

Hedge Accounting

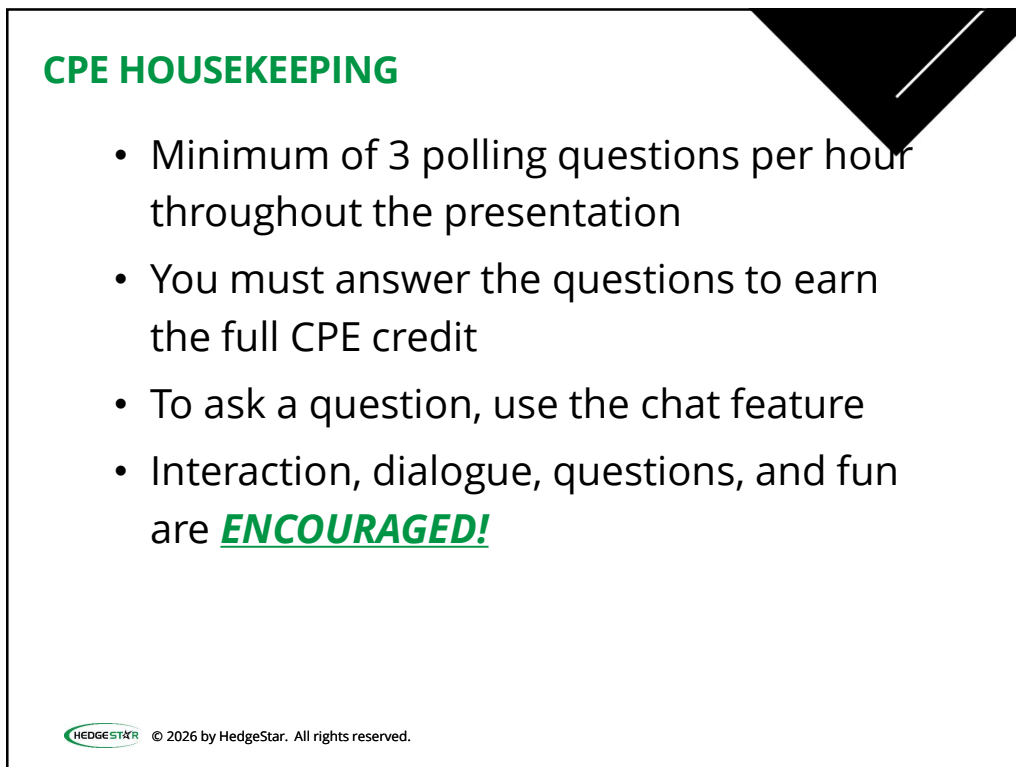
Catalyst Derivatives Symposium

April 28, 2026

Minneapolis, MN | 952-942-6094 | www.HedgeStar.com


The slide features a background image of a modern building with a glass facade. A large green star logo is positioned in the bottom right corner. A green diagonal line runs from the top left towards the center.

1



CPE HOUSEKEEPING

- Minimum of 3 polling questions per hour throughout the presentation
- You must answer the questions to earn the full CPE credit
- To ask a question, use the chat feature
- Interaction, dialogue, questions, and fun are **ENCOURAGED!**

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2

TABLE OF CONTENTS

Top 5 Questions About *Hedge Accounting*

- Why is Hedge Accounting important?
- What am I required to do to use Hedge Accounting?
- Which is better, a cash flow hedge or fair value hedge?
- What happens if I need to stop hedge accounting?
- What should I know about ASU 2025-09?

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3

WHY IS HEDGE ACCOUNTING IMPORTANT?

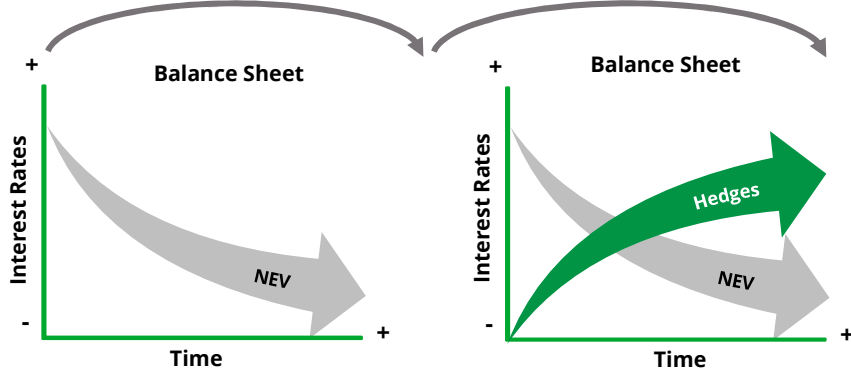
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4

WHY ARE WE HEDGING?



