Chatham
FINANCIAL

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Hedge Accounting Advisory

Intelligent Solutions for Financial Risk Management

Minimize Volatility, Maximize Risk Management Objectives

It's critical that it's right

Hedge accounting can be challenging to "get right" and onerous to apply. Designing an effective hedging strategy and achieving the intended accounting results over time can be a difficult task — especially considering the need to accomplish it in a way that satisfies the concerns of key stakeholders including, management, the board of directors, auditors, and regulators. A financial institution needs to understand the economic and accounting nuances of each hedging strategy and to efficiently administer the program during its lifetime.

Why work with Chatham?

Chatham provides technical accounting consulting, analysis, technology, education, and key hedge accounting deliverables.

- Accountants with deep technical and practical expertise are on call to help.
- ChathamDirect is a practitioner-developed technology and provides efficiencies in administering your program.
- Transparent valuation methodologies and calculations drive better insight into the amounts recorded in your financial statements.

What Our Clients Say

"When I hear Chatham Financial is involved, I breathe a sigh of relief."

Big 4 Accounting Partner

Access advantage

Case Study

PROBLEM: A liability sensitive financial institution is looking to reduce its sensitivity to rising interest rates. The entity has to mitigate liability sensitivity and does not want to borrow wholesale funds to point a pay-fixed swap against.

Goals

- Convert fixed-rate assets to floating
- Minimize income statement volatility caused by a change in value of a derivative transaction

Solutions

Chatham structures a pay-fixed vanilla interest rate swap and helps the financial institution minimize income statement volatility by designating the swap as a fair value hedge of a closed portfolio of prepayable fixed-rate loans as shown below:

- Originate fixed rate loans to create a hedgeable portfolio
  - Loans do not need to have the same maturity or coupon
  - Loans required to be prepayable
- Determine size and duration of risk exposure and compare to average retention period of loans
- Designate the last layer of a closed portfolio of fixed-rate loans (*i.e. $40mm portion that is not expected to prepay of a $100mm portfolio*)
- Execute a plain-vanilla swap with the same notional as the last layer and a duration that address the risk exposure
- Changes in fair value of the swap are offset by changes in fair value of the hedged last layer of the designated prepayable fixed-rate loan portfolio — mismatches are reported in interest income
- Any partial or full prepayments that occur up to the undesignated portion of the closed pool will be ignored for hedge accounting purposes
- Stop hedge accounting once prepayments exceed undesignated portion of the closed pool and encroach into the designated last layer amount
- Consider redesignation of the swap to a new portfolio