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Morgan Stanley

May 15, 2013

Ms. Susan Cospier
Technical Director
File Reference No. 2013-220
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 2013-220; Proposed Accounting Standards Update – Financial Instruments–Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities

Dear Ms. Cospier:

Morgan Stanley appreciates the opportunity to comment on the Proposed Accounting Standards Update, *Financial Instruments–Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* (the “ASU”). We have also contributed to the letters submitted by the International Swaps and Derivatives Association’s (ISDA) Accounting Policy Committee and by the Global Financial Institutions Accounting Committee of the Securities Industry and Financial Markets Association (SIFMA) and are generally supportive of those responses.

We are broadly supportive of the Financial Accounting Standards Board’s (the “FASB” or the “Board”) efforts to converge with the International Accounting Standards Board (the “IASB”) and of the objective to develop a consistent, comprehensive framework for classification and measurement of financial instruments. We generally agree that the classification and measurement of financial assets should be based on an instrument’s cash flow characteristics and the business model in which the asset is managed. However, we have significant concerns with certain of the specific proposals in the ASU and believe that they will increase complexity and yield results which are inconsistent with an entity’s business model.

Below is a summary of our primary comments and suggestions. Please find our detailed responses to those questions posed in the ASU that are significant to Morgan Stanley in the Appendix to this letter.

- Elimination of the unconditional fair value option: We disagree with the Board’s proposal to remove the unconditional fair value option (“FVO”) in current U.S. GAAP. The unconditional FVO is useful and relevant in order to align the accounting for an instrument with the business management strategy and to reduce accounting complexity and asymmetry, without applying detailed and complex analysis in order to qualify for use of the option. Because the FVO is typically employed as part of a business management strategy, thereby already achieving the

result desired by the FASB, we believe that the additional operational burden to qualify for the use of a limited FVO is not justified. Application of the FVO is generally consistent amongst peers within an industry and is transparent through disclosures to users of the financial statements. Therefore, we believe the benefit of an unconditional FVO exceeds any potential reduction in comparability.

- Contractual cash flow characteristics assessment: While we agree that the cash flow characteristics of an instrument should be considered in the classification and measurement model for financial assets, we are concerned that the assessment of whether cash flows are *solely* payments of principal and interest (the “SPPI test”) as proposed in the ASU may have unintended consequences and will result in classification and measurement that is not in line with an entity’s business model for managing the asset. We propose that the cash flow characteristics assessment should be based on a qualitative consideration of the significance of embedded features and the likelihood of the feature(s) to impact the cash flows in order to determine whether the contractual cash flows are *primarily* payments of principal and interest.
- Business model assessment: We are supportive of the principle that classification and measurement of a financial asset should be based on the business model in which the entity manages the asset. However, we believe the hold to collect model as proposed in the ASU is too narrow and would require most instruments that are held primarily for the collection of cash flows to be measured at FV-OCI. In order to better align the principle of the model with realistic business models, sales of financial assets that are in line with prudent risk management strategies (e.g., risk concentrations) and that may be required for regulatory compliance should not violate the hold to collect business model.
- Recognition of own-credit risk in other comprehensive income: We are supportive of the requirement to record the portion of the changes in fair value related to changes in an entity’s own credit risk for financial liabilities under the FVO to be recognized in other comprehensive income (“OCI”) and are also strongly supportive of the provision for early adoption of this guidance upon issuance of a final standard. We believe that the cumulative gain/loss related to changes in own-credit should be recognized or recycled in net income upon derecognition of the financial liability and have suggested that the IASB should converge on this point. We recommend that the Board consider applying this presentation requirement in a consistent manner to derivatives instruments accounted for under Topic 815. The recognition of gains/losses related to changes in own-credit in OCI for both financial liabilities under the FVO and derivative instruments is consistent with the direction of proposed regulatory rules whereby both would be excluded from the calculation of capital requirements.
- Equity-method investments: We believe the equity-method of accounting under current accounting guidance in conjunction with a FVO is the appropriate accounting model for equity investments when the investor has the ability to exercise significant influence. This model allows an entity to reflect its business strategy with respect to the investment. In cases where an entity manages an investment on a fair value basis but would be precluded from measuring the investment at fair value because it does not meet the held for sale criteria, we do not believe the equity-method of accounting would provide the most relevant and useful information about such investments. Conversely, we are concerned that the proposed model for equity-method investments that are “held for sale” is not an improvement over existing U.S. GAAP as it would result in investments carried at fair value when that is not consistent with the business strategy with respect to the investment.

