

## Morgan Stanley

January 31, 2007

Mr. Lawrence W. Smith Director, TA&I - FSP 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: File Reference No. FSPFIN39A, Proposed FASB Staff Position No. FIN 39-a, Amendment of FASB Interpretation No. 39

Dear Mr. Smith:

Morgan Stanley appreciates the opportunity to provide comments in response to the Proposed FASB Staff Position ("FSP") No. FIN 39-a, Amendment of FASB Interpretation No. 39. We have also contributed to the January 31, 2007 letter submitted by the International Swaps and Derivatives Association ("ISDA").

Morgan Stanley strongly endorses the Board's decision to issue the proposed FSP to amend FASB Interpretation No. 39 ("FIN 39"), Offsetting of Amounts Related to Certain Contracts. We support the premise in the proposed FSP that receivables and payables related to cash collateral amounts posted in connection with net derivative positions should be offset and agree with the Board that such netting results in an accurate portrayal of the amount of counterparty credit exposure when the related derivative instruments are also offset under a master netting arrangement. Accordingly, we would like to see the prompt issuance of a final FSP. We have, however, noted certain items that we believe may require additional clarification and consideration by the Board.

## Fair Value of Receivables/Payables Related to Cash Collateral Amounts

The proposed FSP FIN 39-a amends FASB Interpretation No. 39 ("FIN 39"), Offsetting of Amounts Related to Certain Contracts, to permit the offsetting of fair value amounts recognized for derivative instruments executed with the same counterparty under master netting arrangements with the "fair value amounts" recognized for the right to reclaim (receivable) or the obligation to return (payable) the cash collateral. In addition, paragraph 4 (d) of the proposed FSP (proposed paragraph 10A of FIN 39) requires separate (gross) disclosure of receivable and payable amounts that have not been offset because those amounts "are not fair value amounts." The requirement that collateral receivables and payables represent fair value amounts introduces a new concept which is not clearly defined in the proposed guidance. During deliberations, some Board members noted that receivables or payables generally represent fair value or an amount that approximates fair value. It was indicated that if daily collateral calls take place and the amounts outstanding bear a current or market interest rate then cash collateral receivables and payables would

be presumed to be at fair value. Weekly collateral calls may also occur with interest on the related cash collateral receivable and payable balances re-set on this basis. In these instances, we believe the receivable and payable balances approximate fair value.

We understand the Board's concern that amounts recognized for collateral receivables and payables should represent fair value amounts in order to present the net fair value for the entire position. However, we believe it would be helpful if the Board could clarify in the Background Information and Basis for Conclusions that amounts that approximate fair value, as well as amounts that are at fair value, are eligible for netting under the proposed guidance.

## Scope Exclusion for Physically Settled Contracts

The proposed FSP revises the scope exception in paragraph 10 of FIN 39 to permit netting only for those instruments that meet the definition of a derivative per FASB Statement No. 133 ("SFAS 133"), Accounting for Derivative Instruments and Hedging Activities. Historically, FIN 39 has permitted netting of conditional or exchange contracts executed with the same counterparty under a master netting arrangement. The terms "conditional" and "exchange" were used to ensure that contracts with similar characteristics were appropriately captured under paragraph 10 of FIN 39. That is, the contractual amount to be received or paid or the item to be exchanged upon settlement is dependent upon and varies in accordance with changes in interest rates, exchange rates, commodity prices, or other similar factors. Application of the strict SFAS 133 derivative definition results in balances related to physically settled instruments, such as certain commodity contracts, no longer being eligible for netting even though these instruments are subject to the same master netting arrangement and the amount to be exchanged varies based on factors such as commodity or security prices or interest rate movements.

We have difficulty understanding why physical settlement alone would warrant a scope exclusion from the proposed guidance and note that the requirement to post cash collateral for physically settled instruments is based on the same premise as that for cash settled instruments. That is, the amount of collateral required and the resulting receivable or payable recognized upon receipt or payment of such collateral depends upon and fluctuates in accordance with changes in the net exposure of the physically settled instrument. We believe that to require gross reporting for physically settled instruments and related collateral receivable and payable amounts but to permit net reporting for cash settled instruments will lend to inconsistencies in financial reporting for balances and contracts that are based on the same underlying principle and recommend the Board expand the scope of the proposed FSP to encompass these instruments.

We appreciate the Board's concern that broadening the scope of the proposed guidance beyond SFAS 133 derivative instruments may invite the netting of almost any receivable or payable balance recognized at fair value, particularly when the fair value option standard is issued. However, we believe a distinction can be drawn for instruments, such as physically settled commodities, whose contractual amounts and related collateral balances fluctuate based on changes in exposure imposed by the terms of the contract. In contrast, receivable and payable amounts that change based on the payor not acting in

accordance with the contractual terms should continue to be excluded from the scope of the guidance.

## Disclosures

Paragraph 4 (d) of the proposed FSP (proposed paragraph 10A of FIN 39) outlines the disclosures related to cash collateral receivable and payable balances including a requirement to separately disclose balances recognized for the right to reclaim or obligation to return cash collateral, regardless of whether such balances have been offset in the financial statements in accordance with paragraph 10 of FIN 39. We are unclear as to the benefit this information will provide to users of financial statements particularly in instances where such balances have in fact been offset. The Board determined that the offsetting of derivative instruments and related collateral amounts in the statement of financial position is appropriate because this results in an accurate depiction of an entity's counterparty credit exposure. We do not believe that the separate disclosure of such amounts will provide any more information about the uncertainty of future cash flows than the net amounts presented would, and ask the Board to re-consider including this requirement.

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We would be pleased to discuss our concerns with the Board or the Staff. Please contact Esther Mills at (212) 276-4364, Donna Grabarek at (212) 276-2459 or myself at (212) 276-7716 with questions or comments.

Sincerely,

/s/ Greg Sigrist
Managing Director