JEFFERIES GROUP INC /DE/
Form 10-Q
May 09, 2007

Table of Contents

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

FORM 10-Q

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

For the quarterly period ended March 31, 2007

OR

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

For the transition period from __________ to

Commission file number 1-14947

JEFFERIES GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	95-4719745
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
520 Madison Avenue, 12th Floor, New York, New York	10022
(Address of principal executive offices)	(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

Indicate the number of shares outstanding of the registrant s class of common stock, as of the latest practicable date. 125,431,975 shares as of the close of business May 7, 2007.

JEFFERIES GROUP, INC. AND SUBSIDIARIES
INDEX TO QUARTERLY REPORT ON FORM 10-Q
MARCH 31, 2007

Table of Contents

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

	March 31, 2007	December 31, 2006
ASSETS		
Cash and cash equivalents	$ 216,577	$ 513,041
Cash and securities segregated and on deposit for regulatory purposes or deposited with clearing and depository organizations	692,941	508,303
Investments	135,087	125,533
Investments in managed funds	431,365	372,869
Securities borrowed	14,953,164	9,711,894
Securities purchased under agreements to resell	257,212	226,176
Receivable from brokers, dealers and clearing organizations	725,631	254,580
Receivable from customers	528,082	663,552
Financial instruments owned, including securities pledged to creditors of $2,770,321 and $1,481,098 in 2007 and 2006, respectively	6,839,631	4,606,223
Premises and equipment	100,349	91,375
Goodwill	261,401	257,321
Other assets	554,047	494,590
Total Assets	$ 25,695,487	$ 17,825,457
LIABILITIES AND STOCKHOLDERS EQUITY		
Bank loans and current portion of long-term debt	$ 331,915	$ 99,981
Securities loaned	10,076,504	6,794,554
Securities sold under agreements to repurchase	4,688,989	2,092,838
Payable to brokers, dealers and clearing organizations	984,981	669,196
Payable to customers	1,217,691	1,010,486
Financial instruments sold, not yet purchased	4,940,261	3,600,869
Accrued expenses and other liabilities	444,283	650,974
	22,684,624	14,918,898
Long-term debt	1,169,278	1,168,562
Mandatorily redeemable convertible preferred stock	125,000	125,000
Minority interest	27,426	31,910
Total Liabilities	24,006,328	16,244,370
STOCKHOLDERS EQUITY		
Common stock, $.0001 par value. Authorized 500,000,000 shares; issued 150,912,711 shares in 2007 and 145,628,024 shares in 2006	15	14
Additional paid-in capital	951,880	876,393
Retained earnings	997,906	952,263
Less:		
	(271,162)	(254,437)

Treasury stock, at cost, 26,674,469 shares in 2007 and 26,081,110 shares in 2006		
Accumulated other comprehensive gain (loss):		
Currency translation adjustments	13,430	9,764
Additional minimum pension liability	(2,910)	(2,910)
Total accumulated other comprehensive gain (loss)	10,520	6,854
Total stockholders equity	1,689,159	1,581,087
Total Liabilities and Stockholders Equity	$ 25,695,487	$ 17,825,457

See accompanying unaudited notes to consolidated financial statements.

Table of Contents

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

	Three Months Ended Mar. 31, 2007	Three Months Ended Mar. 31, 2006
Revenues:		
Commissions	$ 77,032	$ 69,002
Principal transactions	144,449	159,980
Investment banking	170,115	127,734
Asset management fees and investment income from managed funds	22,485	40,822
Interest	201,162	113,760
Other	8,041	12,779
Total revenues	623,284	524,077
Interest expense	204,475	108,663
Revenues, net of interest expense	418,809	415,414
Non-interest expenses:		
Compensation and benefits	227,666	232,734
Floor brokerage and clearing fees	14,582	13,933
Technology and communications	22,157	19,245
Occupancy and equipment rental	18,171	15,172
Business development	13,109	12,603
Other	19,631	24,320
Total non-interest expenses	315,316	318,007
Earnings before income taxes, minority interest and cumulative effect of change in accounting principle	103,493	97,407
Income taxes	40,658	38,432
Earnings before minority interest and cumulative effect of change in accounting principle	62,835	58,975
Minority interest in earnings of consolidated subsidiaries, net	576	2,134
Earnings before cumulative effect of change in accounting principle, net	62,259	56,841
Cumulative effect of change in accounting principle, net	¾	1,606
Net earnings	$ 62,259	$ 58,447
Earnings per basic share:		
Basic-		
Earnings before cumulative effect of change in accounting principle, net	$ 0.44	$ 0.44
Cumulative effect of change in accounting principle, net		0.01

Net earnings	$	0.44	$	0.45
Diluted-				
Earnings before cumulative effect of change in accounting principle, net	$	0.42	$	0.40
Cumulative effect of change in accounting principle, net				0.01
Net earnings	$	0.42	$	0.41
Weighted average shares:				
Basic		140,897		130,358
Diluted		152,058		142,942
Fixed charge coverage ratio		5.0X		5.3X

See accompanying unaudited notes to consolidated financial statements.

