FASB Board Concludes on 7 Key Concepts - Credit Impairment Standard

FASB in a joint meeting with the IASB deliberated and approved several key concepts within the credit impairment standard. The following concepts were discussed and approved as part of the process for moving forward with the standard to final release. All votes were 7 to 0 in the affirmative to move to the final standard except for number 4 below which was 6 to 1 in the affirmative.

1. On the issue of how to estimate losses in periods beyond an entities ability to make or obtain reasonable and supportable forecasts. FASB concluded that an entity should revert to a historical average loss experience. For example, if the average term of a class of loans is 60 months, and the reasonable and supportable forecast period is 36 months, the loss estimate for cash flows beyond 36 months will be based on life of loan loss rates.

2. On the issue of which cash flows must be used in the calculation of expected credit losses. FASB concluded that all contractual cash flows over the life of the related financial assets must be included. Therefore, all principal and interest as well as other cash flows would be included in the estimation of the total forecasted cash flows or other modeling.

3. On the issue of whether prepayments should be forecasted in loan cash flow projections. FASB concluded that the contractual cash flows for the life of the related financial assets, should consider expected prepayments. Generally, this calculation is developed using static pool analysis at the class level.

4. On the issue of whether expected modifications should be used to adjust expected cash flows. FASB concluded that an entity **should not** consider expected extensions, renewals, and modifications unless the entity reasonably expects that it will execute a troubled debt restructuring with a borrower. Therefore, in general, there is no adjustment to contractual cash flows for expected modification.

5. On the issue whether an estimate of expected credit losses should always reflect the risk of loss, even when the risk is remote. FASB concluded that an entity would not be required to recognize a loss on a financial asset in which the risk of nonpayment is greater than zero yet the amount of loss would be zero. FASB will issue guidance on how fair value of collateral can be used to support the calculation of zero loss.

6. On the issue of using discounted cash flow models to estimate cash flows for classes of loans. FASB concluded that the standard should allow entities to develop estimates of credit losses using other methods such as loss-rate methods, probability-of-default methods, or a provision matrix using loss factors. All methods must include provisions for reasonable and supportable forecasts.

7. On the issue of guidance for entities in developing factors to be used to adjust historical loss experience. FASB concluded that the final standard should contain guidance on factors that could be used to adjust historical loss experience for current conditions and reasonable and supportable forecasts. While the standard will not contain any required factors, the implementation guidance would discuss how to build the factors into methodology.

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- Through ARCSys Data Warehouse you can perform **Static Pool and Risk Migration Analysis** for any segment or class within seconds
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