Morgan Stanley

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Mr. Russell G. Golden
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
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LETTER OF COMMENT NO. 52

Re: File Reference Number 1590-100, Proposed Statement of Financial Accounting Standards, Accounting for Hedging Activities, an amendment of FASB Statement No. 133

Dear Mr. Golden:

Morgan Stanley appreciates the opportunity to comment on the Exposure Draft for the Proposed Statement of Financial Accounting Standards, Accounting for Hedging Activities, an amendment of FASB Statement No. 133 (referred to as the "Exposure Draft" herein). We have also contributed to the August 15, 2008 letter submitted by the International Swaps and Derivatives Association ("ISDA").

We are supportive of the FASB's efforts to simplify accounting and improve reporting for hedging activities under SFAS 133, Accounting for Derivative Instruments and Hedging Activities ("SFAS 133"). However, we agree with the dissenting Board members' views (as expressed in paragraphs A52 – A60 of the Exposure Draft) that the proposed amendment does not simplify the application of SFAS 133, provides accounting results that are inconsistent with risk management strategies and adds to the differences between SFAS 133 and the international standard on derivatives and hedging (IAS 39) at a time when we should be moving towards convergence. We therefore do not support the issuance of this Exposure Draft.

The FASB's decision to eliminate the ability to hedge-by-risk and require preparers to evaluate effectiveness based upon total change in fair value of a hedged item/transaction (with the exception of own debt at inception) would significantly impact many of the most simple and common hedging strategies used by preparers of financial statements. Derivatives are generally designed to hedge specific risks and hedging all risks (such as one's own credit) may not be a feasible alternative. Given the difficulties this would present, preparers may elect not to apply hedge accounting and assume increased

volatility from the hedged risk or choose not to hedge and therefore, expose themselves to economic risk. The net result of these options is that the accounting for hedge activities would not be reflective of the way a company manages risk, produce financial statement results that are misleading, and decrease comparability amongst preparers.

We also question the timing of this project, which would create significant divergence from IFRS at a time when US public companies expect a migration toward IFRS in the foreseeable future. Implementing the changes in this Exposure Draft then adopting IFRS would present a significant challenge to preparers and would not be helpful to financial statement users. Compounding this dynamic, companies may then be required to change their hedge accounting models yet again based on the outcome of the current International Accounting Standards Board ("IASB") project, Reducing Complexity in Reporting Financial Instruments. We believe this is an unreasonable expectation for preparers with the costs greatly outweighing the benefits.

In addition to these over overarching comments, we also offer comments in MS Attachment I for your consideration. We would be pleased to discuss our comments with the Board members or the FASB staff at your convenience.

Sincerely,

/s/ Greg Sigrist
Managing Director
Global Head of Accounting Policy

cc: Esther Mills

MS Attachment 1

Hedged Risk

Eliminating an entity's ability to designate individual risks in a hedge accounting relationship will result in increased complexities of applying hedge accounting and will distort financial statement results.

The proposed Exposure Draft requires that changes in fair value of the derivative are expected to reasonably offset all changes in fair value (or cash flows) of the hedged item/transaction in order to qualify for hedge accounting (with the exception of own debt at inception). Derivatives are generally designed to hedge specific risks and hedging all risks (such as one's own credit risk) may not be a feasible alternative as there may be limited products in the marketplace or firms may be prohibited from doing so due to concerns about self-dealing and trading on insider information. Firms will be required to include the changes in fair value for risks that cannot be hedged in the income statement, which will distort earnings and will not be reflective of the intended risk management strategy. This proposed change will impact many of the most simple and commonly used hedging strategies by firms, including late hedging of debt, forecasted issuances of debt, and interest-bearing assets.

Many preparers commonly enter into hedges of debt subsequent to inception, as well as replace the derivative instrument (e.g., re-couponing interest rate derivatives reduces the associated credit risk) subsequent to the inception of the hedge, which results in the loss of the ability to continue to hedge the benchmark interest rate risk of the hedged item. The elimination of bifurcation by risk for these transactions will result in reduced comparability between preparers who hedge at inception versus those who hedge post inception or re-coupon hedges despite the fact that they are hedging the same risks.

For these reasons, (also as expressed by the dissenting Board members in paragraphs A52-A60 of the Exposure Draft) we recommend that the FASB retain the ability to hedge by risk as it provides income statement results that are most useful and reflective of how firms manage risks.

We understand that it is FASB's desire to move towards accounting for all financial instruments at fair value. However, we do not believe that it is appropriate to address this issue in an amendment to SFAS 133 which will result in preparers accounting for hedged items at fair value where they have not already elected to do so under SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities. We believe that this issue would be better addressed in a broader project on the accounting for financial instruments. We understand the FASB's concern that allowing hedge-by-risk produces balance sheet measurements for hedged items that are not at amortized cost or fair value. However, we believe that the disclosure requirements in SFAS 161, Disclosures about Derivative Instruments and Hedging Activities, are sufficient in highlighting the adjustments made to hedged items and the impact on financial statements.

We would also like to reiterate our concern with the FASB moving forward with this project, which will create divergence from IFRS and put undue burden on preparers to adopt these changes, at a time when US public companies are expected to be moving towards adopting IFRS in the foreseeable future. We understand that the IASB is also working on a project to simplify hedge accounting (*Reducing Complexity in Reporting Financial Instruments*) and we urge the FASB to discontinue this separate project and to work jointly with the IASB to meet the objectives of eliminating differences between the two standards and to simplify accounting and improve reporting for hedging activities.