- Inherent interest rate mismatch between assets and funding




The diagram consists of two side-by-side graphs. Both graphs have 'Interest Rates' on the vertical axis (with '+' at the top and '-' at the bottom) and 'Time' on the horizontal axis (with '+' at the right). Both graphs are titled 'Balance Sheet'. The left graph shows a single grey arrow starting from the top-left and curving downwards to the right, labeled 'NEV'. The right graph shows two arrows: a grey arrow starting from the top-left and curving downwards to the right, labeled 'NEV', and a green arrow starting from the bottom-left and curving upwards to the right, labeled 'Hedges'. Arched arrows connect the two graphs at the top.

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5

BENEFITS TO HEDGING

- Minimize impact from market volatility
- Stabilize earnings, preserve margin
- Improved regulatory compliance
- Increased stakeholder confidence
- Competitive advantages



The icon depicts a green handshake on the left, two interlocking gears above it, and a classical building with columns and a pediment on the right.


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6

HEDGE ACCOUNTING

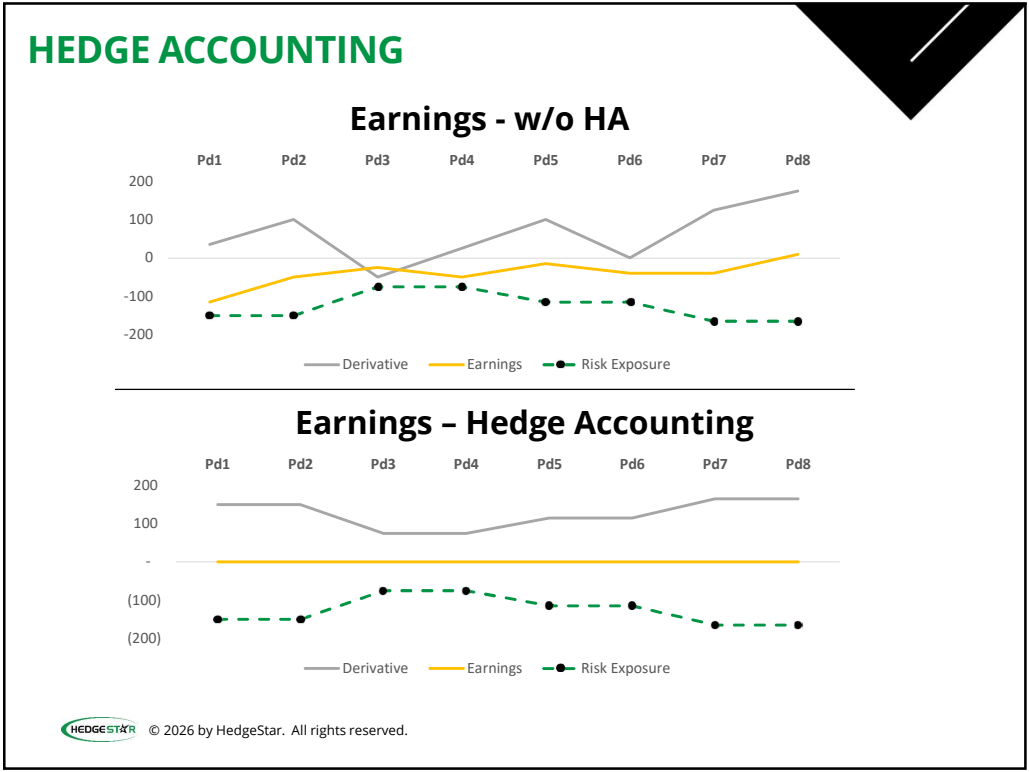
Why hedge accounting?

- Aligns economics with accounting results
- Provides financial statement stability
- Highlights all benefits of hedging, allowing financial results to speak for themselves without "exception" conversations



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7



8

WHAT AM I REQUIRED TO DO TO USE HEDGE ACCOUNTING?

