

Trends in the interest rate environment and new Accounting Standards Update for ASC 815 (ASU 2017-12)

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Agenda

- Introductions
- Recent interest rate environment
- Impact on valuations
- Hedging
- Hedge accounting



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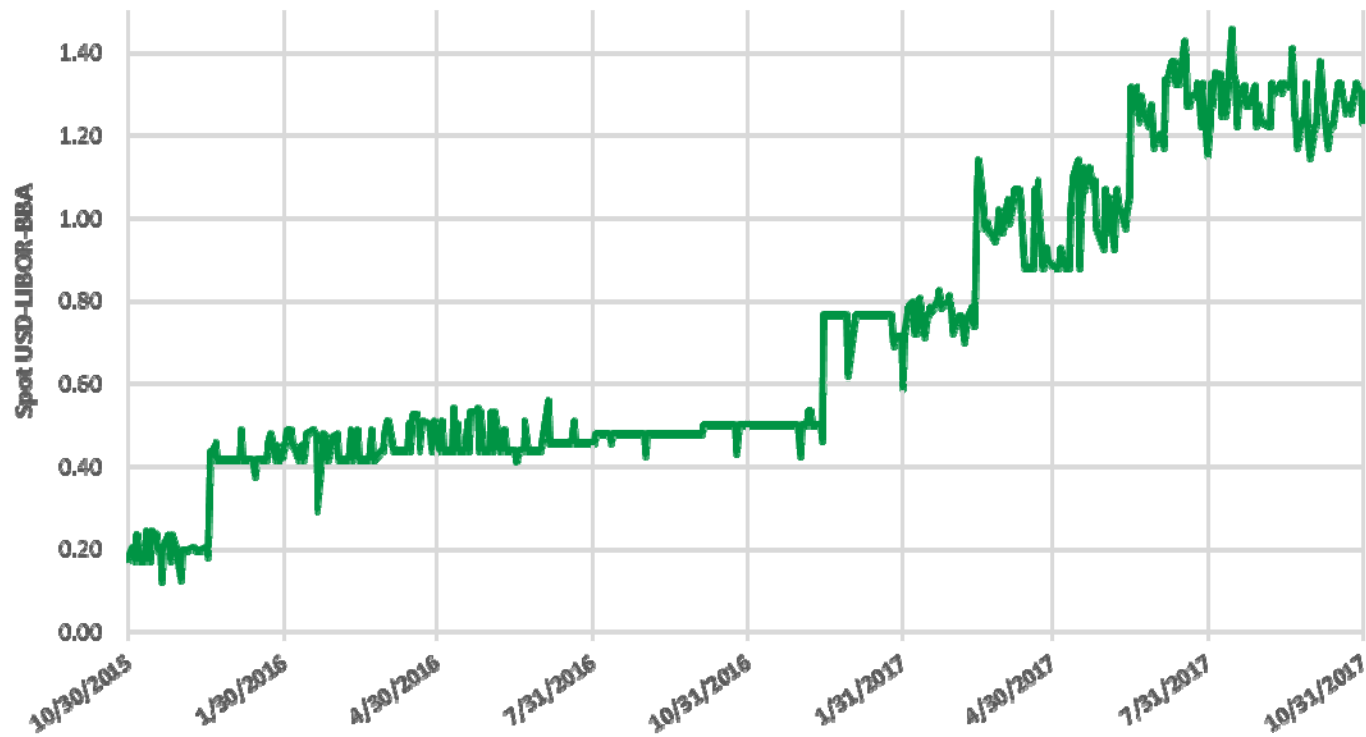
Craig Haymaker, CPA
Chief Operating Officer
HedgeStar



