Building a better working world

Credit impairment standard reference card

Applying the new accounting model for certain beneficial interests (BIs)

How to set the initial yield and allowance under the new standard

High credit quality securities (AA and above)	Yield is based on contractual cash flows.
Low credit quality securities (A and below)	Yield is based on expected cash flows.
Residual interests (if "purchased credit deteriorated" or there is a significant difference between contractual and expected cash flows)	Yield is no longer based on expected cash flows. Instead, initial basis is grossed up (with corresponding allowance) for cash flows not expected to be collected, and yield is initially based on contractual cash flows.

For details on the accounting for certain beneficial interests, refer to section 4 of our Financial reporting developments publication, *Credit impairment under ASC 326*

What are BIs?

A beneficial interest (BI) is the right to receive all or portions of specified cash inflows received by a trust or other entity.

Examples include mortgage-backed securities, asset-backed securities and residual interests.

A holder may obtain a BI by purchasing it or retaining a BI from its own securitization.

What's changing?

Entities need to create an allowance for credit losses on BIs rather than reduce the amortized cost basis of the BI.

The other-than-temporary impairment model will no longer be used.

Changes in expected cash flows are generally reflected through an allowance for credit losses.

While any changes in yield are still accounted for prospectively, yield adjustments may not be as common.

Which BIs are affected?

BIs that are not high credit quality will continue to be subject to a separate accounting model under the new guidance.

Other aspects of the new standard apply to high credit quality BIs, which are generally those BIs rated AA and above.

BIs previously accounted for as purchased credit-impaired (PCI) assets need to be evaluated to determine whether they are considered lower credit quality BIs.

Initial recognition

For the lowest credit quality BIs, credit losses are estimated at initial recognition and added to the asset's basis, with a corresponding allowance (a gross-up); the effective interest rate on these BIs is initially based on contractual cash flows.

For other BIs, there is no gross-up for expected credit losses. The effective interest rate on these BIs is initially based on expected cash flows.

Other considerations

Holders of BIs will need to establish a policy to write off amounts deemed uncollectible.

The guidance does not specifically address how BIs measured at fair value through the income statement are affected by the changes, but it does preserve the prospective yield approach for these assets.

Transition

Generally, for BIs that were previously PCI, record an allowance through a gross-up of amortized cost.

However, no gross-up is required for available-for-sale BIs that were previously accounted for as PCI that are in an unrealized gain position at transition. Record an allowance if and when cash flow expectations decrease after transition (and the fair value falls below cost).