

Morgan Stanley

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

9 March 2011

Dear Sirs,

IASB Exposure Draft ED/2010/12: Hedge Accounting

Morgan Stanley appreciates and welcomes the opportunity to comment on the IASB's ("the Board") Exposure Draft ED 2010/12 *Hedge Accounting* issued in December 2010 (the "ED").

In addition to our comments below, we have participated in the preparation of the respective responses to the ED submitted by the International Swaps and Derivatives Association ("ISDA"), and the Institute of Chartered Accountants in England and Wales ("ICAEW") and are supportive of these responses. Our response is therefore focused on key points only.

Overall, we are supportive of the proposed move to simplify hedge accounting and move towards a more principles-based approach, aligning risk management activities with hedge accounting. We believe that the removal of the threshold for the purposes of effectiveness testing, the increase in hedging instruments and eligible risk components, as well as the ability to proactively rebalance a hedge relationship without the requirement to de-designate the existing relationship are positive steps in meeting this objective.

We do however have a number of concerns about the ED as it stands, which we believe will require both further outreach and re-deliberation before the final standard is issued. Our principal concerns are:

- *Alignment of risk management strategy and hedge accounting:* We agree with the Board's proposal to more closely align risk management strategies and hedge accounting. However, as currently proposed we believe there will continue to be risk management strategies implemented by management that will not be eligible for hedge accounting.
- *Clarity of new concepts introduced in the ED:* The ED could benefit from clearer articulation of many of the new concepts introduced in the ED. In particular we believe that the concept of 'no bias' and 'other than accidental offset' within the objective of hedge effectiveness needs further refinement, as do the requirements relating to rebalancing. We are particularly concerned about the operability of rebalancing as proposed in the ED and believe that rebalancing should not be mandatory unless triggered by risk management action. Mandating rebalancing is contradictory to the overall objective of the ED to link risk management activities to hedge accounting.

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- *Designation of risk components:* We agree with the proposals to permit a broader range of risk components as eligible hedge items for non-financial items where they are separately identifiable and reliably measurable. Furthermore, we believe this principle should be equally applicable for financial items and their risk components e.g. credit risk, and urge the Board to expand this principle to include financial items.
- *Ability to make voluntary de-designations:* We believe not permitting the voluntary de-designation of hedges is inconsistent with the principle of aligning more closely risk management strategies and hedge accounting. Risk management strategies are established at a much higher level in practice than hedge accounting relationships. Therefore, there will be situations where a hedging relationship needs to change to be consistent with management's risk management strategy.
- *Proposed presentational change for fair value hedges:* We do not agree with the proposal to require separate presentation in the balance sheet of the fair value change attributable to the hedged risk. We do not believe that this information will help users of financial statements and we are concerned that this will result in a cluttered balance sheet. If this information is considered necessary, we recommend it is included within the disclosures.

In addition, although we appreciate that the FASB has issued a Discussion Paper on hedge accounting, we are concerned that the IASB and FASB do not appear to be working jointly on this project. We understand that the hedge accounting model of either Board needs to be consistent with their respective classification and measurement models, however we are concerned that the approaches adopted by the Boards are quite different and we strongly encourage the Boards work together to eliminate any differences in their approaches.

We hope you find our feedback helpful. If there are any comments that are unclear, or you would like to discuss anything further, please do not hesitate to contact me on 0207 425 8551 or Vicky Worster on 0207 425 7552.

Yours faithfully,



Alex Brougham
Managing Director
Global Accounting Standards and Control