A Strategic Guide to the New "Purchased Seasoned Loan" Accounting

Executive Summary

Since the adoption of the Current Expected Credit Losses (CECL) methodology under ASC 326, banks and credit unions have grappled with a frustrating accounting quirk: the "double count" of credit losses on acquired loans. Under the original guidance, if an acquired loan had not experienced a "more-than-insignificant" deterioration in credit quality, institutions were forced to record it at fair value (which was already baked in credit risk) *and* immediately recognize a Day-1 credit loss expense.

The Financial Accounting Standards Board (FASB) heard the industry's feedback. In November 2025, the FASB issued **Accounting Standards Update (ASU) 2025-08, *Financial Instruments—Credit Losses (Topic 326): Purchased Loans***, fundamentally changing how financial institutions account for acquired financial assets.

This whitepaper outlines the core provisions of the new update, introduces the "Purchased Seasoned Loan" (PSL) designation, and details the specific measurement methodologies institutions must navigate ahead of the December 2026 effective date.

Understanding the Economics: Credit Marks vs. Interest Rate Marks

To understand why ASU 2025-08 is so impactful, it is essential to look at the mechanics of purchase accounting. When an institution acquires a loan (or a portfolio of loans), the purchase price represents the asset's **Fair Value**.

Fair Value is almost always different from the loan's Unpaid Principal Balance (UPB). This difference—the "mark"—is primarily driven by two distinct factors:

1. **The Interest Rate Mark:** The difference in value caused by changes in market interest rates since the loan was originated. If you buy a 3% fixed-rate mortgage when current market rates are 6%, you will pay less than UPB. This creates a discount.
2. **The Credit Mark:** The reduction in value corresponding to the market's expectation of future credit losses (defaults) on that specific loan.

The Legacy Problem: The Day-1 Double Count and Inflated Yields

Under the previous CECL framework, acquired loans were funneled into two distinct buckets: PCD (Purchased Financial Assets with Credit Deterioration) and Non-PCD.

For **Non-PCD** loans, the accounting was deeply uneconomic.

- **The Double Count:** The institution recorded the asset at fair value (which already had the *credit mark* deducted from the purchase price). Then, CECL required the institution to immediately calculate an Allowance for Credit Losses (ACL) and record it as a Day-1 credit loss expense. Expected losses were penalized twice—once in capital allocation (the purchase price) and again in the income statement (the Day-1 provision).
- **The Premium/Discount Distortion:** Because the loan was recorded at fair value, the *entire* discount (both the interest rate mark and the credit mark) was lumped together. Over the life of the loan, this total discount was accreted into interest income. This artificially and inaccurately inflated the apparent yield of the loan portfolio, masking the true underlying interest margin.

The Solution: The "Purchased Seasoned Loan" (PSL)

ASU 2025-08 drastically expands the use of the **gross-up approach** by introducing a new category of financial assets: the **Purchased Seasoned Loan (PSL)**.

Moving forward, an institution must first assess if an acquired asset is PCD. If it is *not* PCD, the institution must evaluate if it qualifies as a PSL. If it does, it is granted the gross-up accounting treatment, which entirely eliminates the Day-1 double count and fixes the premium/discount distortion.

How the Gross-Up Approach Fixes the Marks

Under the PSL gross-up approach, you add your initial ACL directly to the purchase price to establish the **Initial Amortized Cost Basis**.

- The ACL explicitly represents the **credit mark**.
- The remaining difference between the Initial Amortized Cost Basis and the UPB is strictly the **noncredit discount or premium** (the true interest rate mark).
- **The Result:** You avoid the Day-1 earnings hit, and *only* the true interest rate mark is accreted/amortized into interest income over the life of the loan. This results in highly accurate, economically realistic yield reporting.

Qualifying as a Purchased Seasoned Loan

To qualify as a PSL, the asset must be a loan and meet specific criteria regarding how it was acquired:

- **Business Combinations:** All non-PCD loans acquired in a business combination (under Subtopic 805-20) are automatically deemed seasoned.
- **Asset Acquisitions (e.g., Portfolio Purchases) & VIEs:** For loans acquired outside of a business combination, the loan must meet two strict tests:
  1. **The 90-Day Rule:** The loan was obtained more than 90 days after its origination date.
  2. **No Prior Involvement:** The acquiring institution was not involved in the origination of the loan (e.g., no early loss-sharing agreements or substantive influence on the underwriting).

The Strategic Importance of Loan-Level Evaluation

Crucially, the FASB mandated that the seasoning tests (the 90-day rule and prior involvement) must be evaluated on an **individual loan basis**, rather than at the portfolio level.

This was a major victory for the industry. If the FASB had required a portfolio-level test (e.g., "substantially all" of the portfolio must be 90 days old), acquiring institutions would face **portfolio contamination**. A portfolio of 1,000 highly seasoned loans could be disqualified from PSL treatment just because 50 of the loans originated 30 days prior to the sale. By mandating loan-level testing, the 950 seasoned loans get the favorable gross-up treatment, protecting the institution's Day-1 capital and earnings, while only the 50 unseasoned loans are treated as non-PCD.