Table of Contents

JEFFERIES GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY (Unaudited)
THREE MONTHS ENDED MARCH 31, 2007 AND YEAR ENDED DECEMBER 31, 2006
(Dollars in thousands, except per share amounts)

	2007	2006
Common stock, par value $.0001 per share		
Balance, beginning of year	$ 14	$ 7
Issued stock	1	7
Balance, end of period	$ 15	$ 14
Additional paid in capital		
Balance, beginning of year	$ 876,393	$ 709,447
Benefit plan share activity (1)	13,713	33,360
Amortization expense	29,158	83,137
Proceeds from exercise of stock options	1,720	17,543
Tax benefits	30,896	32,906
Balance, end of period	$ 951,880	$ 876,393
Retained earnings		
Balance, beginning of year, as previously reported	$ 952,263	$ 803,262
Cumulative effect of adjustment from adoption of FIN 48	(410)	
Net earnings	62,259	205,750
Dividends	(16,206)	(56,749)
Balance, end of period	$ 997,906	$ 952,263
Treasury stock, at cost		
Balance, beginning of year	$ (254,437)	$ (220,703)
Purchases	(16,657)	(23,972)
Returns / forfeitures	(68)	(9,762)
Balance, end of period	$ (271,162)	$ (254,437)
Accumulated other comprehensive income (loss)		
Balance, beginning of year	$ 6,854	$ (5,163)
Currency adjustment	3,666	8,802
Pension adjustment		3,215
Balance, end of period	$ 10,520	$ 6,854
Total stockholders equity	$ 1,689,159	$ 1,581,087

Comprehensive income		
Net earnings	$ 62,259	$ 205,750
Other comprehensive income	3,666	12,017
Total comprehensive income	$ 65,925	$ 217,767

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

See accompanying unaudited notes to consolidated financial statements.

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

	Three Months Ended	
	Mar. 31, 2007	Mar. 31, 2006
Cash flows from operating activities:		
Net earnings	$ 62,259	$ 58,447
Adjustments to reconcile net earnings to net cash used in operating activities:		
Cumulative effect of accounting change, net		1,606
Depreciation and amortization	5,693	5,273
Accruals related to various benefit plans, stock issuances, net of forfeitures	42,804	22,851
(Increase) decrease in cash and securities segregated and on deposit for regulatory purposes or deposited with clearing and depository organizations	(184,458)	150,052
(Increase) decrease in receivables:		
Securities borrowed	(5,241,270)	(1,537,046)
Brokers, dealers and clearing organizations	(468,817)	(174,859)
Customers	136,652	(113,171)
Increase in financial instruments owned	(2,233,765)	(926,661)
Increase in securities purchased under agreements to resell	(31,036)	
Increase in other assets	(58,156)	(146,519)
Increase in operating payables:		
Securities loaned	3,281,950	1,142,060
Securities sold under agreements to repurchase	2,596,151	
Brokers, dealers and clearing organizations	313,719	325,696
Customers	207,233	77,881
Increase in financial instruments sold, not yet purchased	1,339,392	952,670
Decrease in accrued expenses and other liabilities	(196,884)	(16,276)
Decrease increase in minority interest	(4,484)	(3,874)
Net cash used in operating activities	(433,017)	(181,870)

Continued on next page.

Table of Contents

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

	Three Months Ended	
	Mar. 31, 2007	Mar. 31, 2006
Cash flows from investing activities:		
Decrease in short term bond funds		7,037
Increase in investments	(9,545)	(5,626)
Increase in investments in managed funds	(58,496)	(3,383)
Business acquisitions, net of cash received	(14,567)	(19,944)
Purchase of premises and equipment	(14,236)	(6,426)
Net cash used in investing activities	(96,844)	(28,342)
Cash flows from financing activities		
Tax benefit from the issuance of stock based awards	30,896	14,053
Net proceeds from (payments on):		
Bank loans	231,927	1,927
Issuance of senior notes		492,155
Issuance of mandatorily redeemable convertible preferred stock		125,000
Repurchase of treasury stock	(16,657)	(3,418)
Dividends	(16,206)	(9,547)
Exercise of stock options, not including tax benefits	1,720	2,873
Net cash provided by financing activities	231,680	623,043
Effect of foreign currency translation on cash and cash equivalents	1,717	169
Net (decrease) increase in cash and cash equivalents	(296,464)	413,000
Cash and cash equivalents beginning of period	513,041	255,933
Cash and cash equivalents end of period	$ 216,577	$ 668,933
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 212,192	$ 116,633
Income taxes	$ 7,104	$ 42,785

See accompanying unaudited notes to consolidated financial statements.