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9

HEDGE ACCOUNTING

Requirements



- **Documentation**

- Formal documentation of each hedging relationship is required



- **Valuation**

- **Effectiveness assessment**

- Generally, a “highly effective” hedge would offset hedged risk 80% to 125%



- **Record results**


- Impact of hedge settlements, mark-to-market gains or losses, and hedged item adjustments

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10

DOCUMENTATION

Formal designation and documentation of the hedging relationship is required




- Hedge Relationship
- Risk Management Objective
- Effectiveness Assessment
- Financial Statement Impact

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11

EFFECTIVENESS ASSESSMENT

- The cash flows (or fair value) of the hedging instrument must be highly effective in offsetting the cash flows (or fair value) of the hedged transaction(s) / hedged item



Hedged Risk

Date	Hedging index	Hedged rate
10/29/2018	2.5	2.5
4/29/2019	2.5	2.5
10/29/2019	2.0	2.0
4/29/2020	0.5	0.5
10/29/2020	0.5	0.5
4/29/2021	0.5	0.5
10/29/2021	0.5	0.5
4/29/2022	2.5	2.5
10/29/2022	4.5	4.5
4/29/2023	5.5	5.5



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12

HEDGE ACCOUNTING

Hedging activities that are “highly effective” qualify for favorable accounting treatment

- Mark-to-market gains and losses (unrealized)
- Derivative settlements (realized)

	Cash Flow	Exposure to variability in cash flows (variable rate)
	Fair Value	Exposure to changes in price or value (fixed rate)

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13

WHICH IS BETTER; A CASH FLOW HEDGE OR FAIR VALUE HEDGE?

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14

HEDGE ACCOUNTING



Cash Flow


Exposure to variability in cash flows (variable rate)



Fair Value

Exposure to changes in price or value (fixed rate)

	Cash flow	Fair value
Fixed payer	Variable expense	Fixed asset
Fixed receiver	Variable income	Fixed liability

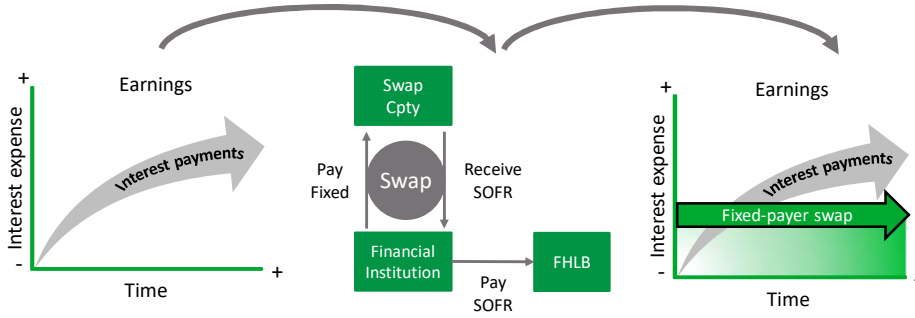
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15

CASH FLOW HEDGE ACCOUNTING

Example:


- Hedged risk - short-term borrowing rates (SOFR+)
- Hedge - 5-year swap, 4.00% fixed-payer / receive SOFR



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16

CASH FLOW HEDGE ACCOUNTING

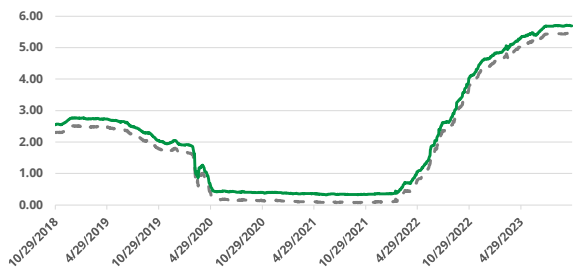


Cash Flow

Exposure to variability in cash flows (variable rate)

- The cash flows (or fair value) of the hedging instrument must be highly effective in offsetting the cash flows (or fair value) of the hedged transaction(s) / hedged item
 - i.e., correlation of hedging rate with hedged risk


Hedged Risk



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17

CASH FLOW HEDGE ACCOUNTING



Cash Flow

Exposure to variability in cash flows (variable rate)

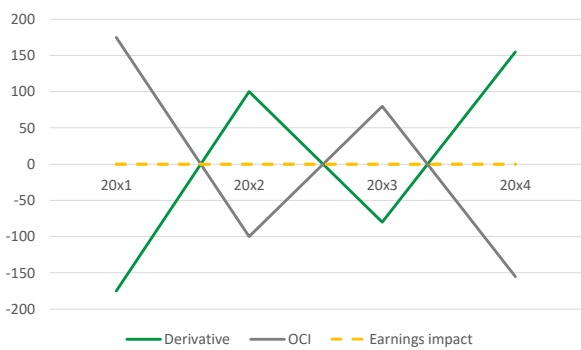
Balance sheet

- Derivative value
- Derivative accrual
- Other comprehensive income

Income Statement

- Derivative accrual/settlements

Cash flow hedge accounting



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18

CASH FLOW HEDGE ACCOUNTING

✓
 Design risk management program


✓
 Hedge memo

✓
 Effectiveness test

Record results

It's more than mark-to-market gains and losses...

