

STAFF PAPER

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REG FASB | IASB Meeting

Project	Impairment of financial assets		
Paper topic	Cover paper		
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Background

1. Since May 2011, the boards have been considering a three-bucket approach to impairment of financial assets. In July, the boards initially favoured an approach that would initially place all originated and purchased assets in Bucket 1 (ie a Bucket 1 Approach). If credit loss expectations deteriorated, thereby affecting the certainty of collectability of cash flows, the assets would first move into Bucket 2 and finally into Bucket 3. Loans acquired at a discount because of credit losses were outside the scope of the discussion.
2. In September 2011, the boards discussed the feedback received from the initial outreach activities, in particular the operational challenges that would result from the requirements to classify all financial assets in Bucket 1 on initial recognition. The operational issues arise because current credit risk management systems do not typically store historical data, including origination data, in a way that is easily accessible for accounting purposes. To address these operational concerns, the boards tentatively decided to classify financial assets within the buckets in accordance with their credit quality levels as of the reporting date (ie a Credit Quality Approach).

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IASB Agenda ref	3
FASB Agenda ref	112

Issues addressed

3. The boards recognised that the Credit Quality Approach would lead to day 1 recognition of lifetime expected credit losses for financial assets classified outside Bucket 1. The boards directed the staff to explore how to deal with situations when the day 1 effect would be pronounced, namely for:
 - a. entities that primarily engage in origination of financial assets at lower credit quality levels; and,
 - b. purchased financial assets, including those purchased in a business combination.
4. As a result, the staff have prepared the following papers to present possible solutions to the issue above:
 - a. IASB Agenda Paper 3A/FASB Memorandum 113: Originated financial assets at lower credit qualities
 - b. IASB Agenda Paper 3B/FASB Memorandum 114: Purchases and business combinations, including those of assets at lower credit qualities.