MorganStanley

Letter of Comment No:
File Reference: FSPFAS140C
Date Received:

August 22, 2005

Mr. Lawrence W. Smith
Director, Technical Application and Implementation Activities —FSP
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed FASB Staff Position No. FAS 140-c, Clarification of the Application of Paragraphs 40(b) and 40(c) of FASB Statement No. 140 (the "Proposed FSP")

Dear Mr. Smith:

Morgan Stanley appreciates the opportunity to provide comments in response to the Proposed FSP. We commend the Financial Accounting Standards Board's (the "Board") efforts in addressing the issues identified within the Proposed FSP. However, we urge the Board not to issue the Proposed FSP given the Exposure Drafts issued on August 12, 2005, that would amend Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities ("Statement 140"). The Exposure Drafts would allow for notional amounts of derivative financial instruments entered into by a qualifying special purpose entity ("QSPE") to equal the total amount of beneficial interests issued, including those held by a transferor, its affiliates, and its agents, thus invalidating much of the guidance in the Proposed FSP, particularly as it relates to market-making and trading activities.

Morgan Stanley has also actively contributed to the development of comments in the letter responding to the Proposed FSP presented by the American Securitization Forum dated, August 22, 2005 and we endorse the tenets in that letter.

Prepayments, Market-Making and Trading

With the understanding that the Board intends to amend Statement 140 with the recently issued Exposure Drafts, any clarification of existing guidance that enables constituents to currently account for transactions in a manner similar to that proposed in the Exposure Drafts seems prudent. Thus, we would accept clarifying that the existing guidance indicates that the threshold for determining prepayment expectations is a good-faith effort

and not one that must incorporate unexpected events in order for a QSPE to comply with paragraphs 40(b) and 40(c) of Statement 140. However, requiring comparable measures for market-making or trading activities may lead to less consistency and less comparability in financial reporting for these transactions depending on an SPE's creation date given that yet another accounting model would then be in place under the Exposure Drafts as the proposed transition provisions indicate applicability only to existing QSPEs that do not meet the grand-fathering provisions.

Moreover, in relation to QSPE status and the impact of market-making activities, parties to non-qualifying SPEs, either upon transition to the Proposed FSP or for SPEs created during the intervening period up to the effective date of any revisions to Statement 140, may unknowingly need to perform a consolidation analysis under FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, an interpretation of ARB No. 51, without having access to the information necessary to perform such an analysis.

Additionally, given market demands, investor appetite, and rating agency requirements relating to pricing issues and risk mitigation for QSPEs, we do not believe derivatives that comply with the Proposed FSP's requirements are feasible. The marketplace requires that derivatives with a notional amount equal to the total beneficial interests issued by the QSPE be executed at inception and be in place throughout the life of the structure. This is because the derivative serves as a mechanism to allocate the cash flows between the assets transferred to the QSPE and the beneficial interests. If the notional amount of the derivative is not equal to the total beneficial interests issued by the QSPE, the marketplace would view the structure as nonoperational and the beneficial interests could not be placed with investors. Further, we question whether the concept of "remedial action taken by the qualifying SPE to "rebalance" the derivative amount with the amount of beneficial interests held by parties other than the transferor, its affiliates, or its agents...in accordance with the terms and activities specified in the governing documents of the qualifying SPE" could ever be a practical option given decision making restrictions for QSPEs contained within paragraph 35(b) of Statement 140.

Therefore, we believe that the proposed guidance for market-making and trading activities should not be provided at this time, but rather postponed so that, to the extent guidance in this area is necessary, it is ultimately consistent with the conceptual bases of any final revisions to Statement 140.

In the event the Board does move forward with the Proposed FSP, we have further technical comments outlined below on certain aspects of the Proposed FSP.

Transition

Due to our aforementioned concerns, the transition provisions of the Proposed FSP, at most, should only prescribe the prospective application of this guidance to new SPEs. To the extent that application of this guidance remains applicable to existing SPEs, then please provide clarity on how to apply the transition requirements to those entities. For example, we could not determine whether the facts and circumstances existing at the effective date

of the Proposed FSP may indicate that an existing QSPE may need to be prospectively treated as a non-QSPE on the effective date or, rather, that the guidance would only be applied to existing QSPE arrangements upon modifications, rebalances or some other event.

Definition of Market-Making or Trading

The third and fourth sentences of paragraph 6 reference "owning, for a short period of time" beneficial interests in relation to market-making and trading activities. While we are aware that paragraph 12 of Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities ("Statement 115"), utilizes similar language in describing trading activities, we note that Q&A 115--A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities: Questions and Answers, numbers 34 and 35 indicate that an enterprise is not precluded from classifying as trading a security that it does not intend to sell in the near term and in fact may plan to hold for a longer period. Additionally, Sections 1.54 and 2.45-2.47 of the AICPA Audit and Accounting Guide, Brokers and Dealers in Securities, that discusses trading and market-making activities by broker-dealers imply that even though many of these activities will be completed quickly, if not simultaneously, certain of these activities contemplate holding positions for longer periods of time. Therefore, we believe the Proposed FSP should not prescribe or imply any specified time period if the beneficial interests are obtained in the normal course of market-making or trading activities.

Detail Corrections

The second sentence of paragraph 5 states that "... a transferor typically obtains a notional amount of derivatives to mitigate risks..." We suggest that this be rephrased as "a QSPE enters into a derivative with a certain notional amount to mitigate risks."

The last sentence of paragraph 6 indicates that beneficial interests obtained in a trading as well as a market-making capacity "are typically highly rated." Our experience indicates that variously rated and non-rated, and not just "highly rated" beneficial interests, are obtained in market-making and trading activities and suggest that this sentence be modified to encompass actual market experience.

Within the first sentence of paragraph 10, we do not understand the purpose of using the phrase "outside the control of" in lieu of the phrase "[held by] parties other than" presently contained within paragraph 40(a)(1) of Statement 140. Is there a particular reason for the change? If so, please clarify the purpose of the change for constituents. We suggest revising the Proposed FSP to revert to the language currently in paragraph 40(a)(1) of Statement 140.

Again, we commend the Board's efforts to address the issues in the Proposed FSP. Nevertheless, we reiterate that we urge the Board not to issue the Proposed FSP given the recently issued Exposure Drafts that would amend Statement 140, in which the Board has proposed differing guidance regarding the notional amount of derivative financial instruments held by a QSPE and which we believe provides constituents with a means to address the issues identified within the Proposed FSP. We would be pleased to discuss our comments with the Board or the Staff. Please contact Staci Lublin at (212) 276-2456, David Prinzivalli (212) 276-2477 or myself at (212) 276-2620 with questions or comments.

Sincerely,

/s/ David S. Moser
Managing Director
Principal Accounting Officer