- Hedge settlements are:
 - Reclassified from OCI to earnings when the hedged item affects earnings
 - Recorded in the same income statement line item as the hedged item



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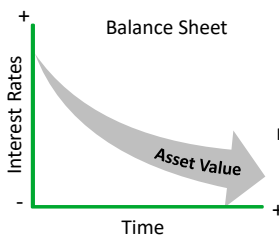
19

FAIR VALUE HEDGE ACCOUNTING

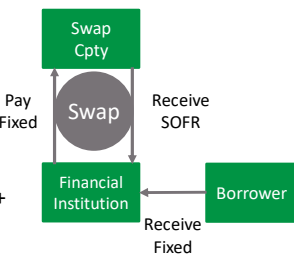
Example:

- Hedged risk - closed pool of 30-year fixed-rate mortgage loans
- Hedge - 5-year swap, 4.00% fixed-payer / receive SOFR

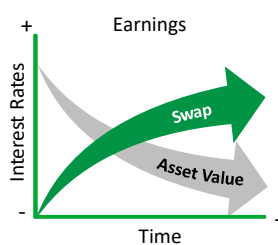
Balance Sheet



Swap




Earnings



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20

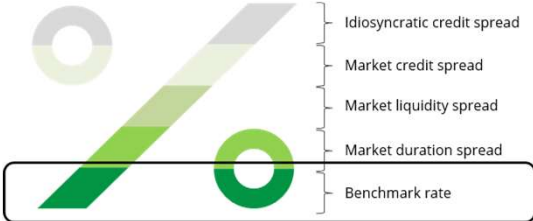
FAIR VALUE HEDGE ACCOUNTING



Fair Value

Exposure to changes in price or value (fixed rate)


- Hedged item: single asset or liability, or a portfolio of similar assets/liabilities
- **Portfolio Layer Method**
 - Hedge of *benchmark interest rate risk* against a *partial term* of a portfolio of *prepayable* assets
 - Hedged portion is the last loans affected by prepayments, defaults, sales, etc.



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21

FAIR VALUE HEDGE ACCOUNTING

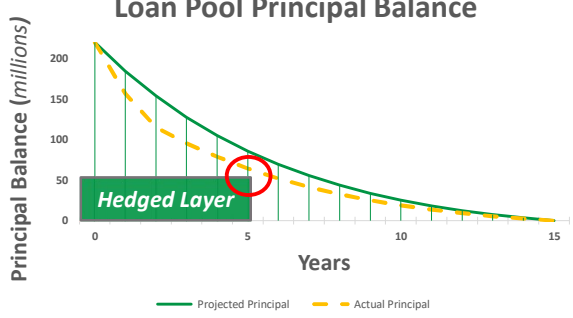


Fair Value

Exposure to changes in price or value (fixed rate)

- **Portfolio Layer Method:** Prepayment risk is NOT part of hedged item adjustment, but must be monitored in relation to whether the hedged amount exists

Loan Pool Principal Balance




— Projected Principal - - - Actual Principal

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FAIR VALUE HEDGE ACCOUNTING

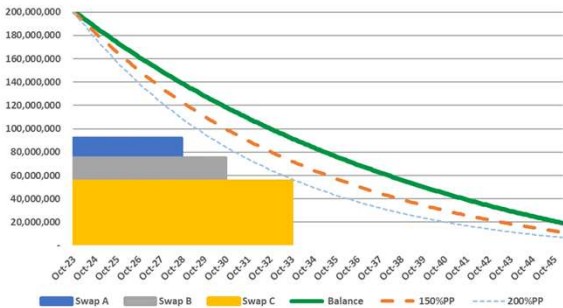


Fair Value

Exposure to changes in price or value (fixed rate)

- **Portfolio Layer Method:** When designating multiple swaps to one portfolio, aggregate hedge notional must be less than projected principal


