Hedging - DIY Or Outsource

hedging risk management

Summary: Implementing a hedging strategy involves many elements, such as determining the economic risks your bank faces. We walk you through it.

National Geographic says those cute furry critters known as hedgehogs live about 7Ys, have prickly spines for protection, are mostly nocturnal and are found in Europe, Asia and Africa.

A different sort of hedging for community banks can also add protection. Here, a cohesive, overall hedging strategy can reduce the negative impact after sudden changes in interest rates.

Implementing a strategy involves determining the economic risks your bank faces, which risks are of most concern and what negative outcomes would hurt your performance the most.

Hedging strategies typically consider portfolio and loan level approaches. Once you've decided on a hedging strategy, you have other key decisions to make. For instance, will you handle the hedge trades yourself, or do you prefer to outsource it?

Managing back-to-back swaps in particular can be a complicated process. Some things you will need to consider include: identifying and listing the sort of trades you'll permit, learning the ins and outs of hedging, educating yourself and your staff, getting permission from your board, and other factors.

Of course, hedging instruments are subject to FAS133/ASC815 accounting regulations. If you expect to take care of hedging in-house, it will be beneficial to understand the required accounting treatment.

Next, you'll need to find a counterparty, go through a credit review, sign a master hedging contract, put up collateral (if your counterparty requires it), and include a host of other due diligence and tracking documentation on an ongoing basis.

Once this is all set up, you'll do each transaction with a hedging broker, which involves paying a fee. Then, on an ongoing basis (daily, weekly and monthly), your bank will get a notice of each hedge contract's value. As rates move along, these can move up and down, so you could get collateral back or owe additional collateral. Proper accounting is very important to keep things on track and avoid future issues.

Researching and executing your own hedge trades isn't impossible, of course, but it also isn't likely a core competency of most community bankers.

Yet, hedging can still benefit banks, so outsourcing some of the work here could be a decent option. When done right, your team works with people who are hedging experts. That relieves you of the need to become a hedging expert yourself, assign that job to a staff member, or hire a trader. It also reduces the time, money, and opportunity costs for each of these choices.

The hedging solution we first developed and launched more than 15Ys ago is uniquely designed to help community financial institutions leverage hedging tools to capture customers, while our team of experts provides support and expertise to do so. We handle the hedging pieces and you handle the customer pieces, keeping the entire process simple and easy.

Perhaps best of all, an outsourced hedging solution lets you focus on what you do best - running a financial institution. Call us today to learn more.

HEDGING SERVICES FOR COMMUNITY BANKS

Community bankers seeing long-term fixed rate demand from business clients can transform payments into a floating rate on their books using Borrowers' Loan Protection (BLP). Contact us today for more information.