Week beginning 18 July2011

International Accounting Standards Board

Financial Accounting Standards Board

Impairment: Transfer between buckets

Slides to accompany
IASB Agenda Paper 7A / FASB Memorandum 100

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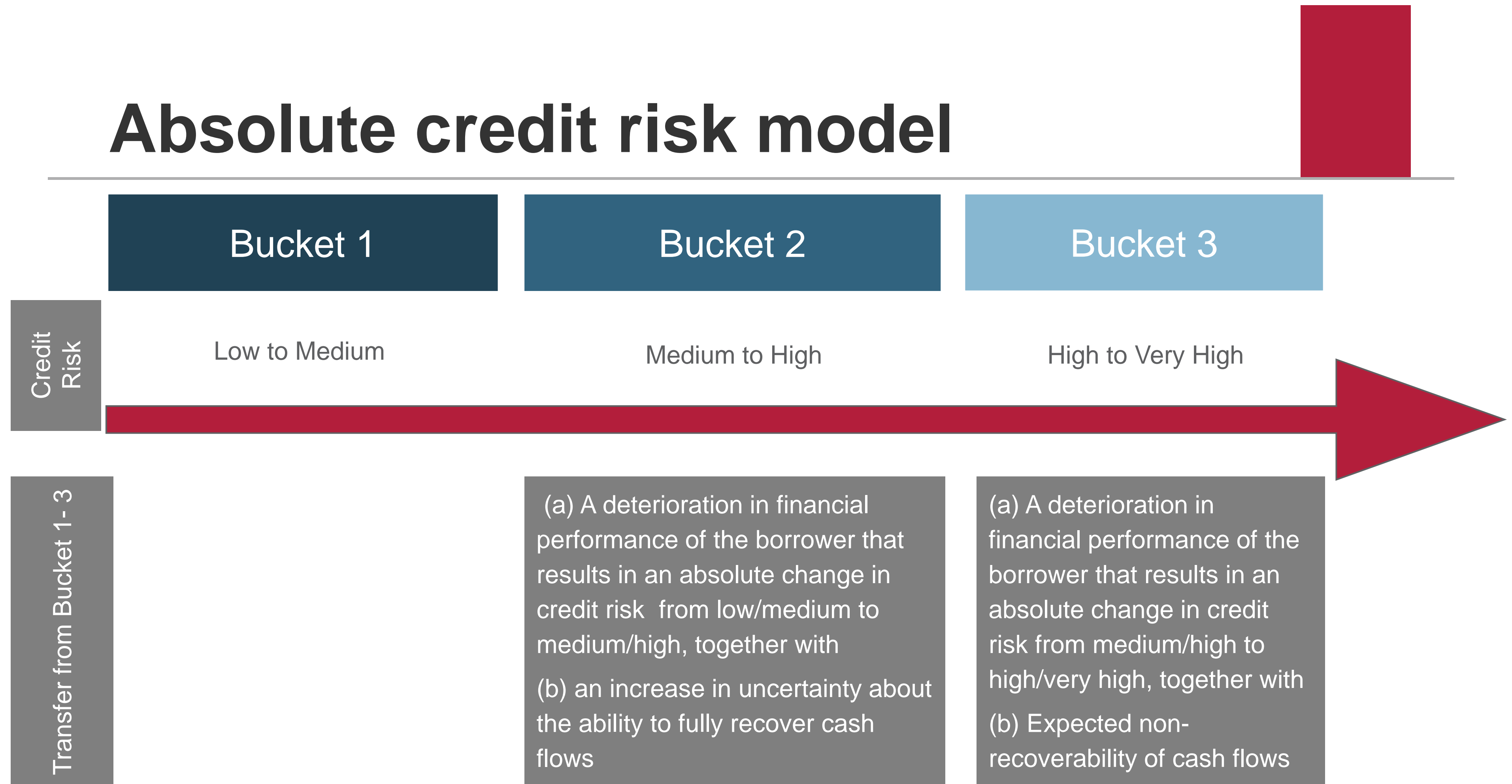
Event-based approach

Individual approaches considered

Bucket 1	Bucket 2	Bucket 3
Macroeconomic factors	Non-macroeconomic factors	
No events with direct relationship to possible future defaults	Events with a direct relationship to possible future defaults (Expected credit losses NOT individually identifiable)	Events with a direct relationship to possible future defaults (Expected credit losses individually identifiable)
Events that would result in a *limited* change in product or pricing	Events that would result in a *significant* change in product or pricing	Events that would result in refusing to give the product (Expected credit losses individually identifiable)
Events with *limited* effect on loss expectations	Events with *significant* effect on loss expectations	Events with *severe* effect on loss expectations (Expected credit losses individually identifiable)

Absolute credit risk model



- Internal credit categories need to be mapped to buckets
- As loans are purchased or originated, they are classified in one of the three buckets in accordance with the absolute level of credit risk (ie its credit rating)
- Transfer between buckets is based on the absolute level of credit risk (ie its credit rating)
- Loans migrate downward or upward into another bucket depending on the change in credit quality/rating (ie the 'new' level of absolute credit risk)
- Newly originated high credit risk loans would be in Bucket 2