Recent interest rate environment

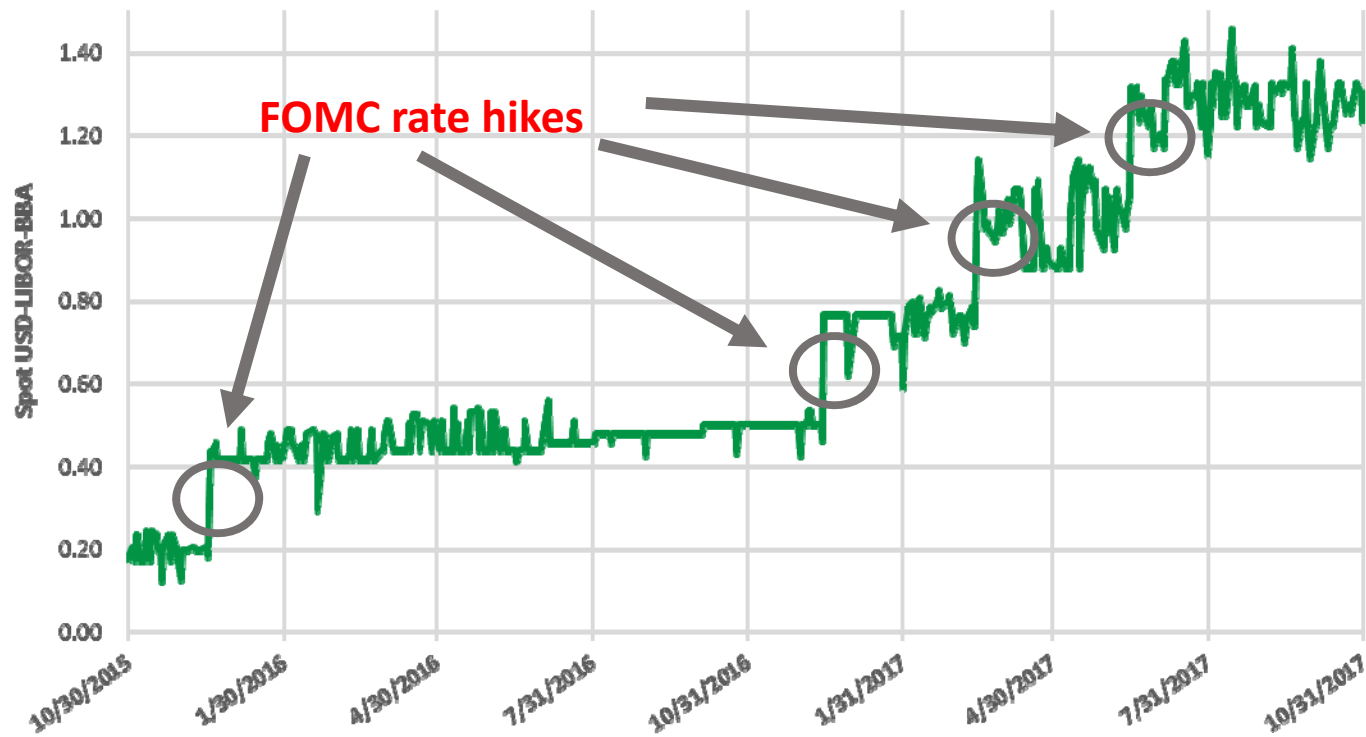
Recent interest rate environment

Spot LIBOR Rates
10/15 through 10/17



Recent interest rate environment

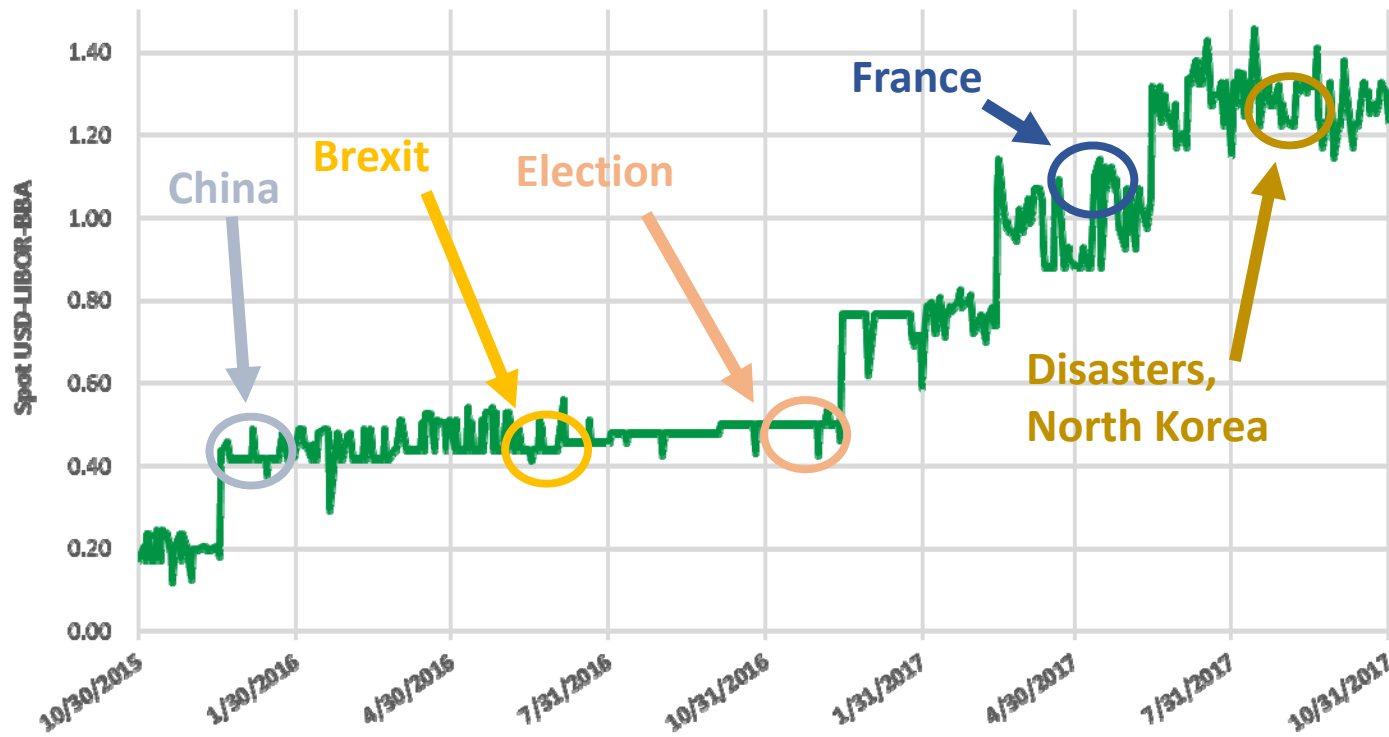
Spot LIBOR Rates
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Recent interest rate environment

