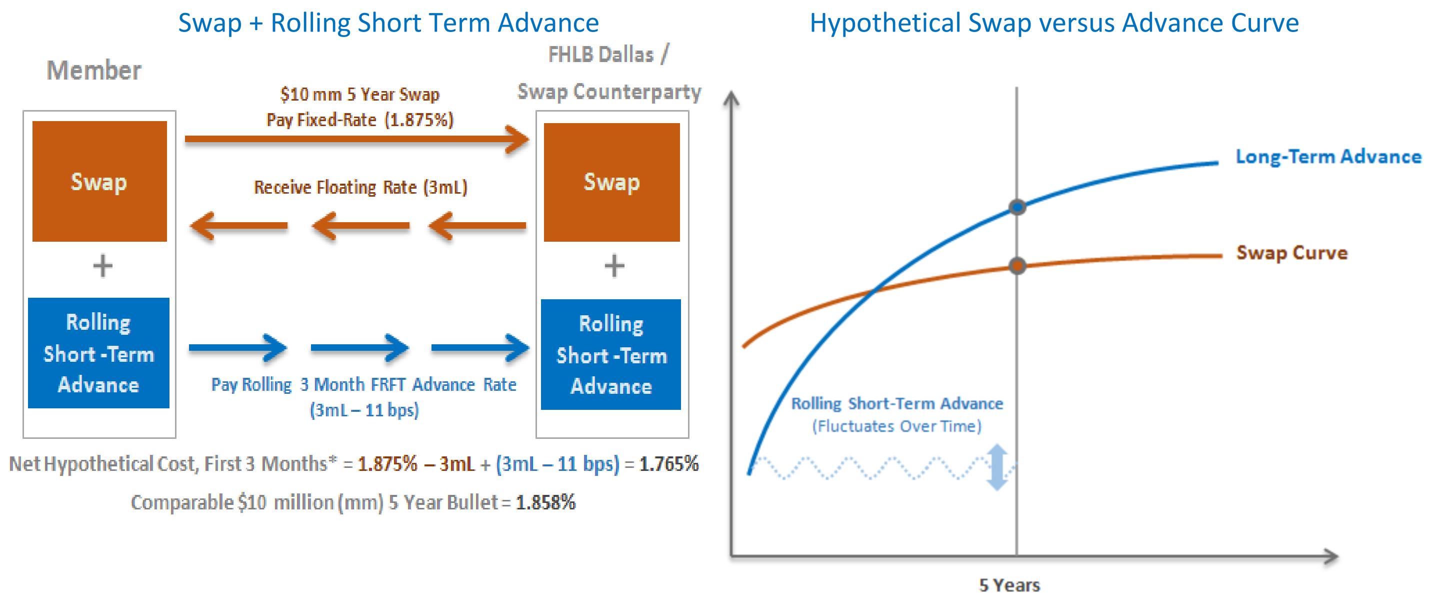
FHLBANK DALLAS

Pay-Fixed Swap + Rolling Short-Term Advance Funding Strategy

Frequently Asked Questions (FAQ)

What is a Pay-Fixed Swap + Rolling Short-Term Advance Funding Strategy?

By combining a swap and a rolling short-term advance, you may be able to obtain a net lower cost of long-term funding versus traditional wholesale funding. Specifically, you may be able to take advantage of spread differentials between the swap and advance pricing curves to achieve net lower, long-term borrowing costs compared to traditional advances or other wholesale funding. The following figures illustrate how you may be able to “Beat the Spread.”



* Rates/spreads are hypothetical. Net costs are determined by the relationship between 3-month LIBOR (3mL) and the 3-month advance rate, which may fluctuate at each 3- month interval.

This funding strategy provides an alternative to a long-term advance or other long-term wholesale borrowing. As illustrated above, you could enter into successive, short-term (e.g., 3-month), fixed rate advances and a long-term swap, whereby you pay a fixed-rate and receive a floating-rate (e.g., 3-month LIBOR).The usefulness of this strategy depends on the relative position of the swap curve to the advance pricing curve in the short- and long-term. If swap rates are consistently higher than advance rates in the short-term and lower in the long-term, you may be able to create a synthetic long-term borrowing with net lower costs. Pairing a pay-fixed swap with a rolling, short-term advance in this scenario results in a lower all-in cost because it eliminates the long-term credit spread.

What are some of the potential uses and benefits of this strategy?

