



Hedging Your Bet With Your Pet

by [Steve Brown](#)

Anyone who has ever brought their dog or cat into any of the major pet stores knows there are countless products targeting the pets themselves. As you walk the aisles with your furry companion, you notice many items seem conveniently positioned right at nose level for those four legged impulse shoppers. Given how much money people spend on their pets, we weren't particularly surprised to learn that there is now a two-way audio video system that allows pet owners to monitor and converse with pets, dispense treats and release scents into the air when you are not around. The system is operated with a smart phone app and even has a built-in laser that pet owners can use to try and get their furry friends involved in a quick game of chasing the laser light every now and then to keep them fit.

The idea of a two-way pet camera system that can give peace of mind to pet owners made us think about the peace of mind bankers receive when they are protected against interest rate risk.

A low rate environment has pushed many small businesses to seek out longer term fixed rate loans, and this certainly makes sense when you look through their eyes. After all, locking in a low fixed rate for a longer term means borrower payments are known, regardless of where rates go - giving peace of mind to all.

For most community banks, however, when customers pressure lenders to refinance or originate loans with longer terms (10Y, 15Y, 20Y or 25Y) at a fixed coupon, the hair stands on end and concern begins to mount. This is because the vast majority of community bank core funding is relatively short (1month to 1Y) in term structure (DDAs or CDs).

This enormous mismatch typically raises fears in management teams, but it doesn't have to. Today, community bankers can very easily give the customer what they want (long term fixed rate loans) and manage interest rate risk by hedging.

Though this practice is nothing new for the industry's largest players, an extended period of low interest rates, high demand from customers and heavy competition have driven community banks with assets of \$200mm or more to begin to dip their toes into the world of hedging.

On the most basic level, hedging interest rate risk is a contractual process. In a traditional hedging relationship, a community bank reviews and signs agreements created by the international swaps dealer association (ISDA). These agreements are standardized globally and total about 200+ pages of legally worded pages that include such things as binding master agreements, a credit support annex, adherence letters, procedures, user guides, FAQs, protocol letters and other things. To do these, community banks also need to address accounting matters, ongoing tracking and payments, collateral posting and a host of other issues. It is also critical that community bankers pursuing this route hire attorneys with significant experience drafting such transactions, as they can be very complex to set up.

Of course, another way to do this without all that hassle and nonsense is through our Borrower's Loan Protection program or BLP for short. Here, we handle all of the ISDA stuff, while your customer pays a fixed rate coupon and your bank books a floating rate loan. This structure allows your bank to keep the loan relationship, without having to post collateral or deal with hedge accounting issues. To learn more about this program that we pioneered in the banking industry almost a decade ago, join us at one of our free online webinars by registering on our website at: <https://www.pccb.com/company/events/>

BANK NEWS

Cost Load

Research by the Fed finds compliance costs amount to 8.7% of non-interest expenses at banks with assets <\$100mm vs. only 2.9% for banks with assets \$1B to \$10B.

M&A Activity

1) Berkshire Bank (\$8.0B, MA) will acquire wealth management company Ronald N. Lazzaro PC for about \$10.2mm. 2) Salem Five Cents Savings Bank (\$3.9B, MA) will acquire Georgetown Bank (\$300mm, MA) for about \$49mm in cash or roughly 1.48x tangible book. 3) Stratford State Bank (\$110mm, WI) will combine with Heritage Bank (\$105mm, WI) in a merger of equals (MOE) transaction.

Jobs Report

The Fed indicates 75k to 120k jobs added per month is the level required to keep the unemployment rate stable. Below that level and unemployment rises, while above that level it declines. Over the past 3 months job growth has been 156k (Sep), 167k (Aug) and 252k (Jul). Over the past year job growth has averaged 178k per month.

Big Change

In order to be compliant with the new fiduciary rule, Merrill Lynch said it will no longer give retirement savers the option of paying commissions for trades. It will instead require all investors in retirement accounts to pay a fee based on a percentage of assets. The new rule takes effect in April 2017.

Millennial Payments

A WYSE Travel Confederation survey of millennials finds the preferred payment methods used are: debit cards (28%), credit cards (24%) and cash (22%).

Minimum Wage

A Stanford University study finds manufacturing robots now cost about \$4 an hour.

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