

# Make More Loans with Interest Rate Swaps

February 2024



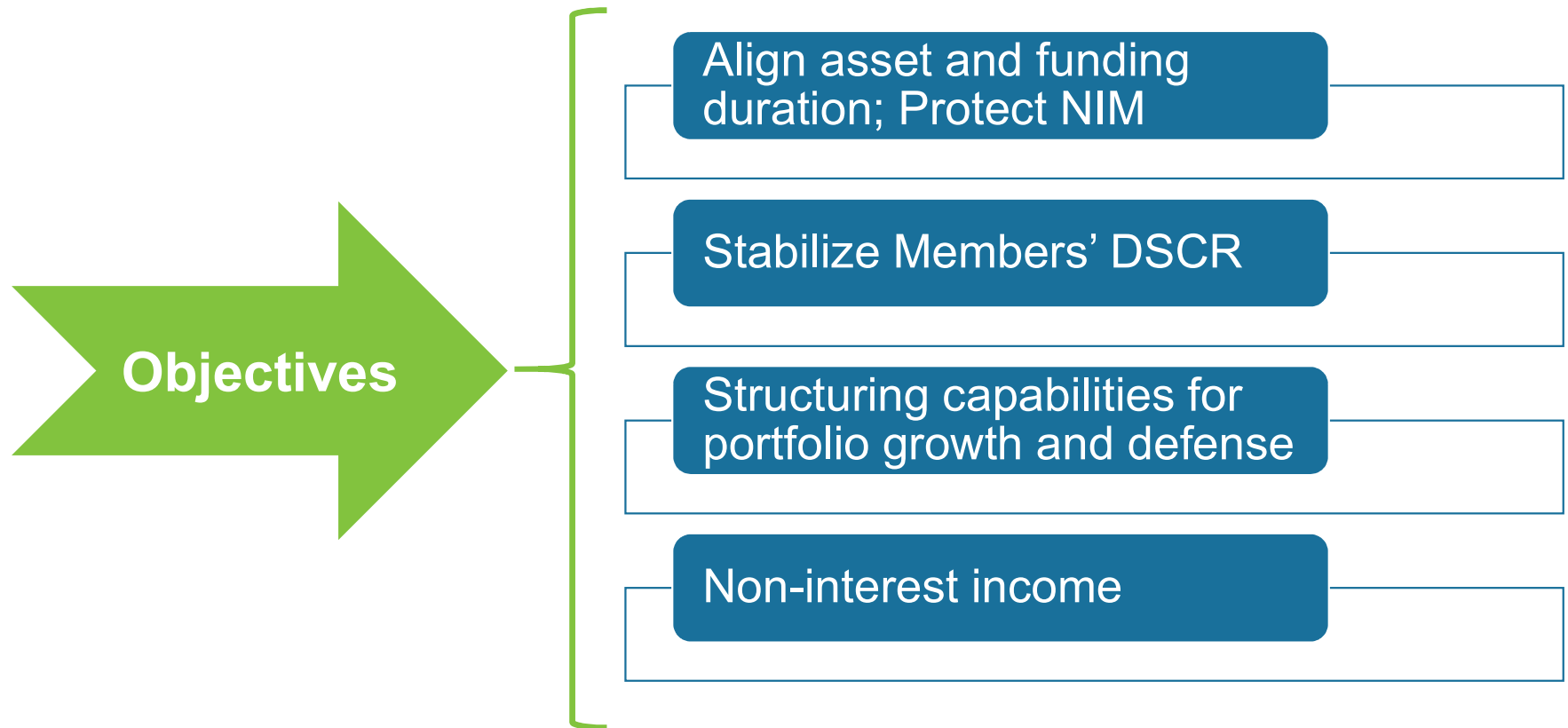
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# Business Lending Challenges



