

Performance Trust

Derivatives Life Cycle

Derivatives can be an important tool for enhancing balance sheet performance in multiple scenarios over time.

De-Bunking the “D” Word—Derivatives

In the past, a host of issues prevented smaller financial institutions from getting involved in derivative transactions. Whether it was a lack of transparency, complex accounting, or just a lack of familiarity many smaller financial institutions saw derivative misuse by some larger

institutions and avoided the topic. Derivatives are often uncharted territory for community banks; however, derivatives deserve another look as much has changed in this space.

Today, in a post-Dodd-Frank world, there are many improvements in this market such that smaller institutions have greater accessibility to interest rate swaps and other derivatives. There is increased transparency into what was once an opaque corner of the financial world. Community financial institutions now have direct access to this market which has provided enhancements through simplified accounting rules, a more favorable regulatory environment, better collateral terms, and transparent pricing.

STEPS TO SUCCESSFULLY IMPLEMENTING DERIVATIVES

STEP 01 | **Education:** Let Performance Trust provide you and your institution with a variety of education primers on derivatives.

We cover the accounting rules for hedging single exposures (*Basic Hedge Accounting*) and a portfolio of exposures (*Hedge Accounting Variable Cash Flows* and *Portfolio Layer Method*)

Derivatives Streamlined and Simplified

- We provide the accounting expertise you need to facilitate an informed dialog with outside auditors
- Derivative Policy Formation
 - Our team developed a variety of flexible policies designed to best help meet your needs
 - Our team is well-versed in typical regulatory issues and can address them in your derivative policy
- Swap Pricing Mechanics, Trading Protocols, and Back Office Support
 - In-depth knowledge of the pricing behind interest rate swaps and options, whether basic or complex we have all the tools you need to understand swap valuations and pricing
 - When it is time to hedge, we will serve as your Introducing Broker aligning you with a swap counterparty that is right for your needs
 - Per Dodd-Frank Rules pricing is fully transparent and all revenue is disclosed
 - We will assist you in any back-office concerns and help assist in outlining a separation of duties between your front and back office

STEP 02 | **Strategy Formation:** We are dedicated to educating and assisting you in the strategy formation with derivative instruments.

- Through our extensive educational seminars, webcasts, and face-to-face discussions we help our clients understand how derivatives can impact your institution in a variety of rate environments
- Through our proprietary Shape Management™ analysis you will see directly how derivatives can impact your income statement and balance sheet over time and in multiple scenarios allowing you to implement the best strategies for your institution's future

STEP 03 | **Documentation:** Derivative transactions use industry-standard master documents that are customized for each institution. The types of transactions and the size/creditworthiness of your institution will determine the type of document and the business terms in the document.

- We will assist with both the formal documentation process and the KYC/AML steps that are necessary to transact
- Our legal counsel is ready to assist your firm in the negotiation of all the necessary documentation

STEP 04 | **Hedge Accounting and Execution:** We will guide you through the process every step of the way.

- Trade executed via Performance Trust with client and bank dealer
- Trade confirmation sent and executed by client and bank dealer
- Hedge accounting inception documentation provided by Performance Trust within 48 hours of the hedge execution through the Bond Trust Portal:
 - PT will supply the hedge accounting election document
 - PT will furnish the hedge accounting effectiveness assessment
- Quick Access to Needed Documentation on our Bond Trust Portal:
 - Hedge accounting inception documentation
 - Hedge accounting election documentation
 - Hedge accounting effective assessment
 - Ongoing journal entries

STEP 05 | **Trade Monitoring and Support:** On-going monitoring for your institution allows you to see the economic impact of your derivatives execution and accounting effectiveness.

- A hedge either goes to the maturity date or is terminated prior to maturity
 - If terminated prior to maturity, the derivative gain or loss is calculated
 - Derivative gain/loss is recognized in earnings (if the hedged exposure no longer exists) or is amortized to earnings over the remaining term of the hedge relationship if the hedged exposure still exists
 - Derivative cash gain/loss settled or embedded into new hedge relationship
- If hedge is terminated, termination confirmation is generated and confirmation is executed by client and bank dealer
- Cash payment is generally settled in 2 business days

Derivatives can be an important tool for enhancing your balance sheet management. To learn more about this simplified process, please contact us for a step-by-step analysis.

Contact Your Performance Trust Team to Learn More | performancetrust.com



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