- Balance sheet presentation: We disagree with the requirement for dual presentation of both fair value and amortized cost information on the face of the balance sheet for a majority of financial instruments. The balance sheet should convey to users the primary measurement model for an entity's financial instruments that is reflective of the entity's strategy with respect to recognition of the benefits and obligations associated with these instruments. Furthermore, we believe that fair value information that is already required to be disclosed in the footnotes is sufficient and presentation on the face of the balance sheet would only serve to clutter the statement and confuse users. We also believe that the requirement to present amortized cost information for issued debt that is measured at fair value is not useful. It would be operationally challenging to compute the amortized cost basis for these financial liabilities (e.g., structured notes) as the embedded feature would complicate the effective interest calculation. This amount is not relevant, would be costly to prepare, and provides no added benefit to users.

We believe the above suggestions would serve to simplify and improve the usefulness of the classification and measurement model for financial instruments. Our further detailed comments are provided in our responses to the particular questions raised in the ASU in the following Appendix.

Again, we thank you for the opportunity to provide comments. Please contact me at 212-276-7824 or Mona Nag at 212-276-5129 if you have any questions.

Sincerely,

A handwritten signature in blue ink that reads "G. David Bonnar".

G. David Bonnar
Managing Director
Global Advisory and Policy

APPENDIX

Please find below our responses to the questions posed in the ASU that are significant to Morgan Stanley:

Question 1: Do you agree with the scope of financial instruments included in this proposed Update? If not, which other financial instruments should be included or excluded from the guidance in this proposed Update and why?

Response: Financial guarantees generally are excluded from the scope of the ASU. We would not suggest that financial guarantees should be in scope of the ASU, but do suggest that if the Board accepts our proposal to retain the unconditional FVO in current U.S. GAAP, then financial guarantees should also be eligible for the unconditional FVO.

Question 4: Do the proposed amendments appropriately convey the principle associated with the contractual cash flow characteristics assessment? If not, why? What would you propose instead?

Question 6: Do the proposed amendments contain sufficient application guidance and illustrations on implementing the cash flow characteristics assessment? If not, why?

Response: We are concerned that the SPPI test as proposed would result in financial assets, with insignificant embedded features that are not expected to impact the fair value or cash flows, being required to be classified as fair value through net income (“FV-NI”) in their entirety even when that does not reflect the business model with respect to recognition of the cash flows. As currently proposed, a financial asset with terms that could result in cash flows that are not solely payments of principal and interest fails the contractual cash flows test and will be measured at FV-NI. An entity would be required to consider any embedded features of an instrument, irrespective of either the significance of the embedded feature on the fair value or the expected cash flows of the instrument or the likelihood that the embedded feature will be triggered and actually modify the cash flows.

The proposal does provide some latitude with the ‘solely payments of principal and interest’ criteria as it relates to only interest rate resets or leverage situations. However, we believe the scope is too narrow and should be extended to any embedded feature that would not be expected to materially affect expected cash flows. Further, an assessment of the cash-flow characteristics could be necessary for instruments with even a very slight degree of complexity and would include identification of a reliable (or determination of a hypothetical) benchmark instrument and would need to be made on an instrument-by-instrument basis at inception. The cost and operational complexity associated with identifying a benchmark instrument and comparing the cash flows of the benchmark instrument to those of the instrument with only a slight modification feature is not justified.