# Why CFIs Use Interest Rate Swaps



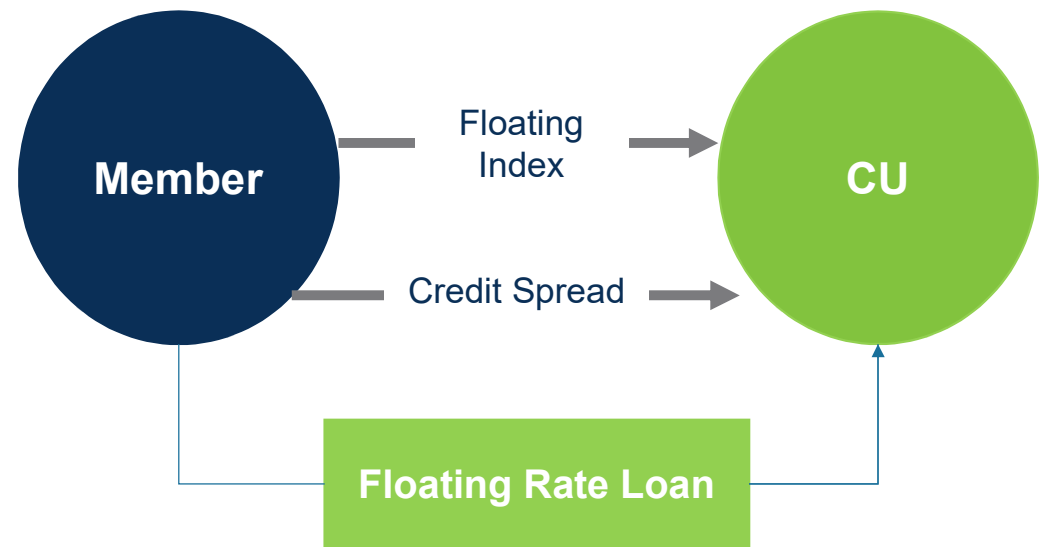
# Fixed Rate Options

**Scenario:** Member seeks fixed rate financing for 10 years

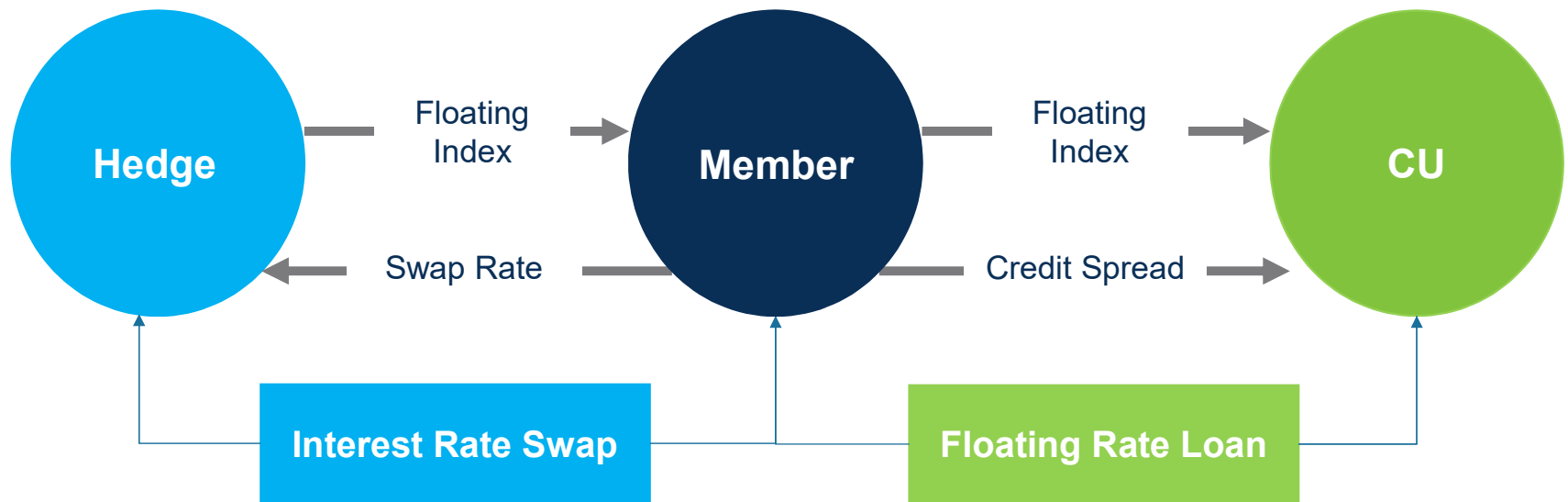
10Y fixed rate loan on balance sheet	10Y loan with 5Y reset	10Y floating rate loan with fixed rate swap
<ul style="list-style-type: none"><li>• Satisfies member</li><li>• <b>NIM at risk</b></li><li>• <b>Costly advance</b> if match funding</li></ul>	<ul style="list-style-type: none"><li>• Partial satisfaction</li><li>• <b>NIM at risk</b></li><li>• <b>Reset risk for member</b></li></ul>	<ul style="list-style-type: none"><li>• Satisfies member</li><li>• Protects NIM</li><li>• <b>Lower cost option</b></li></ul>