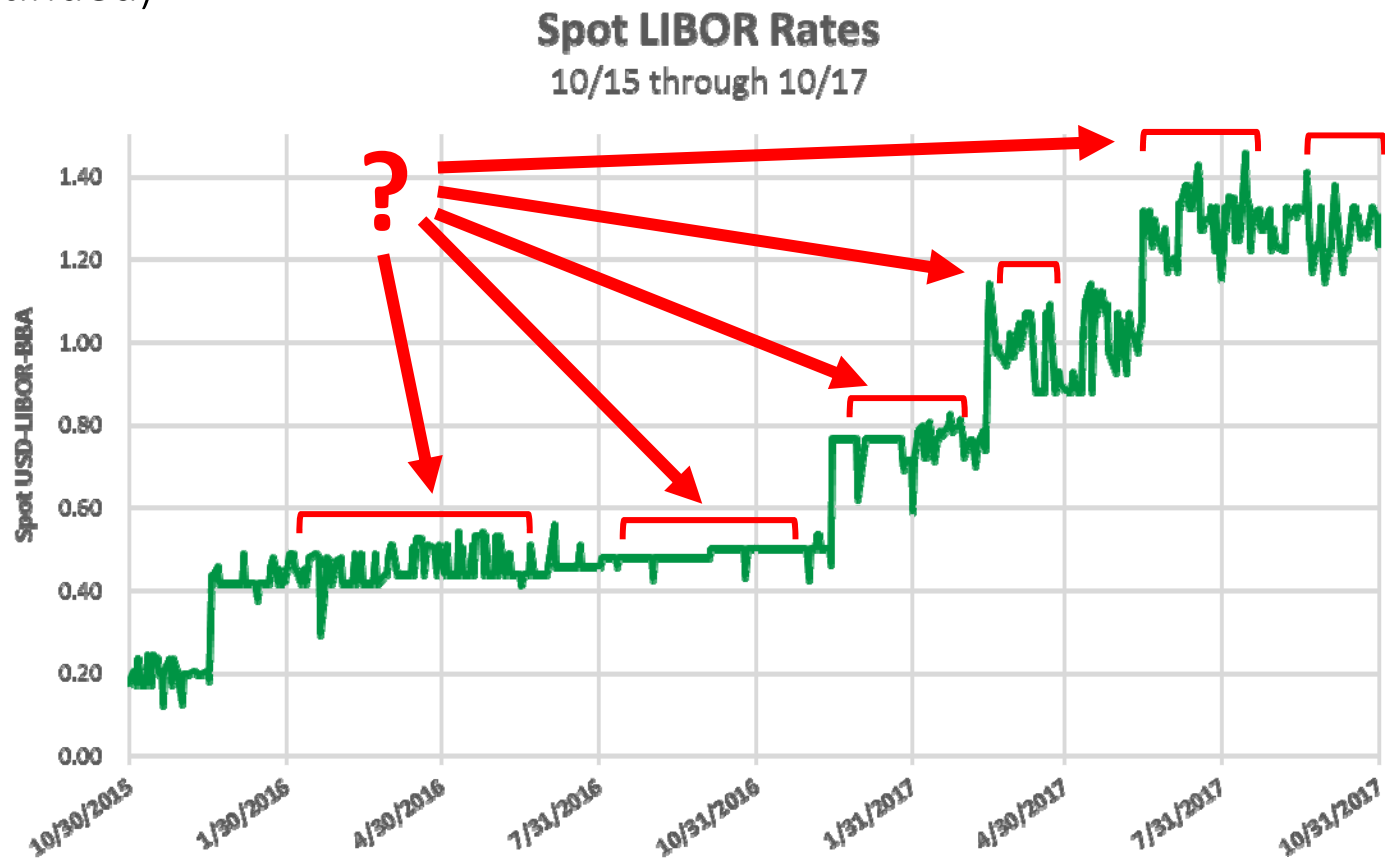
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Spot LIBOR Rates
10/15 through 10/17