If an instrument that otherwise has cash flows that are *primarily* principal and interest include involuntary conversion or suspension provisions that are highly unlikely to be triggered at the time of recognition of the instrument, then the inclusion of such conditions in the terms of the instrument should not disqualify it under the SPPI test. The test should be amended to require or permit additional consideration of whether terms of conversion or suspension of payment are materially likely to affect the expected cash flows. As an example, one type of contingent convertible bond (CoCos) is a debt instrument that is mandatorily converted into shares of equity upon a triggering event that is typically linked to a solvency event or severe undercapitalization scenario. The trigger event is expected to be highly unlikely to occur and the instrument would not be expected to convert to equity under normal circumstances. However, under the proposed model, the probability of such an

event occurring is not considered in applying the SPPI test. As such these instruments would fail the SPPI test and would be required to be measured at FV-NI, which would not reflect the normal business model or expected future cash flows of such instruments. Including instruments subject to remote contingencies into FV-NI, regardless of the business model, would in our opinion be detrimental to users of financial statements.

We propose that a qualitative consideration of the cash flow characteristics of an instrument to determine whether the cash flows are *primarily* payments of principal and interest should precede the quantitative requirement to compare the cash flows of the modified instrument to those of a benchmark instrument. The qualitative assessment would consider the significance of the embedded feature to the hybrid instrument and also the likelihood of the feature to impact the cash flows. If such embedded features are deemed to be remote upon acquisition, such instruments should qualify to be held in accordance with the applicable business model. A more flexible approach is required if extensive and instrument-specific guidance or exemptions are to be avoided. In order to decrease operational complexity we recommend that a quantitative assessment on an instrument-by-instrument basis should only be required if a qualitative assessment cannot be made.

Question 5: The proposed amendments define *principal* as the amount transferred by the holder at initial recognition. Should the definition of *principal* be expanded to include repayment of the principal amount at maturity or other settlement? If so, what instruments would fail (or pass) the contractual cash flow characteristics criterion as a result of this change?

Response: The proposed definition of principal as the amount transferred by the holder at initial recognition is too narrow and may have unintended consequences as it relates to consideration of principal in the cash flow characteristic assessment. The proposal may result in prepayable debt instruments that are purchased at a premium or discount and zero-coupon bonds that are callable at par to fail the SPPI test. However, in our opinion, these are vanilla debt instruments and they should be eligible for classification based on the business model in which they are managed.

Question 7: Should a financial asset with a contractual term that modifies the economic relationship (see paragraphs 825-10-55-17 through 55-20) between principal and interest be considered to contain cash flows that are solely payments of principal and interest? Should this be the case if, and only if, the contractual cash flows could or could not be more than insignificantly different from the benchmark cash flows as discussed in paragraph 825-10-55-19? If not, why? What would you propose instead?

Question 8: Do the proposed amendments contain sufficient application guidance in paragraphs 825-10-55-17 through 55-20 on assessing a modified economic relationship? If not, why?

Response: Further to our response to Questions 4 and 6, we believe that application of the SPPI test as currently proposed for instruments with features that modify the economic relationship between principal and interest does not accommodate certain vanilla debt instruments. As an example, adjustable rate mortgages typically consist of a low introductory rate that is fixed for a specified period, followed by adjustment to a variable interest rate that may be based on a reference index that does not have a tenor (e.g., Prime). It is unclear how these reset features would be evaluated under the model, but we believe such common loan products should be able to qualify for measurement at other than FV-NI, based on the entity's business model.

We are concerned with the ambiguity in determining the benchmark instrument and assessing whether the cash flows of the modified instrument are “more than insignificantly” different than those of the benchmark instrument. While the proposal does not define the threshold at which the cash flow

difference would be considered significant, we are concerned that auditors would develop bright lines in practice.

Lastly, we are concerned about the practicality of applying such an assessment on an instrument-by-instrument basis across loans and securities portfolios on a daily basis. Therefore, we suggest that the quantitative comparison to the benchmark interest rate be required only where it cannot be qualitatively concluded that the modified economic relationship between principal and interest is not significant.

Question 9: For beneficial interests in securitized financial assets, the proposed amendments would require an entity to look through to the underlying pool of instruments in determining whether the tranche contains payments of solely principal and interest. Do you agree with this look-through approach? If not, why? What would you propose instead?

