

Market Volatility Checklist

Six Questions to Check the Health of Your Hedge Program(s)

- 1. Are the fair values on derivative liabilities going to threaten corporate liquidity?**
 - Do you have margin posting requirements (see ISDA documents) when losses exceed specified amounts?
 - Are you approaching maturity/settlement on deeply out-of-the-money trades?
- 2. Have you documented the change in business conditions and revisited forecasts as part of the monthly hedge program review and accounting?**
 - Has your forecast changed (formally or informally)? Down or up?
 - GAAP requires a probability assertion for each period-end. If the status of some (or all) of the hedged items drop from “probable to occur”, to “possible”, or “probable not to occur” a change in accounting treatment is required.
 - Are expected short term forecast misses because hedged transaction timing is delayed, or has the hedged transaction disappeared? Widget based transactions can be delayed, service-based transactions generally disappear.
 - Do you have a process to capture gains/losses on over-hedged positions at month or quarter-end for disclosure?
 - Data is hard to get right now so tap all resources.
- 3. Are your ASC 815 effectiveness tests adequate to cover current market conditions?**
 - IR: Does your debt have a zero % floor, but your hedge doesn’t? Likely requirement to return to quantitative testing as increasingly difficult to assert current conditions are not relevant to offset. Consider a short-term derivative floor to offset the long-term floor in debt.
 - IR: Is anticipated future debt issuance timing now likely to change (earlier/later)?
 - FX: Did your inception hedge assessment contemplate the hedged item timing delays?
- 4. Will your derivative liabilities threaten your debt covenant(s)?**
 - Review debt to equity ratios and other debt dependent metrics.
- 5. Have you considered monetizing EUR CCY swaps (many are now significant assets) to lock in low USD swap rates and eliminate future currency spot risks?**
 - Interested in closing out (and cashing in) on your existing swap and then lock in new low USD swap rates to get low-interest rates and eliminate future currency spot risk on the swap?
- 6. New hedgers: Have you drafted qualitative disclosures and outlined required tables for quarter-end reporting?**
 - Ensure that hedge designation documentation is complete within 2 business days.
 - Ensure that inception effectiveness testing is complete before financials are finalized.
 - Draft qualitative disclosures and prepare the required table for quarterly reporting.