# Swap Loan Structuring

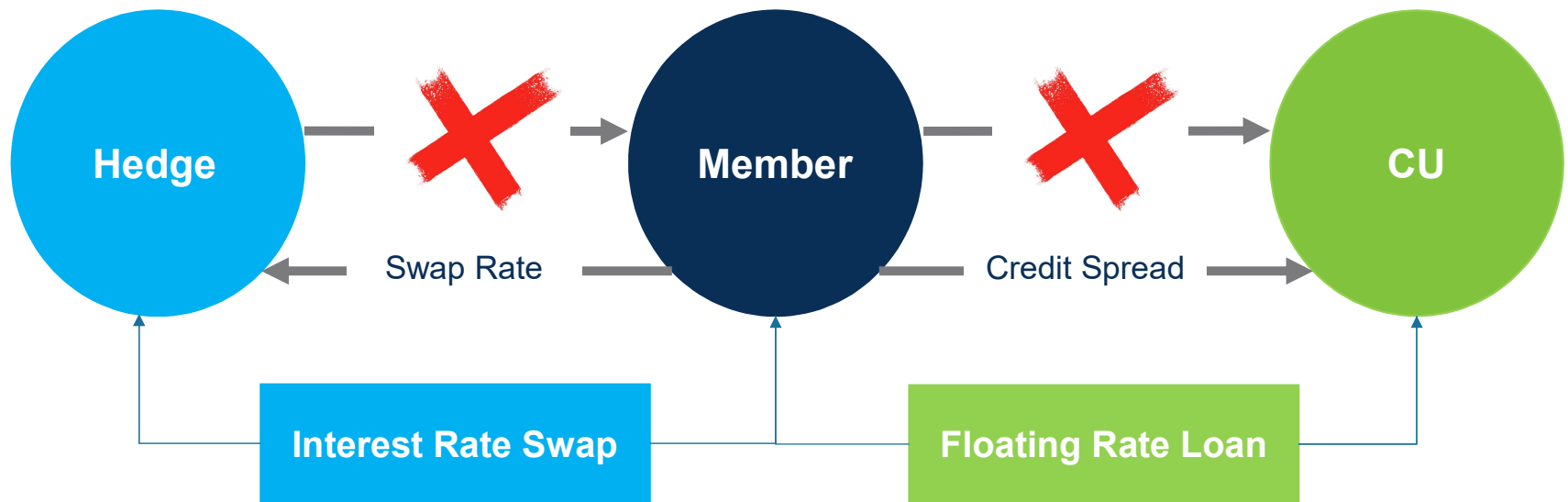
# Member Swap Loan Structuring



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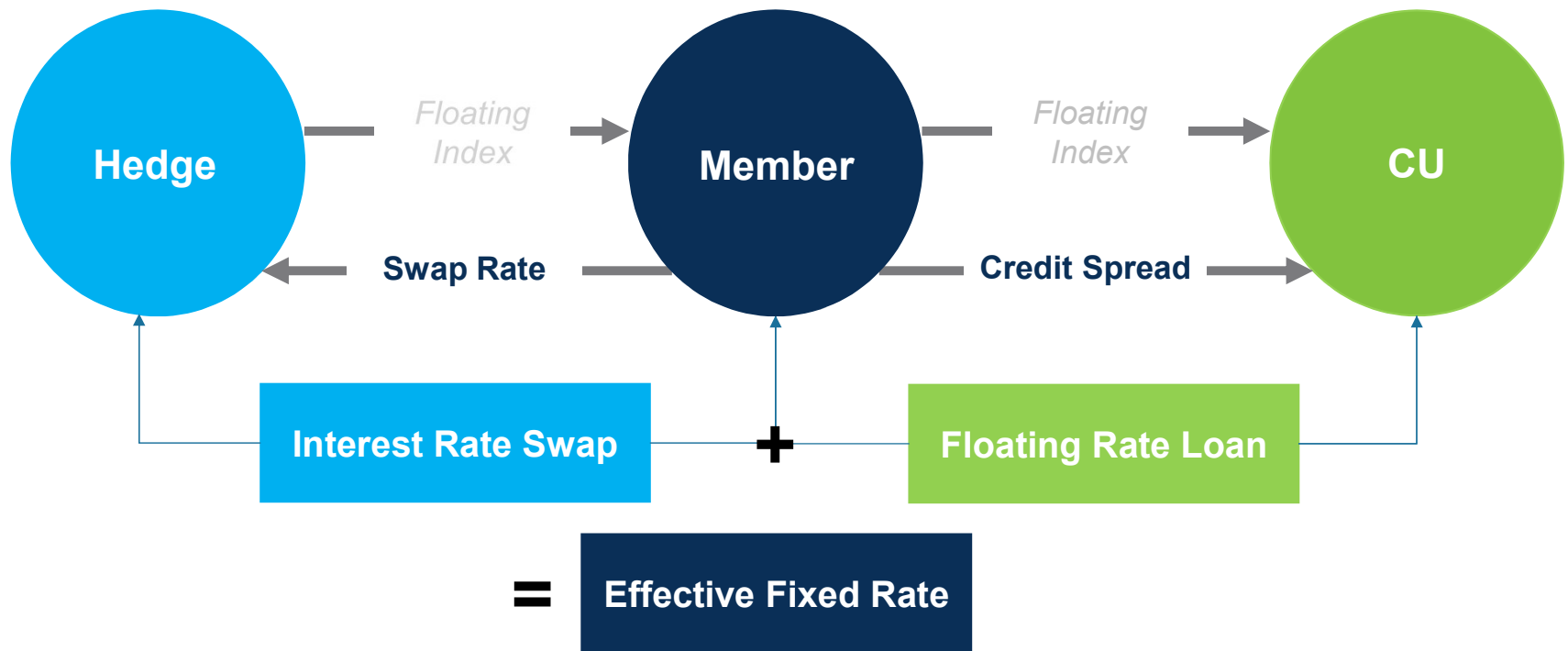