Recent interest rate environment

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Impact on valuations

Impact on valuations

Rising interest rates may cause...

- Fixed rate asset values to decrease, or
- Floating rate payments to increase.



Falling interest rates may cause...

- Floating rate receipts to decrease, or
- Fixed rate liability values to increase.



Hedging

Hedging



Why hedge?

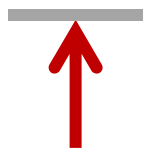
- Mitigate variability, improve predictability
- Be market agnostic
- Enhance budget results
- Promote risk management

Hedge – Hedge Instruments

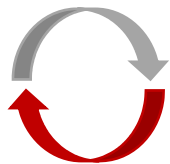
Permissible derivatives under NCUA regulation



US Treasury futures



Interest rate caps and floors



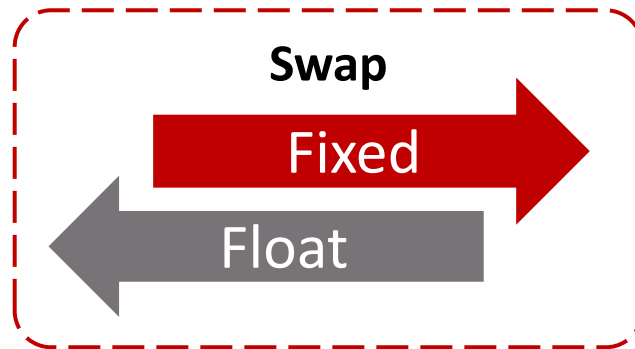
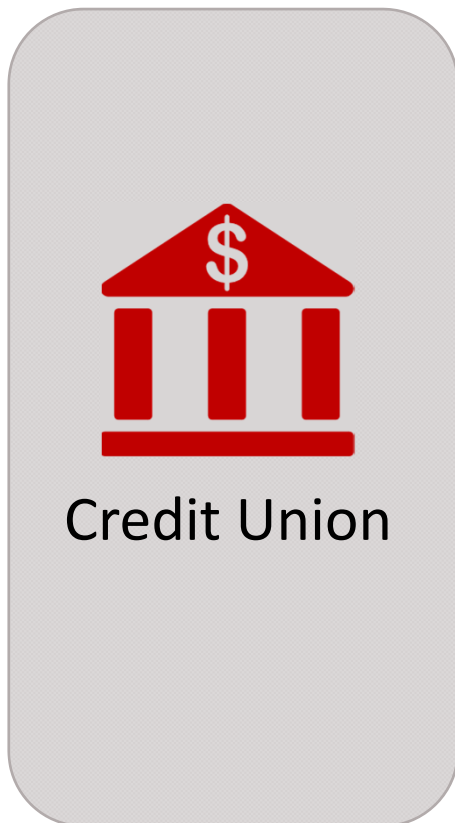
Interest rate swaps / basis swaps