Response: The requirement to look through to the underlying pool of assets in a securitization structure in order to determine whether a beneficial interest passes the SPPI test is problematic. In addition to concerns regarding the availability of or cost to obtain sufficient information in order to perform the stringent SPPI test, it would be costly and operationally burdensome to perform the test for all beneficial interests. Therefore, we recommend that the Board incorporate a threshold whereby senior beneficial interests (e.g., high-quality agency securities) would automatically pass the SPPI test and classification would then be based on the business model assessment. Otherwise, beneficial interests would be carried at FV-NI.

If the Board does not accept this suggestion, then we recommend the following amendments to the proposals in the ASU:

- The SPPI test should only be performed based on the assets initially included in the securitization pool as it would be problematic to predict future scenarios whereby the assets in the underlying pool at a future date might fail the SPPI test. This is consistent with the requirement for other financial assets whereby the SPPI test is performed only at initial recognition.
- The requirement to consider the credit risk of the beneficial interest as compared to the credit risk of the underlying asset pool should be removed on the basis that it is inconsistent with the cash flow characteristic assessment for other types of financial assets. There are other financial assets which may contain higher exposure to credit risk (e.g., loans that are similar in all respects other than the exposure to credit risk of the particular borrowers) or which may be subject to subordination that increases the instrument's credit risk. It is unclear to us why the additional assessment of credit risk should be applied to beneficial interests but not to other types of debt instruments.

Question 10: Do the proposed amendments appropriately convey the principle associated with the business model assessment? If not, why? What would you propose instead?

Question 11: Do the proposed amendments provide sufficient application guidance and illustrations on how to distinguish among the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the proposed guidance provided to describe those business models? If not, why?

Response: We are supportive of the principle that classification and measurement of a financial asset should be based on the business model in which the entity manages the asset. However, we have a number of concerns:

- Permissible sales within a hold to collect business model: We believe the proposals in the ASU with respect to permissible sales from the amortized cost measurement category are too narrow and will result in classification of most loans that are held for the collection of cash flows at fair value through other comprehensive income (“FV-OCI”). In order to better align the principle of the model with realistic business models, sales of financial assets that are in line with prudent risk management strategies (e.g., risk concentrations) and sales that may be required in order to meet regulatory capital requirements, but that may not result from broad regulatory capital rule changes or regulator action impacting the entire industry, should not violate the amortized cost business model. In contrast to sales in response to market conditions or within a business model where sales are required to meet certain business objectives, sales due to concentrations in accordance with a sound risk management strategy should not be deemed to be inconsistent with an overall hold to collect business model.

We also suggest that the Board should be cognizant in providing the same level of application guidance related to each of the business models as the IASB. We are concerned that the additional prescriptive guidance in the ASU might result in different classifications under U.S. GAAP and IFRS, which would hinder comparability. For example, IFRS 9 includes less guidance with respect to when sales of financial instruments are incompatible with the use of the amortized cost category than the FASB, which might result in varying jurisdictional interpretations.

- Pools of similar financial assets: Clarification is required for the application of the business model assessment to pools of similar financial assets when an entity expects to sell a portion and to hold a portion to collect contractual cash flows. Paragraph 825-10-25-30 states that (emphasis added) “**Upon recognition** of a pool of similar financial assets...an entity may expect to sell a portion of the pool and to continue to hold and manage the other portion to collect the contractual cash flows.” While this concept is consistent with common business strategies, we are unclear as to how to apply the guidance when the pool of similar assets is recognized over time (e.g., a warehouse lending program for origination of mortgage loans). We are supportive of the concept of allocation of a percentage of the pool of assets to the relevant classification categories and believe it should be applicable to pools of assets recognized over time.

We are also concerned with the lack of sufficient application guidance and implications on the subsequent accounting for these assets following allocation to classification categories on a percentage basis. Because an entity would not know specifically which assets it will ultimately sell and which will be held for the collection of cash flows, this will inevitably result in sales of assets out of the portion of the pool initially allocated to the hold to collect category. However, an entity would not be permitted to reclassify the assets when the decision to sell is reached. We believe that clarification is required on this point to ensure that subsequent measurement models can be applied consistently and so that subsequent sales activity out of assets allocated to the held to collect category would not result in perceived violation of the business model assessment at initial recognition.