# Member Swap Loan Structuring

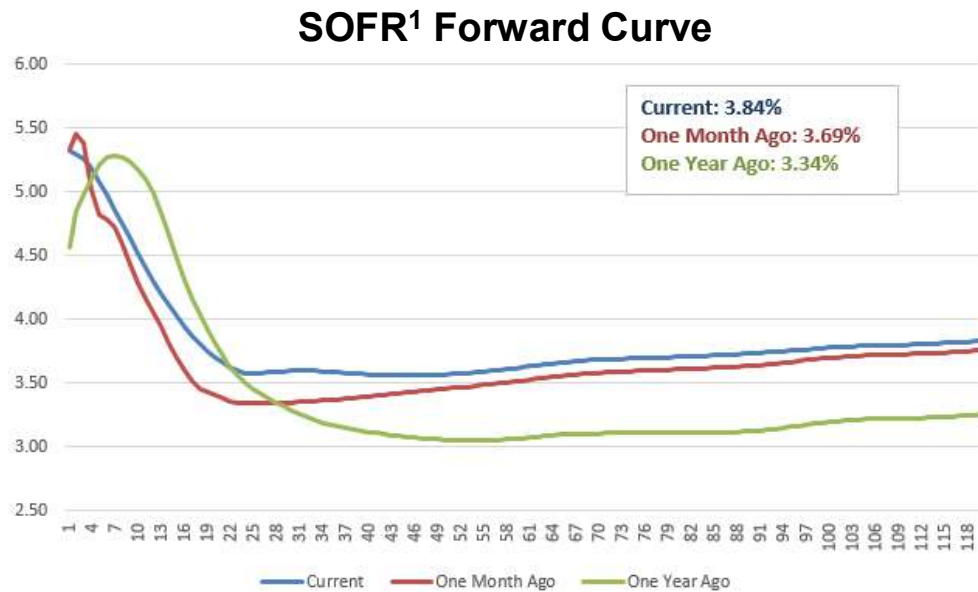




# Member Swap Loan Structuring



# Swap Rate: Where Does it Come From?

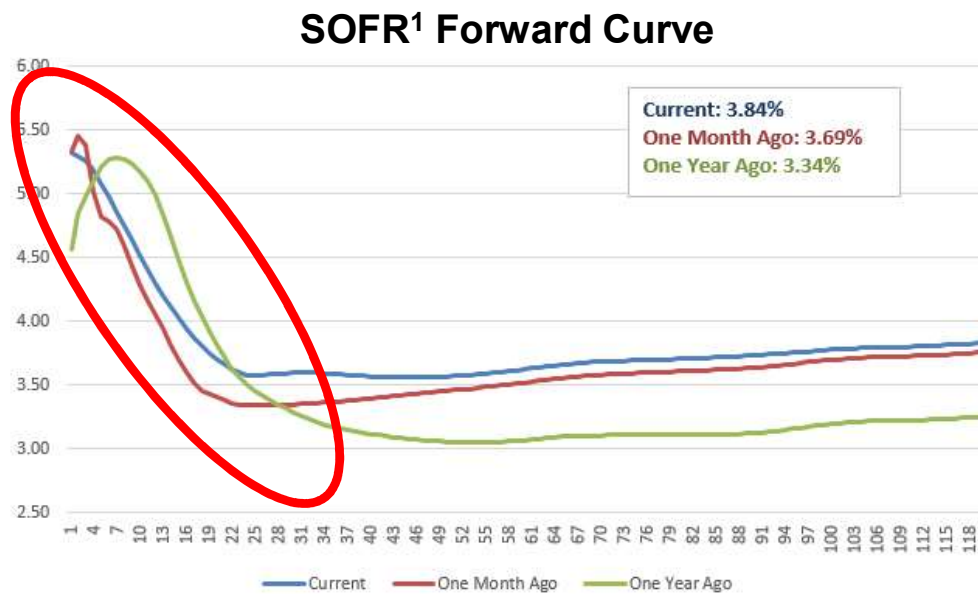


- Forward curves project future variable index rates
- Swap rate = PV average of all the projected future index resets
- Similar profile as US Treasuries

Source: Bloomberg 2/20/2024

1. Secured Overnight Financing Rate (SOFR)

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1. Secured Overnight Financing Rate (SOFR)

- Forward curves project future variable index rates
- Swap rate = PV average of all the projected future index resets
- Similar profile as US Treasuries
- Swap forward curve is currently inverted (as of 2/20/24)

# Swap Loan Pricing In Current Environment

		Member Pays Fixed Swap Rate + Credit Spread		CU Receives Floating Index + Credit Spread	
Amort	Term	Swap	+ 2.50%	Index	+ 2.50%
25	5	4.15%	6.65%	5.30%	7.80%
25	10	4.05%	6.55%	5.30%	7.80%
25	15	4.06%	6.56%	5.30%	7.80%

*Intraday pricing as of 2/20/2024*

- **All-in fixed rate = Swap Rate + Credit Spread**

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*Intraday pricing as of 2/6/2024*

- **All-in fixed rate** = Swap Rate + Credit Spread
- E.g. 10Y/25Y term: 4.05% swap rate + 2.50% credit spread = 6.55% fixed rate