Table of Contents

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

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

Note 1. Organization and Summary of Significant Accounting Policies

Organization

The accompanying unaudited consolidated financial statements include the accounts of Jefferies Group, Inc. and all its subsidiaries (together, we or us), including Jefferies & Company, Inc. (Jefferies), Jefferies Execution Services, Inc., (Jefferies Execution), Jefferies International Limited, Jefferies Asset Management, LLC, Jefferies Financial Products, LLC and all other entities in which we have a controlling financial interest or are the primary beneficiary , including Jefferies Employees Opportunity Fund, LLC (JEOF). The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the U.S. for complete financial statements. In the opinion of our management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month period ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. These unaudited consolidated financial statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2006.

Reclassifications

Certain reclassifications have been made to previously reported balances to conform to the current presentation. These reclassifications had no effect on the Consolidated Statements of Earnings.

Starting in 2006, we included contingent consideration paid in subsequent periods relating to prior business combinations as investing activities in the Consolidated Statements of Cash Flows included in this report and accordingly have corrected the March 31, 2006 period to be consistent with the current presentation. The cash payments related to the contingent consideration are primarily paid during the first quarter. For the quarter ended March 31, 2006, this correction had the effect of reducing net cash used in operating activities and increasing net cash used in investing activities by $19.9 million from that previously reported. The amounts involved are immaterial to the Consolidated Financial Statements. In addition, the change only affects the presentation within the Consolidated Statements of Cash Flows and does not impact the Consolidated Statements of Financial Condition or the Consolidated Statements of Earnings, debt balances or compliance with debt covenants.

Common Stock

On April 18, 2006, we declared a 2-for-1 split of all outstanding shares of our common stock, payable May 15, 2006 to stockholders of record as of April 28, 2006. The stock split was effected as a stock dividend of one share for each one share outstanding on the record date. All share, share price and per share information included in this quarterly report, including the consolidated financial statements and the notes thereto, have been restated to retroactively reflect the effect of the two-for-one stock split.

Table of Contents

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

Summary of Significant Accounting Policies

Principles of Consolidation

Our policy is to consolidate all entities in which we own more than 50% of the outstanding voting stock and have control. In addition, in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 46(R), *Consolidation of Variable Interest Entities* (FIN 46(R)), as revised, we consolidate entities which lack characteristics of an operating entity or business for which we are the primary beneficiary. Under FIN 46(R), the primary beneficiary is the party that absorbs a majority of the entity s expected losses, receives a majority of its expected residual returns, or both, as a result of holding variable interests, direct or implied. In situations where we have significant influence but not control of an entity that does not qualify as a variable interest entity, we apply the equity method of accounting. If we do not consolidate an entity or apply the equity method of accounting, we account for our investment at fair value. We also have formed nonconsolidated investment vehicles with third-party investors that are typically organized as limited partnerships. We act as general partner for these investment vehicles and have generally provided the third-party investors with termination or kick-out rights as defined by EITF 04-5, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights*.

All material intercompany accounts and transactions are eliminated in consolidation.

Revenue Recognition Policies

Commissions. All customer securities transactions are reported on the Consolidated Statement of Financial Condition on a settlement date basis with related income reported on a trade-date basis. Under clearing agreements, we clear trades for unaffiliated correspondent brokers and retain a portion of commissions as a fee for our services. Correspondent clearing revenues are included in other revenue. We permit institutional customers to allocate a portion of their gross commissions to pay for research products and other services provided by third parties. The amounts allocated for those purposes are commonly referred to as soft dollar arrangements. Soft dollar expenses amounted to $7.7 million and $8.0 million for the period ended March 31, 2007 and 2006, respectively. We are accounting for the cost of these arrangements on an accrual basis. Our accounting for commission revenues includes the guidance contained in Emerging Issues Task Force (EITF) Issue No. 99-19, *Reporting Revenues Gross versus Net*, because we are not the primary obligor of such arrangements, and accordingly, expenses relating to soft dollars are netted against the commission revenues.

Principal Transactions. Financial instruments owned, securities pledged and financial instruments sold, but not yet purchased (all of which are recorded on a trade-date basis) and investments are carried at fair value, as appropriate, with unrealized gains and losses reflected in principal transactions in the Consolidated Statement of Earnings on a trade date basis.