We also suggest the Board consider similar guidance for individual assets, such as loan participations and syndications. Consistent with current accounting guidance, we believe that it is reasonable and in line with common business models that an entity should be able to

classify a single loan based on a percentage allocation in accordance with its strategy to syndicate a portion of the loan with other lenders and to hold a portion of the loan to collect cash flows.

- Multiple business models for financial assets: The ASU states that an entity may have more than one business model for managing its financial assets. We are supportive of the flexibility for an entity's management to determine at which level within the organization (e.g., portfolio, desk, division, or segment) the business model(s) should be identified in order to align the classification and measurement model with an entity's business model(s).

Question 13: The proposed amendments would require loan commitments, a revolving line of credit, or a commercial letter of credit (the potential creditor) to be measured on the basis of the likelihood of exercise of the commitment and the classification of the underlying loan that would be made upon exercise of the commitment. Do you agree with the proposed classification of loan commitments? If not, why? What would you propose instead?

Response: We agree with the proposal to classify loan commitments where exercise is not deemed to be remote based on the classification of the underlying loan that would be made upon exercise of the commitment.

Question 14: Do you agree with the initial measurement principles for financial instruments? If not, why?

Response: Financial assets that are classified as either FV-OCI or amortized cost should initially be measured at the transaction price. We are concerned that the requirement to initially recognize an instrument classified as other than FV-NI at fair value if it is determined that the consideration given or received includes a component other than the financial instrument will be narrowly interpreted in practice and could lead to a requirement to consider the fair value of all financial assets at inception. We propose that the Board remove the provisions in paragraphs 825-10-30-4 through 30-6. If the Board does not accept this proposal, then additional application guidance should be provided as to when an instrument that will be classified as other than FV-NI is considered to contain a component other than the financial instrument.

Question 15: The proposed amendments would eliminate the unconditional fair value option (for financial instruments within the scope of this proposed guidance) in existing U.S. GAAP and, instead, permit an entity to elect to measure at fair value, with all changes in fair value recognized in net income, all of the following:

- a. A group of financial assets and financial liabilities if the entity both:
 1. Manages the net exposure relating to those financial assets and financial liabilities (which may be derivative instruments) on a fair value basis
 2. Provides information on that basis to the reporting entity's management.
- b. Hybrid financial liabilities that meet certain prescribed criteria.
- c. Financial assets that meet the contractual cash flow characteristics criterion and are managed within a business model that has the objective of both holding financial assets to collect contractual cash flows and selling financial assets (in accordance with paragraph 825-10-25-25(b)).

Do these options provide decision-useful information? If not, why?

Response: We disagree with the Board’s proposal to remove the unconditional FVO because it will result in added complexity and increased costs, and is not an improvement over current U.S. GAAP. We do not believe the limited FVOs proposed in the ASU are sufficient to provide the most decision useful information regarding an entity’s business model with respect to financial instruments that are managed on a fair value basis. The unconditional FVO is useful and relevant in order to align the accounting measurement for an instrument with the business management strategy and to reduce accounting complexity and asymmetry, without applying detailed and complex analysis in order to qualify for use of the option. Application of the FVO is generally consistent amongst peers within an industry and is transparent through disclosures to users of the financial statements. If the Board decides not to retain the existing unconditional FVO, then at a minimum, the FVO as proposed in the ASU should be expanded to be convergent with IFRS where the FVO can be elected to eliminate or significantly reduce an accounting mismatch.

While we believe it is the Board’s intent that the FVO for groups of financial assets and financial liabilities managed on a net fair value basis should be accommodating for structured notes, we are concerned that narrow interpretations regarding the application of this FVO might be imposed upon an entity in practice. Firms will typically manage the net fair value exposure of groups of assets and liabilities at a trading desk or portfolio level. The net exposure managed at this level may be comprised of a combination of financial instruments entered into with third-party counterparties and instruments transacted with other trading desks within the firm. Therefore, we believe that the application of the FVO for groups of financial assets and liabilities managed on a net fair value basis should be interpreted and applied in a way that accommodates the management of the net exposure of a group of assets and liabilities at a lower level than the ultimate firm level and does not require extensive or detailed documentation to link assets and liabilities at the firm level. Rather, any documentation required to support the FVO election should be aligned with the level at which the net fair value exposure is managed. The requirement for additional documentation at the firm level that may be required would be costly with no added benefit.