Hedging – Fixed Rate Payer Swaps

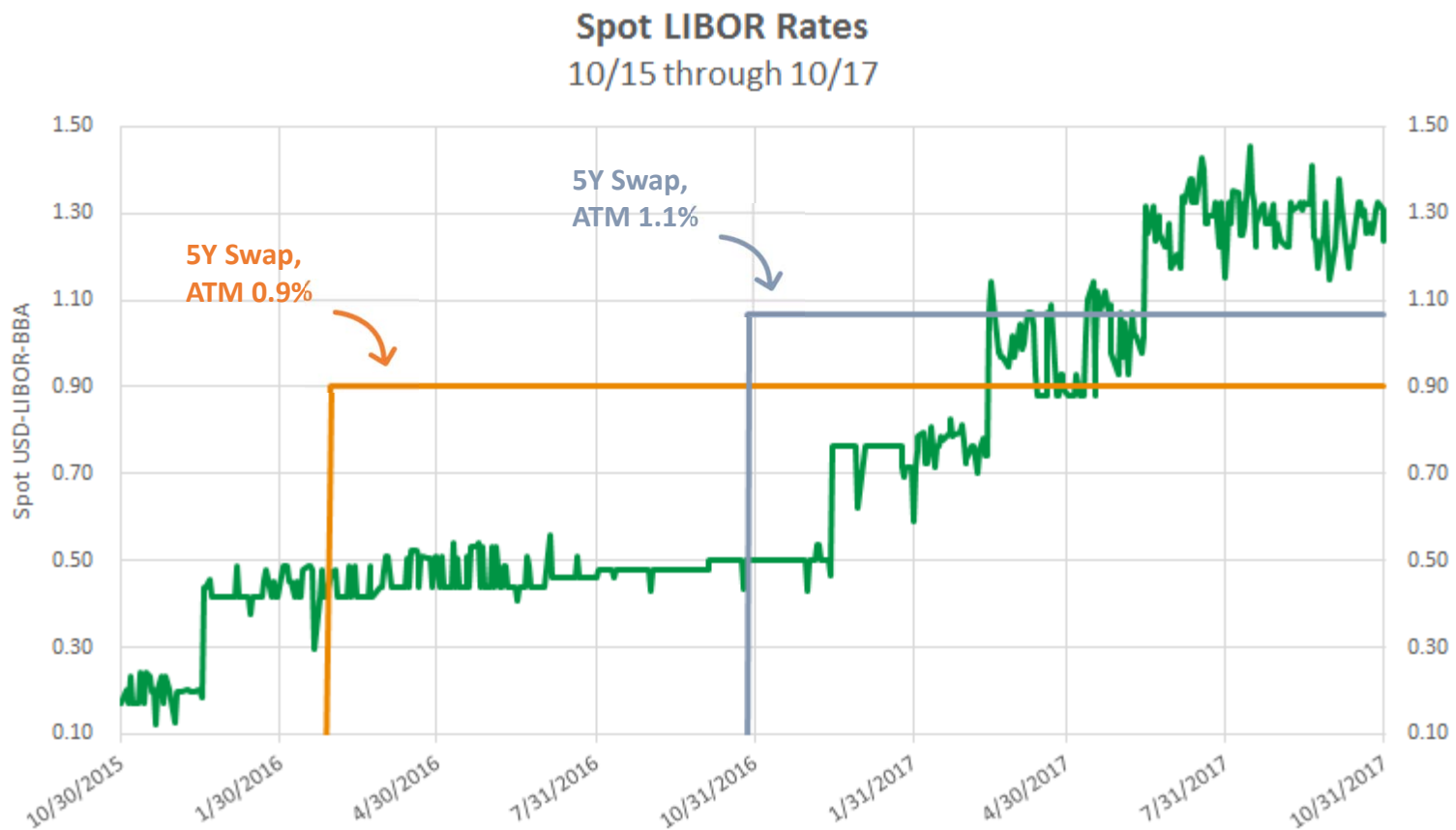
- Agreement to exchange future cash flows
- Swaps stand on two legs – fixed leg and floating leg
 - Net Settlement
- Notional amount
- Underlying index or reference item
- Mark-to-market and accrued interest
 - Rates rise = swap value goes up
 - Rates fall = swap value goes down

Hedging – Fixed Rate Payer Swaps

(Continued)



Hedging (Continued)





Hedge accounting

Hedge accounting

Accounting for Hedges

- Carry hedge instrument at fair value on balance sheet
- Record periodic gain / loss in earnings

Hedge Accounting

- Carry hedge instrument at fair value on balance sheet
- Record periodic gain / loss in Other Comprehensive Income ("OCI")

