

Step By Step Set-Up Checklist Asset Interest Rate Cap

This document includes step by step set-up instructions for adding a specific type of Hedge an Asset – Interest Rate Floor.

If you have questions or need additional help with this process, please call Compass Support at 800 323-3281 or e-mail support@plansmith.com.

Set-Up:



☐ Click the Projections Icon on Navigation Tool Bar. Look for an existing empty folder in the Asset section of the balance sheet.

Some institutions prefer that the Swap be located close to a specific Hedged Asset category, for example either Securities or Loans. Others prefer showing hedges near the bottom of the Assets.

If you can't find an empty folder, call, or e-mail Plansmith support and someone will help you add a new folder.

☐ Right click the name of the new or empty folder and select "Rename". Enter a short description of the hedge like "Interest Rate Cap" and click "OK".

☐ Right click the folder again and choose "Add Account".

☐ The Account Wizard will ask for the Account Name. We'll use "IR Cap" then click Next.

☐ Click Next on the cost factor showing "0".

☐ Select "Interest Bearing", then click Next.

☐ Click Next on the Alternate Discount Rate showing "None."

☐ Click Next on the RBC Factor showing "0."

☐ Select the "Interest Payment Frequency" for your contract, then click next.

☐ Click Next on "Taxable".

☐ Choose the "Interest Basis" for your contract, then click next.

☐ Change "Part of a Hedge" to "Yes", then click next.

☐ Change "Maturing" to "Non-Maturing", then click next.

☐ Click Next on the Decay Rate showing "No".

☐ Click "OK" to complete the wizard.

- ☐ Right click the folder again and choose “Add Account”.
- ☐ Enter “IR Cap Contra” as the Account Name, then click Next.
- ☐ Click Next on the cost factor showing “0”.
- ☐ Click Next on “Non-Interest Bearing”.
- ☐ Click Next on the RBC Factor showing “0.”
- ☐ Click “OK” to complete the wizard.
- ☐ Now we are ready to enter the notional amounts.

Balance Entry:

The notional balance for this swap type normally remains constant over the life of the hedge. Enter a negative number in the “Contra” Account and a positive amount in the other account. That results in a zero balance in the Folder. Should you have a contract providing for amortization of the notional amount, contact Plansmith for assistance.

The balance entry method depends upon when the contract starts.



- ☐ If the contract began before the first month of projections, enter the notional balances in Update Financial.



- ☐ If the contract starts in the current or future month, enter the balances in the EOM Balance column for the month the contract begins. Remember to enter both the positive balance in the main account and the negative balance in the contra.

☐ Then scroll down to the month that the contract expires and adjust the EOM balance for that month to zero if necessary.

☐ Do that for the Contra Account as well.

Pricing:

☐ Return to the Projections view of the IR Cap account (with the positive balance).

☐ This balance has a floating rate, so build a pricing model is to adjust projected income as you update rate Projections.

☐ Click the button at the top of the Offering Rate Column.

☐ Select “New Model”

☐ Change the Driver to the Index used in your contract. In this example we will use Prime.

☐ “Calc:” will be “Spread.”

☐ Change “Edit” to “Modeled Rate”

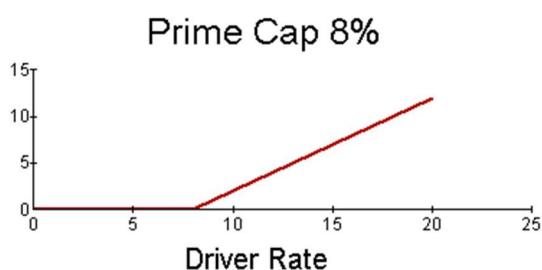
A Cap requires three points to define the yield over the range of all reasonable driver levels.

☐ Point A is the Driver Rate at zero, where the Rate received will also be zero.

☐ Point B is where the Driver is the Cap Rate, in our example 8. At that level, the Rate received is still Zero.

☐ Point C is a Driver Rate that is higher than any foreseeable rate reached in the next 5 years, as well as higher than the current rate plus the maximum shock of 400BP. We’ll use 20%.

☐ At that Driver rate level the rate received is 20% minus the Cap rate of 8%, so enter 12%.



☐ Before saving the model, click the “Chart” button and verify that the graph shows a line starting at zero at a Driver of zero. Then staying at zero until the Driver reaches the 9% Cap Rate, then increasing to 11% at the maximum Driver rate of 20%.

☐ If the graph looks good, close it and click save as.

☐ Enter a model name like “8% Prime Cap”.

The Contra Account on a Cap does not require pricing.



☐ At this point, we can Compute the Plan to update all financial reports.



☐ Compute Rate Shock, and update rate shock income reports to show the projected impact of this Cap.

Monthly Update Procedures:

Swap and Hedge notional amounts (or balances) are often not available in Financial Institution general ledger systems. These amounts normally do not change over the life of the contract, so

Driver:

Driver Value: 7.45 %

Time Lag: Months

Current Price: 0.00 %

Calc:

Edit:

Seg.	Driver	Rate	Spread
	0.00	0.00	0.00
A	0.00	0.00	0.00
B	8.00	0.00	-8.00
C	20.00	12.00	-8.00
D			
E			
F			

most Compass users simply update these amounts manually each month on the Update Financial screen. If your Institution posts income/expense monthly to the GL, you can import them automatically by adding the accounts in DataBridge. If not, enter the income/expense values manually as well.

Rate Shocked EVE:

The EVE calculations in Financial Compass use a single discount factor rather than an array of discount factors over the life of the instrument typically used by investment bankers. To maintain consistency with those results, you may obtain updated Shocked EVE valuations of each swap or hedge contract directly from your Investment Accounting provider or broker each time you prepare an EVE analysis.