



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

September 16, 1997

Mr. Frank J. Maresca  
Managing Director  
Bear Stearns & Co. Inc.  
245 Park Avenue  
New York, New York 10167

**ACT** 1940 ICA  
**SECTION** 18 + 21  
**RULE** \_\_\_\_\_  
**PUBLIC AVAILABILITY** 9/16/97

Re: Securities Lending

Dear Mr. Maresca:

In your letter dated September 2, 1997, you expressed concern over the application of Statement of Financial Accounting Standards No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," ("SFAS #125"), to securities lending transactions because of an example that was included in a footnote in a recent Commission Release, No. IC-22530 (the "Release"). The footnote was included in the Release to illustrate general accounting treatment for a securities lending transaction. It was not intended to limit or redefine the accounting treatment of securities lending transactions. SFAS #125 is the authoritative accounting and reporting standard for securities lending transactions, and any determination regarding the proper accounting treatment of securities lending transactions should be based on SFAS #125.

Your letter describes the securities lending practice of Bear Stearns, whereby an investment company lends its securities to Bear Stearns, in return for securities as collateral.<sup>1</sup> You state your view that collateral received by a securities lender does not have to be recorded as an asset by the lender, if 1) the lender is unable to pledge or sell the collateral, 2) the collateral may not be commingled with the lender's other assets, and 3) the lender is obligated to return such collateral to Bear Stearns whenever Bear Stearns terminates the corresponding securities loan which, under the terms of its securities lending agreement, Bear Stearns is permitted to do at any time in its discretion.<sup>2</sup> You assert that it would be appropriate for an investment company, when acting as lender in these circumstances, to disclose the value of such collateral in a footnote to its financial statements along with the value of the loaned securities.

<sup>1</sup> Your inquiry and our response is limited to the use of securities as collateral in a securities lending transaction.

<sup>2</sup> We note that these arrangements may occur by contract or custom. See SFAS #125, Par.15 (a).

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We would not disagree with that presentation under the facts and circumstances described in your letter. When an investment company does not have "effective control" over the securities collateral, as defined under SFAS #125, it would not record the securities received as collateral as its asset. Conversely, the securities that the investment company has loaned remain its asset and should continue to be reported as part of its portfolio with appropriate footnote disclosure of the securities lending arrangement.

If you have further questions or comments, you may call me at (202) 942-0639.

Sincerely,



John S. Capone  
Assistant Chief Accountant

**BEAR  
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September 2, 1997

Mr. Lawrence A. Friend  
 Chief Accountant  
 Division of Investment Management  
 Securities and Exchange Commission  
 Washington, D.C. 20549

Re: SFAS #125 and Securities Lending

Dear Mr. Friend:

A statement made in footnote 31 to the Commission's Release No. IC-22530 (February 27, 1997) (the "Footnote Statement") seems to suggest that an investment company which has loaned securities would, on the one hand, no longer include such securities in its total assets, and would, on the other hand, include in its total assets the collateral received for such loaned securities. This statement has raised concerns among certain of the investment company clients of Bear Stearns regarding the application of Statement of Financial Accounting Standards No.125 ("SFAS #125") to securities lending transactions. To allay these concerns, we would like to request clarification of the relationship between the Footnote Statement and SFAS #125 and of the proper application of SFAS #125 to securities lending transactions between investment companies and Bear Stearns. In this letter, we limit our inquiry to securities lending transactions in which the collateral received consists of securities.

Bear Stearns, as borrower, engages in securities lending transactions with a number of investment companies as lenders. These transactions are governed by an agreement between each investment company and Bear Stearns which provides that the lending fund may, in its discretion, terminate a securities loan at any time, in which case Bear Stearns is obligated to return the loaned securities to the fund. In addition to having this discretionary power of recall over the loaned securities, the lending fund also remains entitled to receive dividends and other payments that may be made on such securities.

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As regards securities collateral received by it from Bear Stearns in a securities lending transaction, the lending fund is obligated to return such collateral to Bear Stearns whenever the fund terminates the corresponding securities loan. Moreover, the fund is also obligated to return such collateral to Bear Stearns whenever Bear Stearns terminates the corresponding securities loan, which is something that Bear Stearns can do at any time in its discretion. In addition, the lending fund may not pledge collateral consisting of securities, or lend it to others, nor may it commingle such collateral with its own assets.

The foregoing provisions demonstrate, in our view, that the lending fund retains effective control over loaned securities, but does not acquire effective control over collateral consisting of securities, as defined under SFAS #125.

Consequently, it is our view that under SFAS #125 an investment company which engages in securities lending transactions that are subject to contractual provisions with Bear Stearns as described in this letter and which, in such transactions, receives collateral consisting of securities

(1) would continue to carry the loaned securities as its asset, with the result that they would still be included in the fund's schedule of investments, and

(2) would not record as its asset the collateral for such loaned securities, but would instead disclose the value of such collateral in a footnote to its financial statements along with the value of the loaned securities.

Please confirm to us in writing, first, that SFAS #125 in fact controls the accounting treatment to be accorded by an investment company to its securities lending transactions and that the Footnote Statement is not meant to supersede SFAS #125, but is simply an illustration of what total assets would include in those cases where SFAS #125 requires securities lending collateral to be included in total assets, and, second, that an investment company which engages in securities lending transactions that are subject to contractual provisions with Bear Stearns as described in this letter and which, in such transactions, receives collateral consisting of securities would not under SFAS #125 be required to include such collateral in its total assets.

In further support of our request, we enclose an opinion of Deloitte & Touche, dated March 11, 1997, who, on our behalf, have reviewed and considered SFAS #125 in connection with investment company securities lending arrangements. This Deloitte & Touche

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opinion supports our view that when securities lending arrangements are structured as described in the present letter it would be appropriate for investment companies (when acting as lender) to disclose securities collateral in the footnotes to their financial statements (and not to record such collateral as an asset).

Please call Frank Nestor at 212-272-2085 with any questions that you may have about this letter. Thank you for your continuing assistance in our inquiry.

Very truly yours,



Frank J. Maresca  
Managing Director

cc: Michael Minikes  
Elizabeth R. Krentzman  
(Deloitte & Touche)