STAFF PAPER

14 December – 16 December 2011

REG FASB | IASB Meeting

Project	**Financial Instruments: Impairment**
Paper topic	Cover paper

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Decisions reached at last meeting

1. At the October 2011 Joint Board meeting, the boards continued to discuss a 'three-bucket' expected loss approach to the impairment of financial assets. The boards decided to pursue a model in which the guiding principle is to reflect the deterioration in the credit quality of financial assets. Under this approach, all financial assets would start in Bucket 1 (with an allowance measure yet to be defined, but less than expected lifetime losses) and transfer to Bucket 2 and/or Bucket 3 as credit quality deteriorates (with an allowance measure equal to expected lifetime losses).

2. The boards directed the staff to develop a principle that underpins the measurement attribute of the credit allowance for financial assets in Bucket 1. In addition, the boards directed the staff to develop a principle and indicators for when recognition of lifetime expected losses becomes appropriate. The boards emphasised that robust disclosures will be critical to support the principle-based impairment model and to ensure comparability between entities. Furthermore, the boards emphasised that the staff should consider the application of the model for

various types of financial assets, notably debt instruments, and various types of entities, including nonfinancial institutions.

Overview of issues being brought to the boards

3. The joint staff impairment team recognise that the discussions to date have primarily focused on commercial loans. As a result, in developing a model for the boards to consider at the December meeting, the staff felt it is important to:
   - (a) raise the primary conceptual questions, including the critical questions related to the transfer to Bucket 2 and the allowance objective and measurement for Bucket 1,
   - (b) raise a number of smaller, yet pervasive, conceptual questions, and
   - (c) evaluate how such a model might be applied to a variety of financial assets (and what issues, if any, arise in considering those financial assets).
4. The papers addressing critical or pervasive conceptual questions related to the three-bucket model are as follows:
   - (a) AP 6A / Memo 118 - Bucket 1 Allowance
     - (i) This paper discusses the principle underpinning the Bucket 1 allowance, the appropriate allowance measurement for Bucket 1, and clarifies what is meant by 'expected losses'.
   - (b) AP 6B / Memo 119 - Principle of Transfer
     - (i) This paper discusses the principle of when to transfer financial assets between Bucket 1 and Bucket 2.
   - (c) AP 6C / Memo 120 - Pervasive issues
     - (i) This paper discusses the grouping principles for the model and the factor that differentiates Bucket 3 from Bucket 2.
5. The papers addressing application of the 'three-bucket' model to a variety of financial assets are as follows:
   - (a) AP 6D / Memo 121 - Application of the model to loans

   (i) This paper discusses how the 'three-bucket' model may be applied to retail and commercial loans, and presents potential indicators for when to recognise lifetime losses.

(b) AP 6E / Memo 122 - Application of the model to debt instruments

   (i) This paper discusses how the 'three-bucket' model may be applied to debt instruments and presents potential indicators for when to recognise lifetime losses.

6. Because of the interaction of the issues discussed in all the papers, most of the papers do not include a staff recommendation. Instead, the following paper outlines the comprehensive staff recommendations:

   (a) AP 6F / Memo 123 – Staff recommendation

7. The breadth of topics raised in these papers is broader than that for past meetings. However the staff think it is important to consider this wide array of issues cohesively. In this way, it is our hope we can reach resolution to this model more expeditiously.

8. Some important remaining topics to be considered by the boards include a disclosure package and application of the model to purchased loans.