- **Compare to floating rate at SOFR + 2.50%**, currently = 5.30% + 2.50% = 7.80%

# Swap vs. Conventional Loan: 5Y Example

5Y / 25Y Pricing	Benchmark	Index Rate	+ Spread	Rate to Lender*	Fixed Rate from Member
SWAP	SOFR	5.30%	+ 2.50%	7.80%	6.65%
CMT	CMT 5Y	4.23%	+ 2.50%	6.73%	6.73%
FHLB	FHLB 5Y	4.44%	+ 2.50%	6.94%	6.94%

*Intraday pricing as of 2/20/2024*

- Swaps currently offer a lower fixed rate for Members, and a higher floating rate to CUs

*\* Swapped loan rate floating to Lender over term; conventional loan rate fixed to CU over term*

# Additional Structuring Features



## Forward Swaps

### Lock fixed rate immediately for:

- Repricing loans with upcoming resets
- Permanent financing following construction
- New loan proposals and commitments



## Fee Generation

### Record one-time, upfront fee income:

- Typically 10bps to 35bps
- Fee advanced on the closing date
- Full recognition immediately in earnings

# Swap Exposure



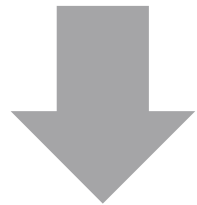


# Swap Termination (Mark-to-Market)

- Swap will fluctuate in value over its lifetime, similar to a Treasury bond
- Asset or liability position based on market **replacement** interest rates
- If replacement swap rate vs. initial swap rate for remaining term:



*Higher:* fixed rate payer has a **hedge gain**



*Lower:* fixed rate payer has a **hedge loss**

# General Qualification for Swaps

## Dodd Frank, Eligible Contract Participant (ECP)

**Primary:** Borrower's net worth is at least \$1,000,000 or

- Borrower's assets are at least \$10,000,000 or
- Combined net worth of Borrower and owners is at least \$1,000,000 and each owner has at least \$5,000,000 in discretionary investments

**Alternative:** Guarantor

- (Indirect proprietor) with net worth of at least \$1,000,000 or has at least \$5,000,000 in discretionary investments or
- Business entity with at least \$10,000,000 in assets

# Swap Loan Methods for Your Business Loan Member

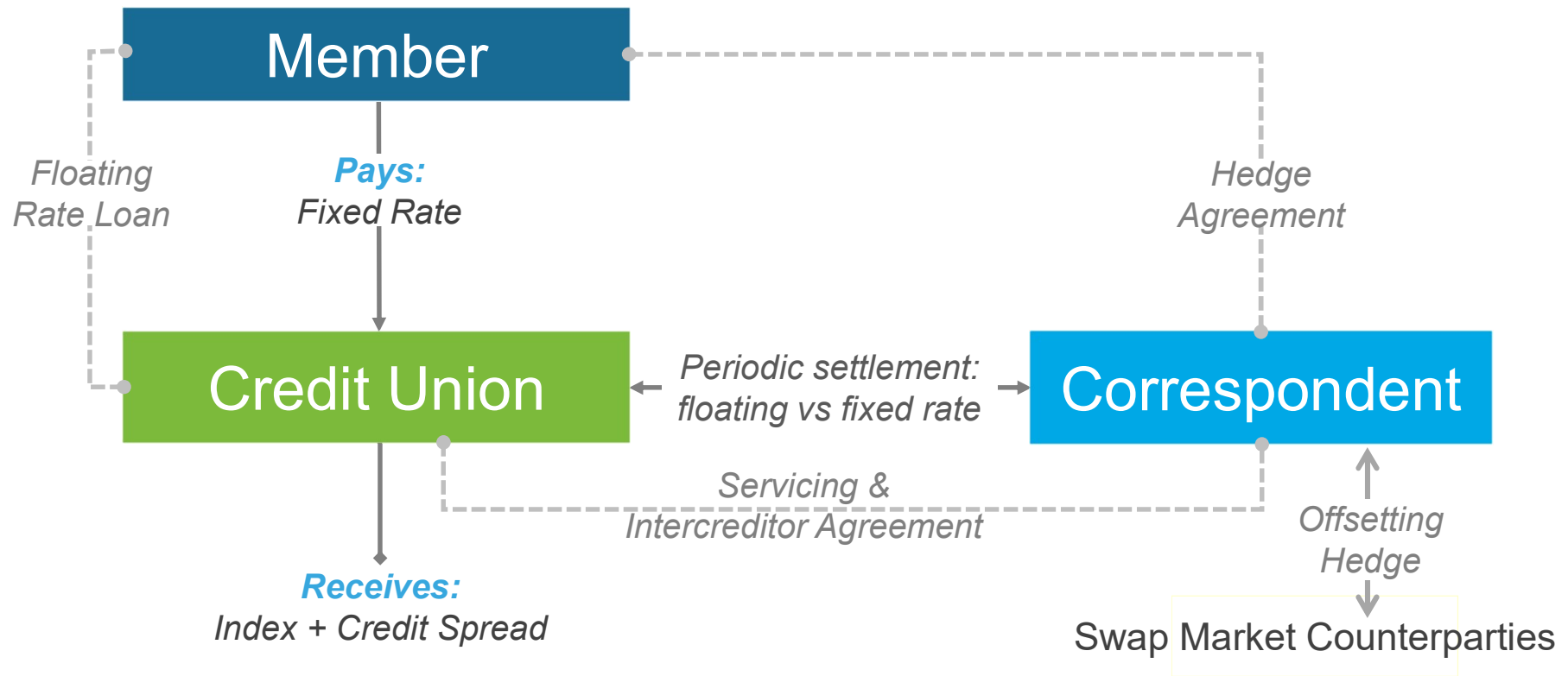


# Correspondent Hedging Program

CU issues floating rate loan; correspondent provides fixed rate protection to Member

- CU has no derivative on the books
- Member's swap obligation is directly with Correspondent
- Hedge agreement between Member and Correspondent
- CU is the interface and servicer of payments
- Servicing and intercreditor agreement (between CU and Correspondent)
- Fixed rate position has portability and can be transferred/assigned, under certain conditions (underwriting, ECP)