The ASU precludes election of the FVO for hybrid liabilities with embedded features that do not require bifurcation and separate accounting. There are numerous examples of structured notes with structured interest rate payments that do not require bifurcation under current U.S. GAAP because the embedded interest rate feature does not fail the “double-double” test. However, such instruments are commonly managed on a fair value basis similar to structured notes with embedded features linked to other types of risks (e.g., equity, commodity, FX) where bifurcation would be required. Bifurcation analysis is operationally burdensome and costly and therefore we do not see a benefit to providing an FVO that is limited to when bifurcation would be required. Furthermore and as stated above, we believe the FVO for groups of financial assets and financial liabilities should be interpreted in such a way that these hybrid liabilities are eligible for the election similar to hybrid liabilities where bifurcation would otherwise be required. This would be consistent with how an entity manages structured notes despite the specific embedded risk type (i.e., equity-linked notes versus notes with structured interest-linked features). The result of such an interpretation also yields the most meaningful results for recognition of changes in own-credit risk in OCI for hybrid liabilities managed on a net fair value basis, irrespective of whether bifurcation would be required.

We are also unclear as to the reason for providing a FVO for assets that would otherwise qualify for classification as FV-OCI, but a FVO is not similarly provided for assets that would be required to be carried at amortized cost. Where such assets are managed on a fair value basis, we believe that the accounting measurement for the asset should be aligned with the business model.

Question 26: The proposed amendments would require an entity to separately recognize in net income changes in fair value attributable to foreign currency gain or loss on foreign-currency-denominated debt securities measured at fair value through other comprehensive income (see paragraphs 825-10-45-14 through 45-15). Is the proposed fair-value-based method provided for computing the foreign currency gain or loss component operable? If not, why? What would you propose instead?

Response: We support the requirement to recognize in net income the changes in fair value attributable to foreign currency gains and losses on debt instruments measured at FV-OCI. We believe that convergence with the IASB on the method to compute the foreign currency gain or loss component of the change in fair value is more important than the specific method itself. Given the complexities that already exist in disaggregating foreign exchange gains and losses, having different methods for this disaggregation in U.S. GAAP and IFRS will introduce significantly more operational complexity for global firms with little external reporting benefit. Therefore, we suggest that the Board and the IASB converge on this point by prescribing a single method for computing foreign currency gains and losses for debt instruments measured at FV-OCI.

Question 29: Do you agree with the proposed disclosure requirements? If not, which disclosure requirement would you change and why?

Response: We do not agree with the following proposed disclosure requirements:

- Quantitative Level 3 disclosures for financial instruments measured at amortized cost: We do not agree with the proposed Level 3 quantitative disclosures of significant unobservable inputs for financial instruments that are measured at amortized cost. Highly unobservable and subjective fair value information for instruments that are measured at amortized cost does not provide useful information. Furthermore, such a requirement will result in voluminous disclosures which are not relevant to users, will be operationally burdensome and costly for preparers, and is not convergent with IFRS. Entities are currently required to disclose the fair values and related fair value hierarchy levels for financial instruments that are not measured at fair value. We believe this level of detail is sufficient for financial instruments that are not carried at fair value as such value is not expected to be realized.
- Core deposit liabilities: The requirement to disclose the implied weighted-average maturity period and estimated all-in-cost-to-service rate will be costly and will not provide useful information because the disclosures would be based on internal and potentially proprietary information. These terms and the method for calculating these amounts is not clearly defined and therefore will not result in comparable or meaningful disclosures. As indicated in the Basis for Conclusions (paragraphs BC142–143), stakeholders disagreed with the previous proposal to measure demand deposits at present value based on a discount rate for which the all-in-cost-to-service rate would be an input because it was too subjective to be useful. For the same reason, we do not believe the suggested disclosures would be useful.

