

Morgan Stanley



LETTER OF COMMENT NO.

79

June 5, 2006

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

Re: File Reference No. 1250-001, Proposed Statement of Financial Accounting Standards, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment to FASB No. 115* (the “Exposure Draft”)

Dear Mr. Smith:

Morgan Stanley appreciates the opportunity to provide comments in response to the above referenced Exposure Draft. We strongly support the Exposure Draft for the reasons cited therein: mitigation of volatility in earnings resulting from a mixed-attribute accounting model, achievement of accounting offset without the complexity of hedge accounting, and convergence with international accounting standards. The Exposure Draft provides an opportunity for significant improvement and simplification in financial reporting. It also represents the most expedient resolution to many of the shortcomings in SFAS No. 133, *Accounting for Derivatives and Hedging Activities*. It will also better align financial reporting with our risk management practices. Therefore, we urge the FASB to proceed with the issuance of a final standard.

We have contributed to the development of the letter dated April 5, 2006 submitted jointly by the American Securitization Forum (ASF), the International Swaps and Derivatives Association (ISDA), the Securities Industry Association (SIA), and the Bond Market Association (TBMA) regarding the Exposure Draft, and we endorse the comments in that letter. We are providing the following additional comments for your consideration; we do not believe any of these comments should delay issuance of a final standard.

Timing

We support the FASB's decision to move forward quickly with Phase 1 of the fair value option (FVO) project and strongly encourage continued efforts in Phase 2 of the project. We request that the FASB proceed with deliberation of Phase 2 of the project as soon as practicable following conclusion of Phase 1. However, we are concerned that Phase 2 could be protracted due to the complexity and breadth of remaining issues. We therefore suggest that the FASB conduct Phase 2 in sub-phases. Phase 2a should address issues that can be resolved in a relatively short period, while Phase 2b should address more complex and controversial issues.

Scope of Exposure Draft

We presently accept the scope as provided in the Exposure Draft. In particular, we strongly believe the FASB should retain within scope both equity method investments and unrecognized firm commitments (as defined under SFAS 133) that relate only to financial instruments. Fair value is a more relevant measure than (i) the accounting model for equity-method investments under APB 18 and (ii) cost (usually zero) used for unrecognized firm commitments.

Scope Suggestions for Phase 2a of FVO Project

We believe the following items should be permitted the fair value measurement election and suggest they be included in Phase 2a of the FVO project:

- (i) Physical commodities and commodity related contracts – Numerous financial services firms, commodity producers, commodity suppliers and others actively trade physical commodities and commodity related contracts. These items are risk managed on a fair value basis and observable market inputs often are available to determine reliable fair value estimates.
- (ii) Written loan commitments not accounted for as derivatives under SFAS 133 – We manage risk related to written loan commitments on a fair value basis; yet, most such contracts are not afforded fair value accounting. We do not believe there is a substantive economic difference between loan commitments to originate mortgages to be sold (within the scope of SFAS 133) and other loan commitments (excluded from the scope of SFAS 133).
- (iii) Financial guarantee contracts within the scope of FIN 45 – Many contracts within FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* ("FIN 45"), are economically similar to derivatives accounted for at fair value under SFAS 133. Financial standby letters of credits are akin to credit default swaps and market value guarantees are akin to written put options.

We believe that a fair value measurement election for all of the aforementioned items would lead to improved financial reporting.

Again, we thank you for the opportunity to provide comments related to the Exposure Draft and we urge the FASB to proceed with the issuance of a final standard. Please contact Karen Dealey at (212) 276-2452 or myself at (212) 276-4364 with any questions or comments.

Sincerely,

/s/ Esther Mills
Managing Director