



Staff  
Paper

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Project	<b>Financial instruments: Impairment</b>		
Topic	<b>Cover Paper</b>		

## Introduction

1. At the July 2011 meeting, the boards continued to discuss variations of a ‘three-bucket’ expected loss approach for impairment of financial assets. The guiding principle of the approach is to reflect the general pattern of the deterioration/improvement of credit quality of financial assets. The different phases of the deterioration/improvement in credit quality are captured through the ‘three buckets’ that determine the allowance balance for all financial assets subject to impairment accounting.
2. At earlier meetings the boards have tentatively decided that the allowance balance for loans in Bucket 1 shall be measured as a portion of remaining lifetime losses (whether the allowance balance shall be measured at 12 months or 24 months will be discussed at a future Board meeting) and that both the allowance balance in Bucket 2 and Bucket 3 shall be measured as the remaining lifetime expected losses.
3. The boards directed the staff to further develop a credit risk management approach to classify and transfer financial assets between the buckets. The boards recognised that credit risk management is a holistic process that includes evaluating all available information. The boards favoured a credit risk management approach that would start all originated and purchased financial assets, regardless of credit quality level, in Bucket 1 and transfer to other buckets on the basis of credit deterioration. This was Approach 2B (now referred to as 2B-Bucket 1 Approach) in IASB Agenda Paper 7A/ FASB Memorandum 100 of the July 2011 board meeting. However, the boards also

directed the staff to perform additional outreach to make sure that such an approach could be made operational.

4. As a result of those meetings and initial outreach performed, the staff has prepared the following papers for discussion at this meeting:
  - (a) IASB Agenda Paper 4A / FASB Memorandum 109 – Credit Risk Management Approach: Initial Feedback Summary. A general summary of the initial feedback received from a meeting held with mostly credit risk managers from international institutions (the ‘Impairment Summit’) and the IASB’s Financial Instruments Working Group.
  - (b) IASB Agenda Paper 4B / FASB Memorandum 110 – Credit Risk Management Approach: Tracking of originated/purchased assets. Provides feedback from several constituents (financial institutions) regarding the tracking of the credit quality of assets from origination of an asset or assets to maturity. This paper also discusses how to classify originated/purchased assets into the three buckets in the period of initial recognition.
  - (c) IASB Agenda Paper 4C / FASB Memorandum 111 – Credit Risk Management Approach – Principle of transfer between buckets. Discusses the principle for how to distinguish between the three buckets.
5. None of the papers requests any decisions. Rather IASB Agenda Papers 4B and 4C / FASB Memorandums 110 and 111 request direction from the boards.
6. Please note that the boards tentatively decided at the March 2011 meeting that loans that are acquired at a discount due to credit losses that would be recognised in the ‘bad book’ would have the EIR calculated taking into account initial credit loss expectations and that no allowance should be established on initial recognition. This is different to accounting proposed for all other loans. As a result, once a basic model is established for all other loans the appropriate bucket allocation for these loans acquired at a discount due to credit losses should be discussed. Those assets will be addressed separately, and are excluded from the discussion included in these papers.