NASHVILLE NOTES

FASB Elects Common Sense

Tuesday, May 6, 2025 9:04 AM CT

By Jeff K. Davis

Jeff Davis is a veteran bank analyst. The views and opinions expressed in this piece are those of the author and do not necessarily represent the views of S&P Global Market Intelligence; Mercer Capital, where Davis is the managing director of the financial institutions group; or StillPoint Capital, where Davis is a registered representative.

After nearly five years of what most bankers and investors view as a ridiculous accounting standard, the Financial Accounting Standards Board (FASB) voted last week to end the "CECL double-count" for bank M&A accounting for fiscal years beginning after Dec. 15, 2026. Early adoption is permitted if annual or interim financial statements have not been issued. The rule apparently will be adopted formally later this year.

In fair-value accounting, acquired assets are marked to reflect "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." It is not quite a mark-to-market standard, but it is close, and incorporates mark-to-model that often will become mark-to-market when credit losses are underestimated and unavoidable.

For loans, fair value entails a rate mark and a credit mark. Non-purchased credit deteriorated (PCD) loans, which represent the vast bulk of loans in most bank acquisitions, are subject to two credit marks: the fair-value mark and a current expected credit loss (CECL) reserve that is established via a provision expense for expected credit losses. PCD loans, ironically, are only subject to one fair-value credit mark under the gross-up method.

The accounting standard for good or good-enough loans makes no sense and impedes bank M&A.

The accounting standard for non-PCD loans — i.e., good or good-enough loans — makes no sense and impedes bank M&A. It forces buyers to record more goodwill and therefore dilution to tangible book value per share when a transaction closes. The initial accounting sin is then recouped via accreting the fair-value mark as a yield adjustment, usually over four years.

Aside from the absurdity of the accounting, the math works against bank M&A to the extent that investors desire (or demand) dilution to tangible book value per share be recovered in two to three years. In effect, the pricing matrix for acquirers is tighter than whatever market conditions and deal economics would otherwise suggest.

My outsider perspective is that the standard reflects an academic approach to accounting at FASB, when common sense says it should never have been adopted. When BB&T and SunTrust announced their merger in 2019 to form Truist Financial Corp., the banks petitioned FASB to amend the standard with the then-pending implementation of CECL for larger public banks to become effective Jan. 1, 2020. FASB declined to do so, and perhaps not coincidentally, the merger closed Dec. 6, 2019.

Aside from the industry pushing for rescission of the rule, I suspect FASB board member Fred Cannon was a credible advocate to drop the double count. Cannon was a long-time bank analyst and eventually director of equity research at Keefe Bruyette & Woods prior to joining the board in 2021.

> ***Bank M&A will not take off because of the elimination of the CECL double-count, but the change is helpful.***

Bank M&A will not take off because of the ruling, but the change is helpful as part of the mosaic that includes a new administration more favorable to business, plus bank regulators that do not impede industry consolidation unnecessarily.

When I began my career in the late 1980s, merger accounting for banks was the opposite of today, in that it was super conducive to M&A. To the extent that the primary consideration paid to the seller was the buyer's common stock (think of a like-kind exchange), the pooling of interests method was simple: The current and historical financial statements were combined. Investors objected, though, because the method did not capture the full cost of deals, including dilution, and because FASB was moving toward fair-value accounting.

If perfect is the enemy of good-enough, then we can take solace that beginning in 2027 the contorted accounting logic of double counting credit marks will not impede bank M&A. Perfect, however, would entail a retroactive adoption to Jan. 1 of this year.

This article was published by S&P Global Market Intelligence and not by S&P Global Ratings, which is a separately managed division of S&P Global.

Jeff K. Davis, Managing Director of Mercer Capital's Financial Institutions Group, is a regular contributor to S&P Global Market Intelligence, formerly SNL Financial. He can be reached at jeffdavis@mercercapital.com or 615.345.0350.