Portfolio Layer Analysis



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23

FAIR VALUE HEDGE ACCOUNTING



Fair Value

Exposure to changes in price or value (fixed rate)

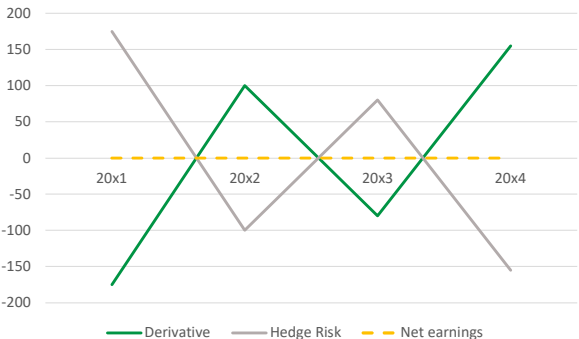
Balance sheet

- Derivative value
- Derivative accrual
- Hedged item basis adj

Income Statement

- Derivative gain/loss
- Derivative accrual/settlements
- Hedged item gain/loss

Fair value hedge accounting



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24

WHAT HAPPENS IF I NEED TO STOP HEDGE ACCOUNTING?

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25

HEDGE ACCOUNTING TERMINATION/ RE-DESIGNATION



- Hedging instrument or hedged item is terminated
- Hedged transactions are probable to **not** occur
- Hedge is re-designated as hedge of another risk
- Hedge is no longer highly effective
- Voluntary termination of hedge relationship (ASC 815-25-40-1)

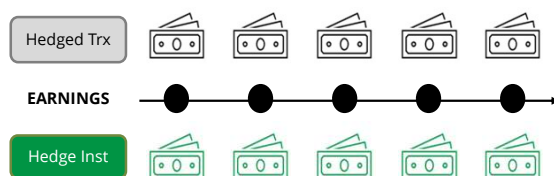
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26

HEDGE ACCOUNTING TERMINATION/ RE-DESIGNATION

Recognition of hedging gain or loss

- If hedged item is probable / still exists
 - **CF hedge:** AOCI balance is reclassified systematically with the hedged item (ASC 815-30-40-4)
 - **FV hedge:** basis adjustment is amortized as discount/premium



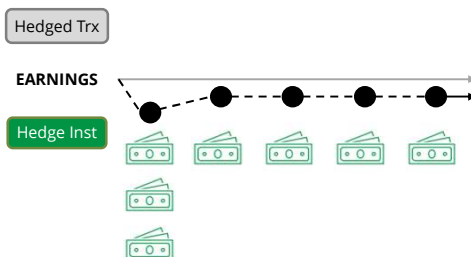
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27

HEDGE ACCOUNTING TERMINATION/ RE-DESIGNATION

Recognition of hedging gain or loss

- If hedged item is not probable / is terminated
 - **CF hedge:** AOCI balance is reclassified immediately (ASC 815-30-40-5)
 - **FV hedge:** basis adjustment is recognized immediately



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28

HEDGE ACCOUNTING TERMINATION/ RE-DESIGNATION

Re-designating (restarting) hedge accounting

- Formal documentation is required to re-designate the hedge in a new relationship
 - Effectiveness assessment considers derivative fixed rate (off-market, or non-zero value) relative to current market rate

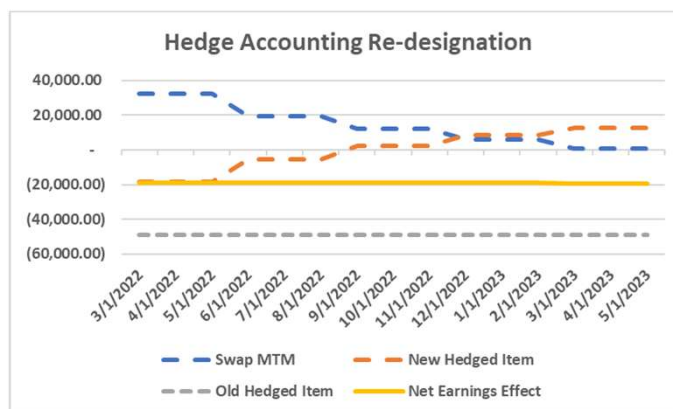


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29

HEDGE ACCOUNTING TERMINATION/ RE-DESIGNATION

- Re-designation impact
 - “Layers” of hedge accounting: old + new



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WHAT SHOULD I KNOW ABOUT ASU 2025-09?

