## **Morgan** Stanley



July 21, 2006

Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: Proposed Amendments to Paragraphs 35c(2) and 40 of FAS 140

Dear FASB Members:

Morgan Stanley is writing in regard to the FASB's (the "Board's") June 7<sup>th</sup> deliberations concerning whether and how it should proceed with the proposed amendments to paragraphs 35c(2) and 40 of FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities ("FAS 140"). Morgan Stanley has also contributed to the June 26, 2006 letter submitted by the American Securitization Forum regarding the FAS 140 Amendments Project.

Morgan Stanley is concerned with the Board's decision to remove from its agenda any further consideration of the proposed revisions to paragraphs 35c(2) and 40 of FAS 140 regarding derivatives held by a qualifying special purpose entity ("QSPE"). The current guidance in these paragraphs results in a significant practice issue as we discuss below. Accordingly, we strongly urge the Board to reconsider its decision with respect to the proposed revisions to these paragraphs.

We understand that the original purpose of paragraphs 35c(2) and 40, which effectively limit the notional amount of the derivatives entered into by a QSPE to the amount of beneficial interests held by parties other than the transferor (or its affiliates or agents) was made to prevent a transferor from circumventing the requirements of FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities ("FAS 133"). However, with the issuance of FASB Statement No. 155, Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140 ("FAS 155"), any potential abuses of FAS 133 will be eliminated — either through bifurcation or marking the beneficial interests to fair value through earnings.

It is common practice for a transferor, its affiliates, or its agents to either 1) retain portions of interests issued by a securitization vehicle that it sponsors or 2) to purchase previously issued beneficial interests in conjunction with market-making or trading activities. For

example, an entity may retain an interest in one or more debt tranches issued by a securitization vehicle. It may also subsequently acquire beneficial interests issued by that vehicle in the secondary market. Many of these entities account for the retained/purchased beneficial interests at fair value, with changes in fair value reported in earnings. As a result, the provisions of FAS 133 would not be evaded - thereby making paragraph 40 unnecessary.

If paragraphs 35c(2) and 40 remain in FAS 140 and are not eliminated or revised, the result would be that a securitization vehicle would fail to achieve QSPE status merely because 1) the transferor (or its affiliates or agents) does not immediately sell all of the issued interests of the SPE to third parties, or 2) the transferor subsequently purchases previously issued interests from outside parties via a secondary market purchase. It is hard to understand why such activities should prevent a securitization vehicle from being considered a QSPE.

We note that paragraph 10 of FASB Staff Position No. FAS 140-2, Clarification of the Application of Paragraphs 40(b) and 40(c) of FASB Statement No. 140 ("FSP 140-2"), provides that "[p]urchases of previously issued beneficial interests by a transferor, its affiliates, or its agents from outside parties that are held temporarily and are classified as trading securities [i.e., marked to fair value through earnings] shall not be considered when determining whether the requirements of paragraphs 40 (b) and 40 (c) are met." That is, for beneficial interests subsequently obtained in the secondary market, these provisions of FAS 140 do not apply. Our suggestion is merely to extend this provision to beneficial interests that are retained at the time of securitization.

The current requirements in paragraphs 35c(2) and 40 of FAS 140 that limit the derivative's notional amount to beneficial interests held by outside parties other than the transferor, its affiliates, or its agents is a significant issue for entities that are applying fair value accounting to interests retained or subsequently re-acquired. Given that the requirements in FAS 155 alleviate the previous concerns of the Board regarding the potential for a transferor to avoid the provisions of FAS 133, we encourage the Board to reconsider including on its agenda the proposed revisions to paragraphs 35c(2) and 40 of FAS 140.

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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 or myself at (212) 276-2456 with questions or comments.

Sincerely,

/s/ Staci Lublin Managing Director