

Hedge Accounting Advisory

Intelligent Solutions for Financial Risk Management

Why does choosing the right hedge accounting partner matter?

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.

- Our team of accountants, many from the Big Four and the FASB, provide deep technical and practical expertise.
- ChathamDirect is a practitioner-developed technology platform and provides efficiencies in administering your program.
- Transparent valuation methodologies and calculations drive better insight into the amounts recorded in your financial statements.



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

Big 4 Accounting Partner



Case study

Problem

A financial institution client needed to hedge the risk of rising interest rates. It had unrealized losses in its available-for-sale bond portfolio and NIM pressure due to increased funding costs.

Goals

- Hedge further potential losses in the investment portfolio
- Reduce pressure on funding costs
- Minimize income statement volatility caused by a change in value of a derivative transaction

Solutions

Chatham structured a series of pay-fixed vanilla interest rate swaps against a portion of the financial institution's AFS securities. This amount was roughly 5% of the financial institution's total assets.

- The financial institution spread out its strategy across multiple swaps to mitigate price risk from executing all the swaps at one time
- The pay-fixed swaps' valuation changes were opposite of the fixed-rate AFS securities providing a hedge on the bond's valuations
- Due to the inverted yield curve, the financial institution had "positive carry," i.e., they were the net receiver of cash flows providing immediate relief to funding costs

Chatham's hedge accounting team supported the financial institution by:

- Providing pre-trade hedge accounting analysis ensuring that the portfolio would be large enough to support the hedged amount
- Running pre-trade hedge effectiveness tests using the regression method
- Drafting the hedge designation memo applying the portfolio layer method under fair value hedge accounting
- Discussing the strategy with auditors before executing
- Finalizing the hedge designation memo and effectiveness test immediately after execution
- Preparing period-end journal entries and re-testing hedge effectiveness at quarter ends

Outcome

The financial institution hedged 50% of its unrealized losses in the AFS portfolio and reduced its funding cost while avoiding unnecessary income statement volatility.

Are you ready to learn more?

To speak with a Chatham advisor, call **+1 484 731 2788** or email fi@chathamfinancial.com.

Transactions in over-the-counter derivatives (or "swaps") have significant risks, including, but not limited to, substantial risk of loss. You should refrain from entering into any swap transaction unless you have fully understood the terms and risks of the transaction, including the extent of your potential risk of loss. For further information about Chatham Hedging Advisors, LLC, and to view its disclosure document, please visit chathamfinancial.com/legal/notices. 23-0279

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