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Morgan Stanley

October 16, 2013

Ms. Susan Cosper Technical Director File Reference No. EITF-12Gr Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: File Reference No. EITF-12Gr (Topic 810): Measuring the Financial Liabilities of a Consolidated Collateralized Financing Entity

Dear Ms. Cosper:

Morgan Stanley appreciates the opportunity to comment on the Proposed Accounting Standards Update, *Measuring the Financial Liabilities of a Consolidated Collateralized Financing Entity* (the "ASU").

We are not supportive of the proposal to measure the financial liabilities of a consolidated collateralized financing entity ("CFE") as described in paragraph 810-10-30-2A of the ASU. We believe the proposed approach potentially distorts the economic position of the reporting entity, adds unnecessary complexity and creates inconsistent accounting and disclosures for economically similar financial liabilities depending on whether they are held by a CFE.

We agree that when a reporting entity measures the financial assets and financial liabilities of a CFE at fair value, the reporting entity should not recognize a gain or loss upon initial consolidation of a CFE. The fair value of the CFE's financial assets should equal the fair value of its financial liabilities. The existence of non-financial assets and/or non-financial liabilities not measured at fair value should not change this result.

Nevertheless, we do not believe the prescribed calculation to use the fair value of the CFE's financial assets and carrying value of the CFE's non-financial assets to measure the CFE's financial liabilities is appropriate. While there may be instances where the fair value of the CFE's financial assets may be more observable than the fair value of the CFE's financial liabilities, we do not believe that always to be the case.

We do not support disregarding more reliable data available to measure the fair value of the financial liabilities of the CFE directly. When the fair value of the CFE's financial liabilities has greater observability than the fair value of its financial assets, preparers should have the

flexibility to use the fair value of the CFE's financial liabilities to derive the fair value of its financial assets. For example, consider a residential mortgage securitization where a reporting entity may have market observations for all of the securities issued by the CFE, but have no reliable observations for the numerous mortgage loans owned by the CFE. The ASU would require that the financial liabilities be measured using the less reliable inputs for the assets and supersede the more reliable market observations for those financial liabilities that may be available. This is inconsistent with the notion of the fair value hierarchy which emphasizes the use of the most observable/reliable inputs in fair value measurements.

We support the original approach proposed by the Emerging Issues Task Force (EITF). That is, a reporting entity would measure the fair value of its net economic risk exposure resulting from its involvement in the CFE in a manner that is consistent with Topic 820, *Fair Value Measurement* (Topic 820) and allocate that fair value to the gross assets and liabilities in a consistent and reasonable manner. In our view, the allocation of fair value on a gross basis should not be prescribed but rather allow for an approach that uses the best information available to recognize the gross assets and liabilities.

The Board has expressed concern that the use of the fair value of a CFE's financial liabilities to derive the fair value of its financial assets may result implicitly in recognizing the fair value of non-financial assets, such as real estate owned ("REO"), in excess of its carrying value. If the fair value of the financial liabilities is used to derive the fair value of the financial assets, the fair value of the financial assets will equal the aggregate fair value of the financial liabilities less the carrying value of REO. In most CFEs, non-financial assets represent a small, frequently immaterial portion of the CFE's assets.

Although we understand the Board's concern, we believe this is a presentation issue. We note that implicit recognition of any excess value of REO will not impact an entity's earnings. Irrespective of the calculation, the entity will recognize no earnings upon the initial consolidation of a CFE. On an ongoing basis, the earnings recognized by the reporting entity for a consolidated CFE will equal the change in the fair value of its beneficial interest in the CFE. We believe this result is correct.

Any measurement error will affect only the balance sheet gross-up upon consolidation. The error from the use of less reliable observations for the financial assets is potentially much larger than the potential overstatement that could result from any excess value of REO.

Further, we do not agree that a reporting entity that consolidates a CFE should be prohibited from measuring the financial liabilities of the CFE using the fair value option. We believe the fair value option should continue to be available for the assets and liabilities of all consolidated variable interest entities ("VIEs") with few limitations. We do not believe that mandating different requirements for VIEs that meet the CFE definition and those that do not results in greater financial transparency.

We also believe the ASU could be affected by two other current FASB projects. The Board already has a separate and broader project to evaluate the fair value model for financial instruments in the *Proposed Accounting Standards Update, Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities.* We do not believe there is incremental benefit to separately proposing a new measurement model for CFEs at this stage, given that the result of this model may be inconsistent with the Board's objectives in that project. In addition, we are concerned that the *Proposed Accounting Standards Update — Consolidation (Topic 810): Principal versus Agent Analysis* may result in different consolidation

at this stage, given that the result of this model may be inconsistent with the Board's objectives in that project. In addition, we are concerned that the *Proposed Accounting Standards Update – Consolidation (Topic 810): Principal versus Agent Analysis* may result in different consolidation conclusions for CFEs in the scope of this ASU. Entities may have to change the accounting for CFEs only to later determine that they are no longer in scope of the ASU if the FASB's consolidation project changes the consolidation conclusions for these entities.

We therefore recommend that the Board either (i) withdraw the ASU entirely or (ii) rather than prescribe a measurement approach, focus it on the principle that a reporting entity should not recognize a gain or loss when it consolidates a CFE and measures the financial assets and financial liabilities at fair value.

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,

G. David Bonnar Managing Director

Global Advisory and Policy