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31

RECENT UPDATES (ASU 2025-09)

- **Accounting Standards Update 2025-09**
 - Amends requirement of forecasted transactions to have *similar* risk exposure rather than have the *same* risk exposure
 - Document and test sources of risk that may serve as hedged item
 - IF one source fails, all fail and relationship must be discontinued (re-designation is possible)

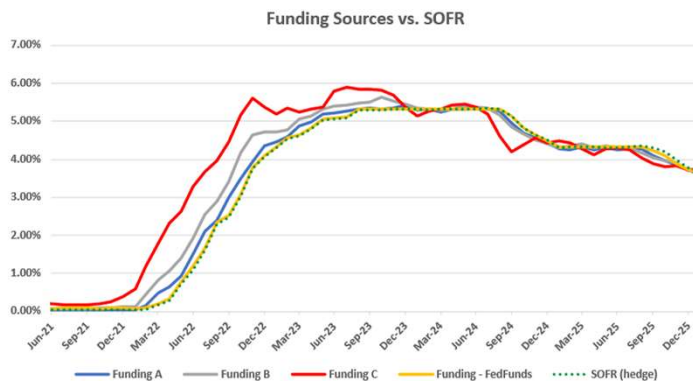
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32

RECENT UPDATES (ASU 2025-09)

- **Similar risk assessment**

	A / SOFR	B / SOFR	C / SOFR	FF / SOFR
RSQ	0.9934	0.9723	0.8530	0.9997
SLOPE	0.9758	0.9540	0.8475	0.9919



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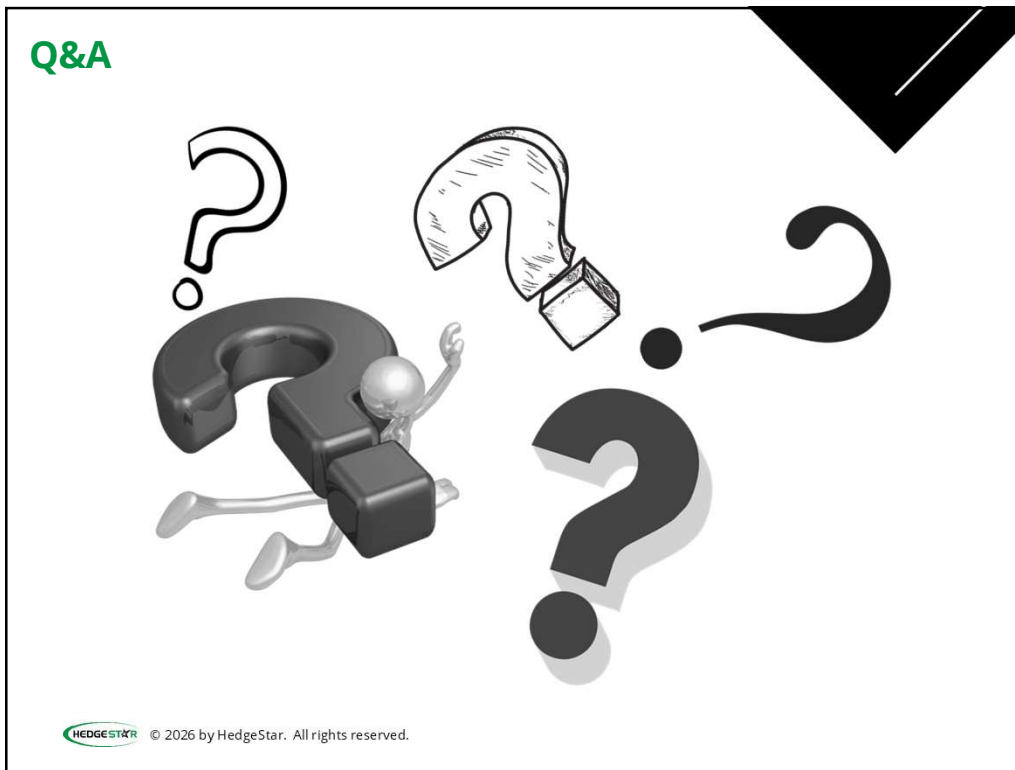
33

REVIEW

- Hedge accounting = bridge between economics and accounting results
- Documentation is critical
- Cash flow vs fair value designation: what's driving the risk?
 - Align hedge accounting with economic objectives
- When discontinuing a hedge relationship, timing of hedge gain or loss recognition will follow the hedged item


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34



35

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36