# Correspondent Hedging Program



# Floating Rate Loan with Back-to-Back Swap

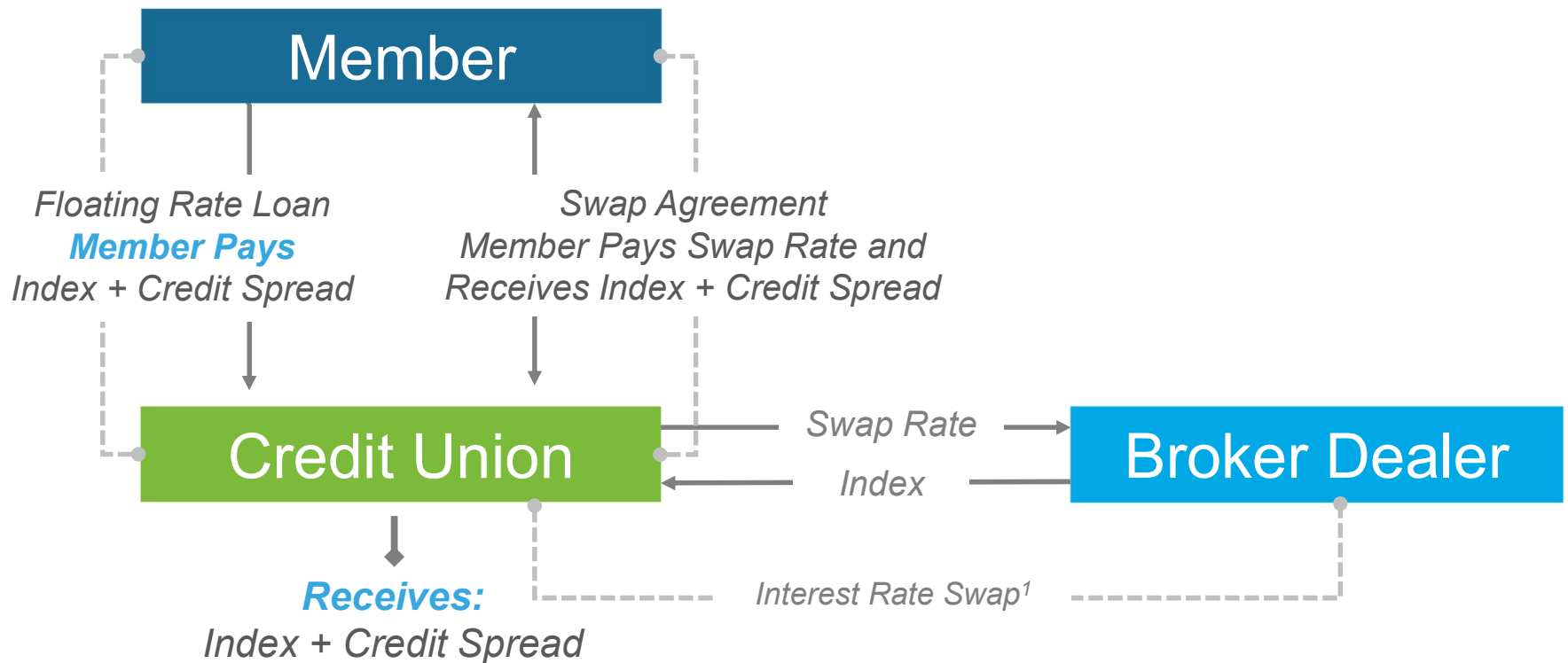
CU issues floating rate loan & offsetting swaps with Member and Broker

- Derivatives on the CU's balance sheet
- Member's swap obligation is directly with the CU
- Early unwind exposure
- Requirements
  - ISDA<sup>1</sup> and CSA<sup>2</sup> documentation
  - Mark-to-market, periodic collateral posting
  - Risk capital for swap credit exposure
  - Hedge accounting
- No portability, position can not be assigned/transferred