This strategy results in a synthetic long-term borrowing that could be used to manage duration risk and match fund long-term fixed-rate assets. Additionally, this strategy may enable you to:

- Pay a net lower, long-term borrowing cost – Beat the Spread!
- Replace higher cost long-term funding, such as brokered CDs
- Offset unrealized losses recorded in accumulated other comprehensive income (AOCI) by hedging the risk of changes in cash flows due to changes in a benchmark interest rate (i.e., LIBOR) for the forecasted issuance of fixed-rate debt

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What are some of the potential implications or risks associated with this strategy?
Members interested in this strategy should consider all risks and costs associated with the strategy prior to execution, especially institutions that have no or limited experience with swaps. There is no guarantee that the 3-month advance rate will continuously be lower than the 3-month LIBOR rate. If the 3-month advance rate is above the 3-month LIBOR rate, the economics of the strategy may be unfavorable. Hedging the interest rate risk associated with the forecasted issuance of rolling fixed-rate advances (a cash flow hedge) requires sophisticated operational infrastructure including, but not limited to, knowledgeable risk management and accounting personnel. Termination of a swap designated in a cash flow hedge of the interest rate risk associated with the forecasted issuance of rolling fixed-rate advances will have hedge accounting implications. Consult your auditors for guidance.

Does FHLB Dallas offer interest rate swaps that could be used in this strategy?
FHLB Dallas offers swaps that meet the needs of this funding strategy. However, you could use either an FHLB Dallas swap or a swap from another counterparty to implement this funding strategy.
If you are interested in interest rate derivative products that FHLB Dallas offers to members, please contact Member Services at 1.844.FHL.Bank or member.services@fhlb.com or visit fhlb.com.

How would I roll the short-term advance?
Simply request a new advance to fund on the maturity date of the current advance either on SecureConnect or by contacting Member Services at 1.844.FHL.Bank or member.services@fhlb.com.

How can I obtain a better understanding of the accounting implications?
The accounting implications depend on how you choose to use the strategy:

- If you choose the simple strategy of "beat the spread" and forego cash flow hedge accounting, follow the Derivatives guidance in FASB ASC 815-10, which will require you to:
    - Recognize the swap at fair value in the statement of financial position as a derivative asset or liability (depending on the fair value) and
    - Recognize changes in the swap's fair value in the statement of income as other non-interest income or expense.
- If you choose to designate the swap as hedging the risk of changes in cash flows due to changes in a benchmark interest rate (i.e., LIBOR) for the forecasted issuance of fixed-rate debt (a cash-flow hedge), follow the additional Hedging-General and Cash Flow Hedges guidance in FASB ASC 815-20 and 815-30:
    - Designate and document the strategy as hedging the risk of changes in cash flows due to changes in a benchmark interest rate (i.e., LIBOR) for the forecasted issuance of fixed-rate debt [FASB ASC 815-20-25-17 through 25-19 and 815-20-25-43(d)(3)].
    - Use the Hypothetical-Derivative method to assess hedge effectiveness [FASB ASC 815-30-35-25 through 35-30].
        - Determine the fair value of both the perfect hypothetical derivative and the actual interest rate swap using discount rates based on the relevant interest rate swap curves.
        - Recognize the actual interest rate swap in the statement of financial position at fair value. Do not recognize the hypothetical derivative.
        - Defer the recognition of changes in fair value of the lesser of the actual swap or the hypothetical derivative in accumulated other comprehensive income (AOCI). Under this strategy, the change in fair value of the actual swap and the hypothetical derivative should but may not be equal.

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- There should be no ineffectiveness recognized in earnings. However, if the swap notional amount exceeds the advance principal (i.e., an over-hedge), ineffectiveness related to the amount over-hedged would be recognized in earnings.

➢ If the hedging relationship is discontinued, recognize the amount in AOCI as a yield adjustment to rolling advances either over the remaining life of the hedge term that was documented at the inception of the relationship or sooner if advances are not rolled.

Please note that FHLB Dallas does not provide accounting advice. You should consult with your auditors for guidance.

What are some of the accounting implications if we terminate the swap or stop rolling the short-term advance?

If this strategy is initially designated as a cash flow hedge, specific criteria must be met throughout the hedge term to support hedge accounting. As discussed above, if cash flow hedging is elected, changes in the fair value of the swap are deferred in AOCI. If the requirements for this hedging relationship are not fully satisfied at any time during the documented hedge term, the hedging relationship must be discontinued and the amounts deferred in AOCI and any future changes in the value of the swap will be recognized in earnings.

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What type of interest rate derivative products does FHLB Dallas provide to members?

FHLB Dallas offers fixed-for-floating interest rate swaps (with either amortizing or bullet maturities), interest rate caps and interest rate floors.

Prior to requesting an interest rate derivative product, a member must have executed and delivered to FHLB Dallas an ISDA Master Agreement and the FHLB Dallas Schedule to the ISDA Master Agreement, have an executed Corporate Certificate of Authority on file with FHLB Dallas, and have the required FHLB Dallas signature cards related to interest rate derivative products on file with FHLB Dallas. The ISDA Master Agreement and the FHLB Dallas Schedule to the ISDA Master Agreement, Corporate Certificate of Authority, and signature cards can be obtained from FHLB Dallas.

For additional information, please contact Member Services at 1.844.FHL.Bank or member.services@fhlb.com or visit fhlb.com.

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