Investment Banking. Underwriting revenues and fees from mergers and acquisitions, restructuring and other investment banking advisory assignments are recorded when the services related to the underlying transaction are completed under the terms of the assignment or engagement. Expenses associated with such transactions are deferred until reimbursed by the client, the related revenue is recognized or the engagement is otherwise concluded. Expenses are recorded net of client reimbursements. Revenues are presented net of related unreimbursed expenses. Unreimbursed expenses with no related revenues are included in business development in the Consolidated Statement of Earnings. Reimbursed expenses totaled approximately $2.2 million and $3.6 million for the period ended March 31, 2007 and 2006, respectively.

Table of Contents

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

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

Interest Revenue and Expense. We recognize contractual interest on financial instruments owned and financial instruments sold, but not yet purchased on an accrual basis as a component of interest revenue and interest expense, respectively. Interest flows on derivative transactions and dividends are included as part of the mark-to-market valuation of these contracts in principal transactions in the Consolidated Statements of Earnings and are not recognized as a component of interest revenue or expense. We account for our short-term and long-term borrowings on an accrual basis with related interest recorded as interest expense.

Cash Equivalents

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

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

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

Foreign Currency Translation

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

Investments

Investments include direct investments in limited liability companies and partnerships that make investments in private equity companies, strategic investments in financial service entities and other investments. With the adoption of FASB No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* (FASB 159), we apply fair value accounting on positions that are risk-managed on a fair value basis. Factors considered in valuing investments at fair value include, without limitation, available market prices, reported net asset values, type of security, purchase price, purchases of the same or similar securities by other investors, marketability, restrictions on disposition, current financial position and operating results of the issuer and other pertinent information. For strategic investments in financial services entities we apply the equity method of accounting. Investment gains and losses are included in principal transactions in the Consolidated Statements of Earnings.

Table of Contents

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

Investments in Managed Funds

Investments in managed funds includes our investments in funds managed by us and our investments in third-party managed funds in which we are entitled to a portion of the management and/or performance fees. Investments in managed funds are accounted for on the equity method.

Receivable from, and Payable to, Customers

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

Fair Value of Financial Instruments

Substantially all of our financial instruments are carried at fair value or amounts approximating fair value. Assets, including cash and cash equivalents, securities borrowed or purchased under agreements to sell, and certain receivables, are carried at fair value or contracted amounts, which approximate fair value due to the short period to maturity. Similarly, liabilities, including bank loans, securities loaned or sold under agreements to repurchase and certain payables, are carried at amounts approximating fair value. Debt is carried at face value less unamortized discount, except for the $200.0 million aggregate principal amount of unsecured 7^3/4% senior notes due March 15, 2012 hedged by interest rate swaps. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). Financial instruments owned and financial instruments sold, not yet purchased, are valued at quoted market prices, if available. For financial instruments that do not have readily determinable fair values through quoted market prices, the determination of fair value is based upon consideration of available information, including types of financial instruments, current financial information, restrictions on dispositions, fair values of underlying financial instruments and quotations for similar instruments.

In addition to the interest rate swaps mentioned above, we have derivative financial instrument positions in exchange traded and over-the-counter option contracts, foreign exchange forward contracts, index futures contracts, commodities swap and option contracts and commodities futures contracts, which are measured at fair value with gains and losses recognized in principal transactions. The gross contracted or notional amount of these contracts is not reflected in the Consolidated Statements of Financial Condition. We follow FIN No. 39, *Offsetting Amounts Related to Certain Contracts* (FIN 39), and offset assets and liabilities in the Consolidated Statements of Financial Condition provided that the legal right of offset exists under a master netting agreement. This includes the offsetting of payables or receivables relating to the fair value of cash collateral received or paid associated with its derivative inventory, on a counterparty basis.

Prior to the adoption of FASB No. 157, *Fair Value Measurements* (FASB 157), we followed Emerging issues Task Force Statement No. 02-3, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities (EITF 02-3).* This guidance generally prohibited recognizing profit at the inception of a derivative contract unless the fair value of the derivative was obtained from a quoted market price in an active market or was otherwise evidenced by comparison to other observable current market transactions or based on a valuation technique that incorporates observable market data. Subsequent to the transaction date, we recognized trading profits deferred at inception of the derivative transaction in the period in which the valuation of an instrument became observable. With the adoption of FASB 157, we are no longer applying the revenue recognition criteria of EITF 02-3. However, FASB 157 requires that a fair value measurement reflect the assumptions market participants would use in pricing an asset or liability based on the best information available.

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

Securities Borrowed and Securities Loaned

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

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

Securities purchased under agreements to resell and securities sold under agreements to repurchase (repos) are treated as collateralized financing transactions and are recorded at their contracted repurchase amount.

We monitor the fair value of the repos daily versus the related receivable or payable balances. Should the fair value of the repos decline or increase, additional collateral is requested or excess collateral is returned, as appropriate.

We carry repos on a net basis when permitted under the provisions of FASB Interpretation No. 41, *Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements* (FIN 41).