Company in the reports filed or submitted by it under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by the Company in such reports is accumulated and communicated to our management, including the Chief Executive Officer and the Chief Financial Officer of the Company, as appropriate to allow timely decisions regarding required disclosure.