1. *International Swaps and Derivatives Association (ISDA)*

2. *Credit Support Annex (CSA)*

# Floating Rate Loan with Back-to-Back Swap



1. Requires ISDA, CSA, periodic collateral posting, risk capital, hedge accounting

# Alternative Method: Balance Sheet Swap

CU issues fixed rate loan to Member, and executes swap with Broker

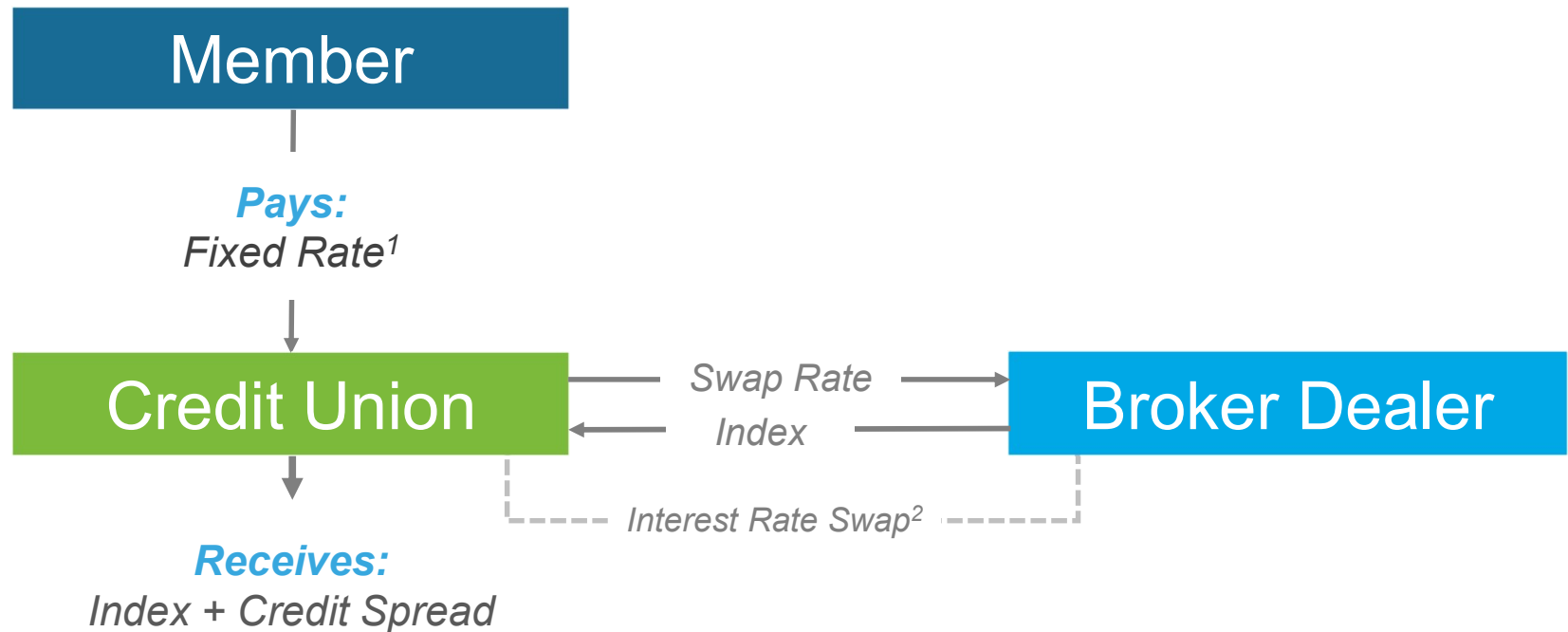
- Member has a fixed rate loan and no involvement with swap
- Derivative on CU's balance sheet
- Early unwind exposure
- Requirements
  - ISDA<sup>1</sup> and CSA<sup>2</sup> documentation
  - Mark-to-market, periodic collateral posting
  - Risk capital for swap credit exposure
  - Hedge accounting

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# Alternative Method: Balance Sheet Swap



1. Fixed rate = swap rate + credit spread

2. Requires ISDA, CSA, periodic collateral posting, risk capital, hedge accounting

# Getting Started

- Assess appropriate hedging strategy
- Educate stakeholders
- Implement framework / infrastructure
- Work with a trusted partner to structure and execute

## Industry Insights Paper

# Developing & Implementing a Loan Hedging Strategy

### Download to learn:

- Understand the benefits of implementing a hedging strategy
- The differences between programs on the market today
- What to consider when selecting a hedging program

Scan to Download



Or visit: [bit.ly/CU-Hedge-IP](https://bit.ly/CU-Hedge-IP)

*\*\*url is case-sensitive\*\**

# Let's Connect!

For more information, please contact:



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