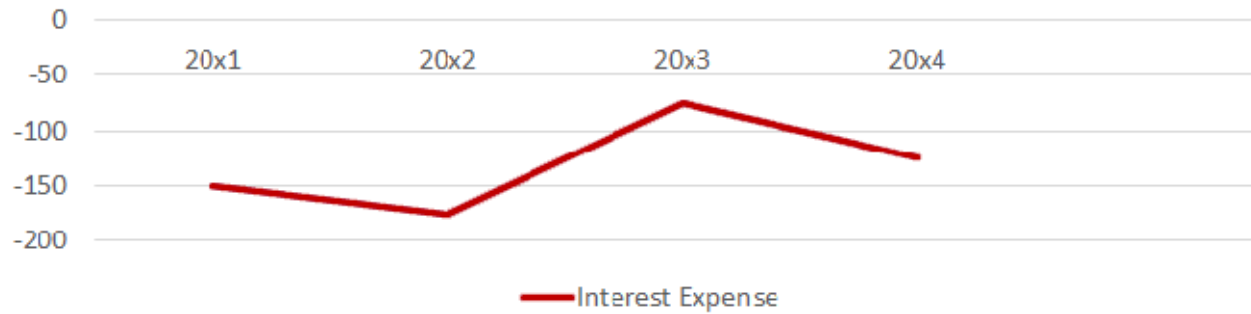
Earnings



Balance
Sheet

Hedge accounting – (Continued)

