## **MORGAN STANLEY**

MORGAN STANLEY GROUP INC. 1221 AVENUE OF THE AMERICAS NEW YORK, NEW YORK 10020 (212) 703-4000

January 15, 1996

Letter of Comment No: 68
File Reference: 1082-154
Date Received: //5/96

Mr. Timothy Lucas
Director of Research and Technical Activities
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

RE: File Reference No. 154-D

Dear Mr. Lucas:

Morgan Stanley Group Inc. (Morgan Stanley) appreciates the opportunity to respond to the FASB's Exposure Draft (ED) on the Proposed Statement of Financial Accounting Standards "Consolidated Financial Statements: Policies and Procedures". We do not agree with the Board's proposal and we believe the effect of consolidating certain merchant banking investments would significantly distort the financial statements of broker dealers and make them less meaningful and more confusing to readers. Moreover, we believe the additional costs that would be involved with the proposed policy would greatly outweigh whatever benefits the Board believes might result from changes in current consolidation accounting practices.

Morgan Stanley is a major international investment bank whose businesses include, among other things, the purchase of securities and other financial instruments with the intent of reselling them. Current accounting for these investments is to carry them at fair value. Equity securities obtained in connection with merchant banking activities are similarly acquired to be resold and are also carried at fair value. The only difference is that the holding period for merchant banking investments can be longer than one year, which under the proposal would require consolidation of such investments. We have closely followed the correspondence submitted by the Financial Management Division (FMD) of the Securities Industry Association (SIA)<sup>1</sup>, specifically illustrating numerous reasons why it is inappropriate for broker dealers to consolidate merchant banking investments. We believe the reasons outlined in such correspondence are sound and that similar to the exemption created for the investment companies, merchant banking investments of broker dealers should be exempted from consolidation.

<sup>&</sup>lt;sup>1</sup> See "Accounting Issues Memorandum for Merchant Banking Investments by Brokers and Dealers in Securities" submitted to FASB dated May 16, 1995.

The ED indicates that the proposed statement would not apply to financial statements of certain reporting entities that in accordance with GAAP carry all of their assets and liabilities at fair value. Broker dealers are required under GAAP to carry repurchase agreements and their long term debt securities at cost and accordingly, do not satisfy the criteria for exemption. In our view, this distinction is not sufficient justification for requiring a significantly different accounting treatment. Moreover, the Board's recent discussions on hedge accounting would have us understand that these financial instruments may be carried at fair value in the future. If the policies currently under discussion are adopted, virtually all assets and liabilities of broker dealers would be carried at fair value, therefore, exempting them from having to consolidate merchant banking investments. It would, therefore, be inappropriate and confusing to require consolidation for one reporting period and then deconsolidate once the contemplated hedge accounting policies go into effect.

Generally, merchant banking transactions are structured such that the broker dealer, through another controlled subsidiary, is the general partner (GP) in the limited partnership making the investment. While the GP typically has a minority financial interest in the investment (in many cases only 10%), the ED would require it to consolidate the underlying entity because it could exert control over the entity's assets. We believe that control over the entity's assets is evidenced only when there is a majority voting and economic ownership interest in the entity.

Paragraph 31 of the ED would require that the consolidated financial statements conform the accounting policies of subsidiaries operating in a specialized industry. Accounting policies for subsidiaries in specialized industries were developed with the intent to present the most meaningful financial information to the readers of such subsidiary's financial statements. Unwinding the accounting for subsidiaries in specialized industries in consolidation will diminish the meaningfulness of such financial information to the readers of such financial statements. It will also involve additional costs to do so, without providing any substantive benefits.

We would be glad to discuss this letter with the FASB or its staff.

Sincerely,

Eileen K. Murray
Managing Director