Question 30: Should an entity be permitted to early adopt only the proposed presentation requirements related to changes in instrument-specific credit risk for hybrid financial liabilities that would qualify for the fair value option under the proposed requirements? If not, why?

Response: We strongly support the ability to early adopt upon issuance of a final standard the proposed presentation requirement related to changes in own-credit risk for financial liabilities that qualify for the FVO.

We note what appears to be an inconsistency in the ASU with respect to the scope of this early adoption provision. Paragraph 825-10-65-2(d) indicates that “early adoption of the presentation guidance only applies to those hybrid financial liabilities that would qualify and be measured at fair value with changes in fair value recognized in net income as if an entity had elected the fair value option in paragraphs 825-30-15-2 through 15-3.” However, the FVO provided in paragraph 825-30-15-2 is not limited to hybrid liabilities. We request that the Board clarify that the presentation requirement related to own-credit changes could be early adopted for all financial liabilities eligible for the FVO under Subtopic 825-30.

As noted in the opening to this letter, we recommend that the Board should extend the presentation guidance related to own-credit changes to derivatives, including the requirement to recognize cumulative amounts in net income upon derecognition of the financial instrument. The recognition of gains/losses related to changes in own-credit in OCI for both financial liabilities under the FVO and derivative instruments is consistent with the direction of proposed regulatory rules whereby both would be excluded from the calculation of capital requirements. However, we understand that the Board may require additional deliberation on this point and we would suggest that this should not impact the ability to early adopt the provision noted above as it relates to financial liabilities that qualify for the FVO.

Question 32: How much time is needed to implement the proposed guidance?

Question 33: Are the transition provisions in this proposed Update operable? If not, why?

Response: The proposals in the ASU represent an extensive and wide-ranging change from current U.S. GAAP and will require a significant amount of time and resources to implement. In order to allow time for planning, assessment of all in-scope financial instruments under the new model, and implementation of the requirements in systems and processes, we believe the ASU should be effective no earlier than three full years following issuance of a final standard that includes both classification and measurement and impairment. We also suggest that the Board and the IASB should agree on a joint implementation date for all components of their respective financial instrument standards. For global firms that are required to report under both U.S. GAAP and IFRS, despite potential divergence in some areas, this would minimize disruption as well as provide more useful information externally.

We believe additional transition guidance is necessary for instruments which are currently carried at fair value but which will be measured at amortized cost or under the equity-method of accounting. If the Board decides to accept our proposal to retain the current unconditional FVO in current U.S. GAAP, then our concerns on this point would be largely alleviated. Additional guidance is also required as to whether, upon transition, an entity would retrospectively assess whether an existing equity-method investment would have been considered held for sale upon initial qualification for the equity-method of accounting or if such assessment would be made at the transition date.

Question 34: The proposed amendments would require investments that qualify for the equity method of accounting in Subtopic 323-10, Investments—Equity Method and Joint Ventures—Overall, to be subsequently measured at fair value with changes in fair value recognized in net income if the investment is held for sale at initial recognition. Are the proposed indicators/conditions operable? If not, why? What would you propose instead?

Response: The proposed model for equity-method investments is not an improvement over existing U.S. GAAP. An entity may manage an investment on a fair value basis but would be precluded from

measuring the investment at fair value because it does not meet the held for sale criteria. Furthermore, the held for sale criteria as proposed in the ASU are overly broad and will result in investments carried at fair value when that is not consistent with the business strategy with respect to the investment. For example, investments in limited life entities or certain tax credit vehicles may meet the broad definition of held for sale when an entity has clearly entered into the investment for strategic purposes and has no intention of realizing changes in fair value of the investment through sales. Further, we also do not understand why the assessment of whether an investment meets the held for sale criteria would be performed only upon initial recognition and would not be reassessed if an entity's strategy with respect to the investment changed. For all of these reasons, we believe the equity-method of accounting in conjunction with an unconditional FVO under current accounting guidance is the appropriate accounting model for equity-method investments in order to align with an entity's business strategy with respect to the investment.