Earnings Volatility – No hedging

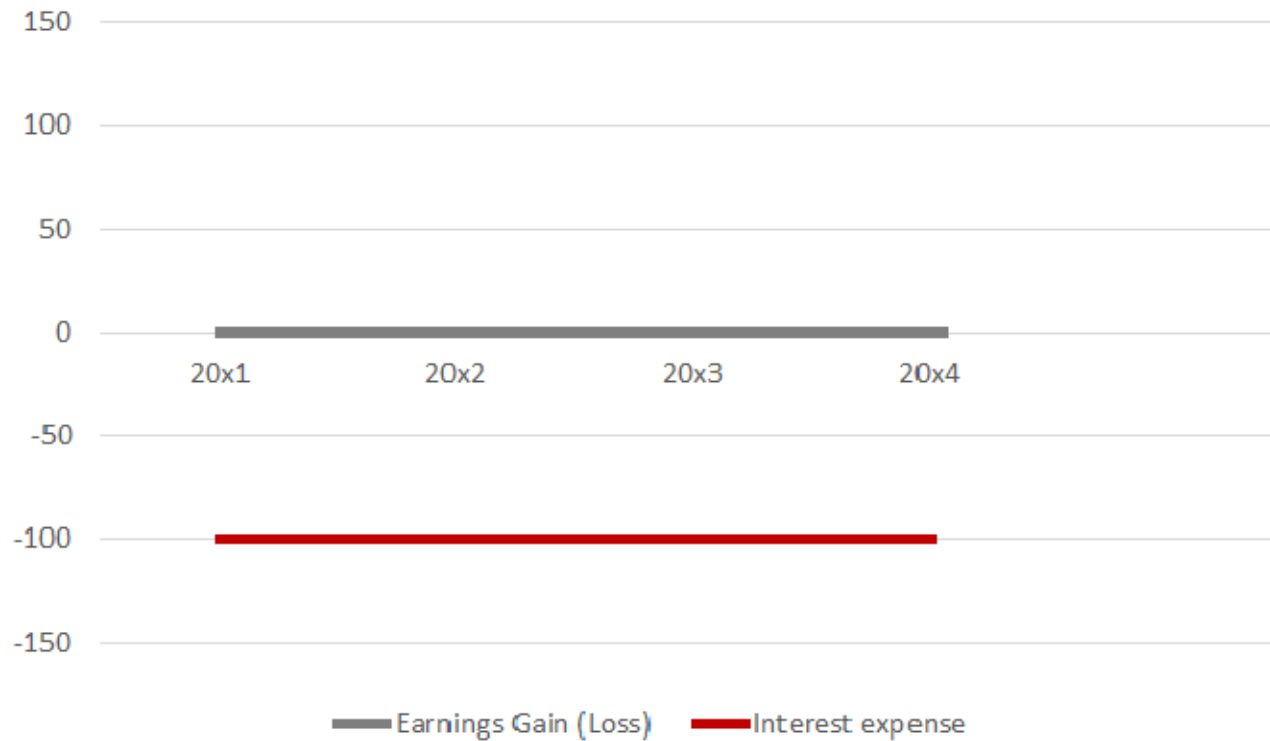


Earnings Volatility – Derivative Accounting

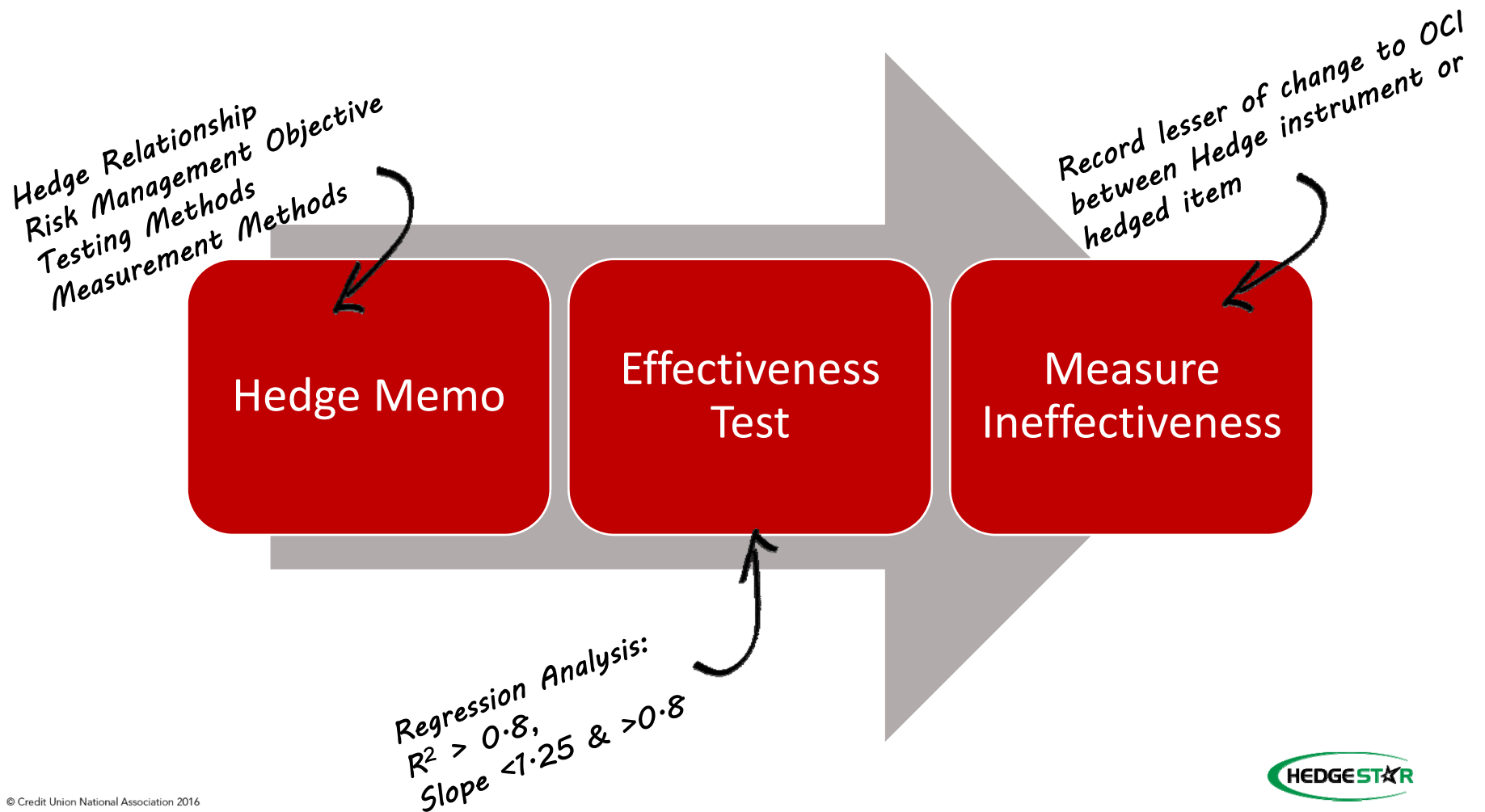


Hedge accounting – (Continued)