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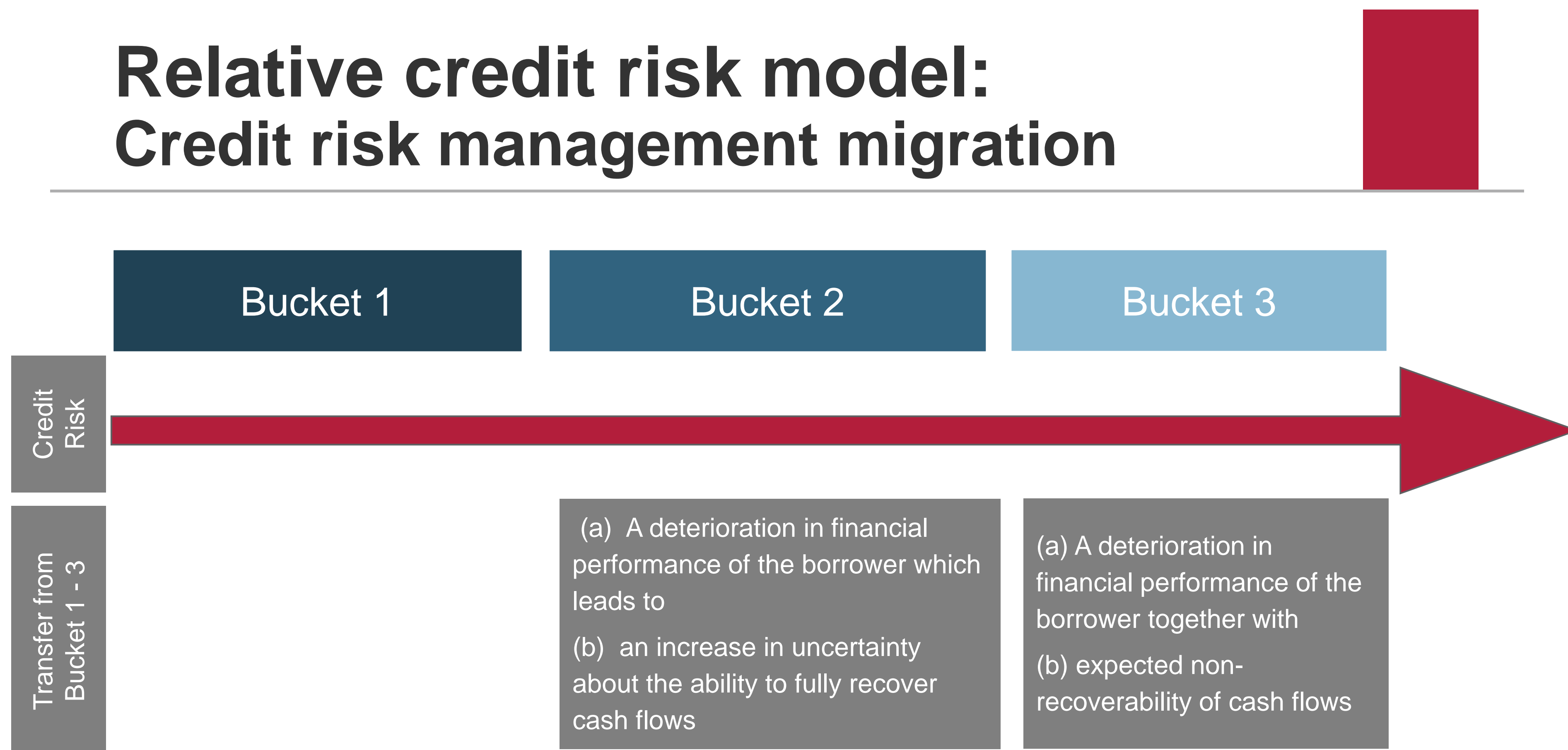
Relative credit risk model:
Credit risk management migration



- All purchased and originated loans included in Bucket 1 (pricing considers original risk)
- Transfer between buckets is based on change in credit risk
- Loans migrate downward/upward into another bucket if the credit quality deteriorates/improves

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Absolute versus relative credit risk approach

Absolute Credit Risk approach	Relative Credit Risk approach
Aligns definition of buckets with absolute level of credit risk – consistent with credit risk management practices	Is based on *changes* in credit risk – incorporates some credit risk management practices
Operationally simple – loans classified to buckets in accordance with absolute level of credit risk (eg credit grade)	Operationally more complex than absolute model – entity needs to compare/contrast credit quality with previous period
New loans originated or purchased at market with high credit risk would go straight to bucket 2 (or 3) with full lifetime losses effect	All new loans originated or purchased at market initially start in Bucket 1. When deterioration in credit quality starts to occur, loans transfer out of Bucket 1
Entities map existing rating categories to the three buckets (may result in lack of comparability). Or, use a comparable approach such as a PD-based model.	

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Questions or comments?

Expressions of individual views by members of the IASB and FASB and their staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB and FASB on accounting matters are determined only after extensive due process and deliberation.

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