Excluded Assets

The FASB explicitly excluded certain assets from being classified as PSLs. These include:

- **Credit Cards:** Excluded due to the operational complexities of high-volume, open-ended active lines of credit. *(Crucial Note: The Board clarified that **other** open-ended lines of credit, such as HELOCs, are considered loans and **are** eligible for PSL treatment).*
- **Debt Securities** & **Trade Receivables** (arising from Topic 606 revenue contracts).

These excluded assets, if not classified as PCD, will continue to follow standard CECL Day-1 loss modeling.

Operational Mechanics: DCF vs. Non-DCF Methodologies

While expanding the gross-up approach is a massive win for financial reporting economics, it introduces new operational considerations for your CECL modeling teams depending on how your institution calculates its allowance.

1. The Discounted Cash Flow (DCF) Method

If your institution uses a DCF methodology to calculate CECL on acquired loans, the transition

is straightforward.

- **The Rule:** You must discount expected credit losses at the rate that equates the present value of your estimate of the asset's future cash flows with the purchase price of the asset.
- **The Result:** The math naturally aligns the expected cash flows with the initial amortized cost basis.

2. Non-DCF Methods (PD/LGD, WARM, Vintage)

If your institution uses a method other than DCF, the standard gross-up approach requires you to estimate expected credit losses based on the **Unpaid Principal Balance (Face Value)** of the loan.

However, because originated loans are typically measured based on their **Amortized Cost**, tracking PSL assets based on Face Value would require financial institutions to maintain parallel data fields and separate calculation logic within the same portfolio segment.

The "Amortized Cost" Policy Election

To solve this operability headache, the FASB provided a specific, irrevocable accounting policy election for Purchased Seasoned Loans (Paragraph 326-20-35-1A):

- **What it is:** Entities using non-DCF methods may elect to measure the ACL on Purchased Seasoned Loans using the **Amortized Cost Basis** at each balance sheet date *after* acquisition.
- **How it works:** You must make this election on an acquisition-by-acquisition basis in the period the transaction occurs. It applies to all PSLs in that specific transaction.
- **The Trade-off:** Electing this option triggers a one-time "true-up" adjustment recorded in net income as a credit loss expense. While this causes a minor, non-recurring P&L impact, it allows you to easily combine the acquired PSL assets with your existing originated pools for future CECL calculations, drastically reducing long-term system complexity. (Note: The initial amortized cost basis and effective interest rate established at acquisition are *not* re-measured).

3. Key Accounting Differences: Recoveries and Nonaccrual (PCD vs. PSL)

It is important to remember that PSLs are strictly non-deteriorated assets. As a result, they do not inherit some of the unique accounting quirks of PCD assets:

- **Treatment of Recoveries (Negative Allowances):** PCD assets face a "recovery cap"—expected recoveries cannot include amounts that result in an acceleration of the noncredit discount. The FASB explicitly clarified that PSLs **do not** face this cap. If credit

expectations improve significantly for a PSL, the allowance calculation allows for negative allowances (up to amounts previously written off/expected to be written off) just like originated assets.

- **Nonaccrual Policies:** Under legacy CECL, PCD assets have unique guidance allowing interest accrual to continue if the acquirer has a "reasonable expectation" of collection. This special treatment **does not** apply to PSLs. PSLs must follow the exact same nonaccrual policies as your originated loans.

Strategic Action Items and Transition

The amendments in ASU 2025-08 are effective for annual reporting periods beginning after **December 15, 2026** (including interim periods within those years). Early adoption is permitted.

Crucially, the amendments must be applied **prospectively** to loans acquired on or after the date of initial application. You do not need to restate historical acquisitions.

To prepare, leadership teams should take the following steps:

1. **Update Acquisition Playbooks:** Ensure your M&A and loan trading teams understand that the binary PCD/non-PCD framework is evolving. Update due diligence checklists to capture exact origination dates to seamlessly apply the 90-day seasoning test for portfolio purchases.
2. **Evaluate Your CECL Vendor:** Speak with your CECL software provider immediately. Ensure their system architecture can handle the new PSL classification and properly apply the gross-up approach to non-deteriorated seasoned assets.
3. **Assess the Policy Election:** If your institution relies on non-DCF methods (like WARM or PD/LGD), model the potential Day-1 "true-up" impact of electing the Amortized Cost option. Weigh this one-time expense against the long-term operational savings of unified pool tracking.
4. **Review Disclosures:** While no brand-new disclosures were added, the Rollforward of the Allowance for Credit Losses (Paragraph 326-20-50-13) will now require a separate line item for the initial allowance recognized on financial assets accounted for as PSLs. Ensure your reporting systems are tagged to capture this data point at acquisition.

Conclusion

ASU 2025-08 represents a significant victory for the banking industry, aligning the accounting reality of loan acquisitions with true underlying economics. By eliminating the punitive Day-1 double count for the vast majority of acquired loans, institutions can execute strategic growth through acquisition without artificially handicapping their capital. However, realizing these benefits efficiently requires proactive system adjustments and strategic policy elections today.