Earnings Volatility – Hedge Accounting



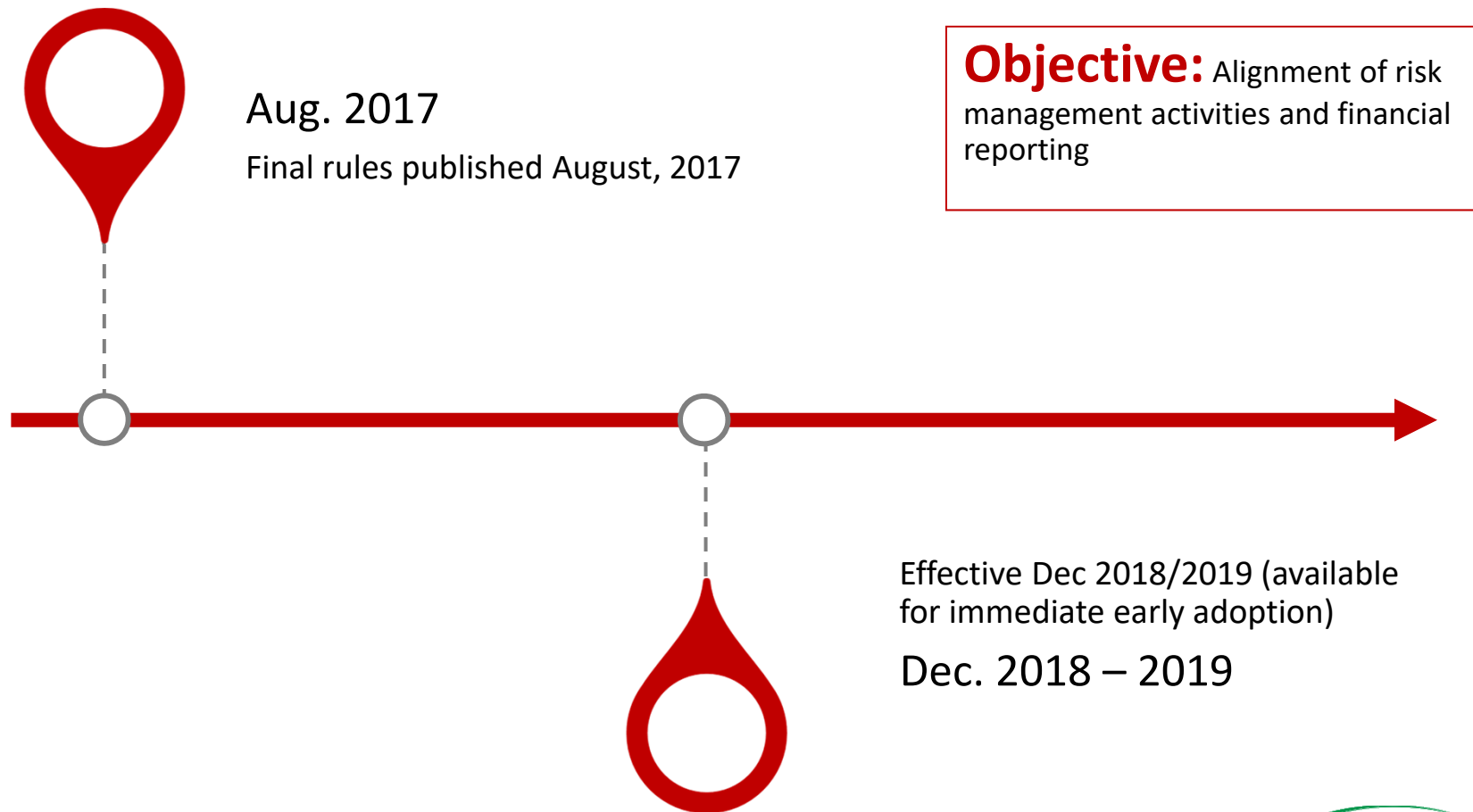
Hedge accounting: process flow



New accounting standards update ASC 815

[FASB – Update 2017-12: Topic 815](#)

Accounting Standards Update: Topic 815



Accounting Standards Update: Topic 815

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Old World

- Designating a contractually specified index
 - Only LIBOR or Fed Funds allowed
- Measuring hedge ineffectiveness
 - Book to OCI the lesser of change in value of hedged item or hedge instrument
- Effectiveness Tests
 - Required at hedge inception and quarterly thereafter (at a minimum)
- Portfolio Fair Value Hedges
 - Homogeneous instruments
 - Principal paydowns considered

New World

- Designating a contractually specified index
 - Any index (Prime, et al.)
- Measuring hedge ineffectiveness
 - All change in value of hedge instrument goes to OCI
- Effectiveness Tests
 - Required at inception, then *qualitative* test quarterly (at a minimum)
- Portfolio Fair Value Hedges
 - Last of layer method
 - See next slide

Accounting Standards Update: Topic 815

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ASU 2017-12: Last of layer method

Assume a \$100M portfolio of 15-year prepayable assets

Partial-term hedge (7 years, \$10M)

Assumed to not be affected by prepayments, defaults, sales, other factors affecting timing of cash flows.

Un-hedged term / portion

All prepayments, defaults, etc assumed to apply first to the unhedged portion of the pool

- Hedged-term basis adjustments applied at the pool level, provided no de-designation event occurs
- Benchmark interest rate determined at hedge designation date





Questions?



Thank You!



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