Hedge Effectiveness

We support the FASB's proposal to lower the threshold for hedge effectiveness requirements from "highly effective" to "reasonably effective" and to allow preparers to perform this assessment qualitatively. However, if firms are no longer able to apply the hedge-by-risk approach, the benefits of these amendments will be limited.

The FASB prescribes that a qualitative assessment shall demonstrate that changes in fair value of the hedging instrument would be reasonably effective in offsetting changes in the hedged item's fair value or variability in cash flows and that in certain situations, a quantitative assessment may be necessary at the inception of the hedging relationship. After inception, an entity shall reassess effectiveness only if circumstances suggest that the hedging relationship may no longer be reasonably effective.

Including credit risk in the assessment of effectiveness may cause simple and common hedge strategies that currently qualify for hedge accounting to no longer qualify even under the reduced "reasonably effective" threshold. As noted above, in many instances an entity is not able to hedge the credit risk of the hedged item due to the lack of available products or is prohibited from doing so due to concerns over speculating on one's own credit risk. It may be unreasonable to expect that the change in fair value of an interest rate swap would result in a reasonably effective hedge of the change in fair value of the hedged item including all risks (interest and credit), especially if the credit component is unobservable or credit spreads are large and/or volatile.

FASB has not provided criteria for determining when a qualitative versus a quantitative evaluation is necessary. In lieu of such guidance auditors and regulators will likely develop their own criteria or will require a quantitative assessment on an on-going basis to continue to support the assumption that the hedge is expected to be reasonably effective. The FASB believes that the cost of compliance with this proposed amendment will be reduced because entities will not have to develop sophisticated quantitative statistical models to prove a hedging relationship is effective in situations in which it is obvious that a hedging relationship is effective.

Therefore, in order to make this aspect of the proposal truly operational, if the FASB moves ahead with this project, we recommend that the FASB provide additional examples for common hedging strategies (including common interest rate hedging

strategies for both assets and liabilities) demonstrating when a qualitative assessment is sufficient. We also recommend that the FASB limit the reassessment of a hedge relationship subsequent to inception to circumstances in which the critical terms of the hedged item/transaction or the hedging instrument are modified. Only after these criteria are established do we think constituents will be able to assess whether the amendment will provide true "relief" from performing a quantitative assessment of effectiveness.

Presentation of Hedging Gains and Losses

We do not support the issuance of further guidance to prescribe the presentation of gains and losses associated with hedging instruments as we believe the disclosure requirements in SFAS 161 provide sufficient information regarding the location of gains and losses in the financial statements for hedging instruments and the related hedged items.

Designation

We support the dissenting Board member's view that the application of SFAS 133 should not produce accounting results that are inconsistent with a firm's risk management strategy. Certain firms manage risks at an individual transaction level while others may take an overall risk management approach that is not necessarily based on exposures from an individual transaction. Because SFAS 133 hedge accounting requires hedge relationships to be designated at an individual transaction level, many firms designate individual hedges as part of an overall risk management strategy. Changes in the risk profile can require changes in the hedge strategy, which may require the ability to add new hedging relationships or dedesignate existing hedge relationships.

We understand the Board's view that if the economics of the relationship between the hedging instrument and the hedged item have not changed then the accounting should not change. However, as noted above, different firms have different risk management strategies and firms need to have the ability to apply accounting that is reflective of that strategy. We do not support the FASB's decision to eliminate the ability to selectively dedesignate a hedging relationship and find the proposed situations when one can dedesignate a hedged transaction to be unnecessarily restrictive. Providing the option to effectively terminate a derivative by entering into an offsetting derivative is costly and will increase a Firm's complexity to effectively apply their risk management strategy.

We acknowledge the FASB's concern that dedesignation can be used as a tool for changing measurement attributes and/or managing the classification of certain items reported in earnings, however, accounting designations must be made in advance of market movements and we do not agree that the ability to dedesignate a hedge can result in the manipulation of earnings in a given period, given the effects of applying hedge accounting must be amortized to the income statement over the remaining life of the previously hedged item/transaction, so long as that item/transaction continues to exist or is still expected of occurring.

Hedges of Net Investments

It is unclear how the changes to the designation rules as proposed in the Exposure Draft will impact hedges of Net Investments. In the proposed amendments to SFAS 133, DIG H7, which provides guidance for the frequency of designation of hedged net investments, will be superseded. We are concerned that disallowing the ability to dedesignate and redesignate the hedge of these balances will be problematic as they typically fluctuate period to period.

In paragraph A20 of the Exposure Draft the Board stated that a reconsideration of hedge accounting for the types of hedge items and hedging instruments under SFAS 52, Foreign Currency Translation, and carried over in SFAS 133 would not be feasible in this project as it would necessitate reconsideration of SFAS 52 and would not be necessary to achieve the objectives of the project. We question why the FASB's is removing the guidance for Net Investment hedging given the FASB's stated decision not to challenge hedge accounting for transactions under SFAS 52 and the fact that there have been little issues in practice in applying this hedge guidance. We recommend that the FASB exempt Net Investment hedges from the proposed changes to the designation rules and continue to allow hedge accounting for Net Investment hedges as currently prescribed in SFAS 133.