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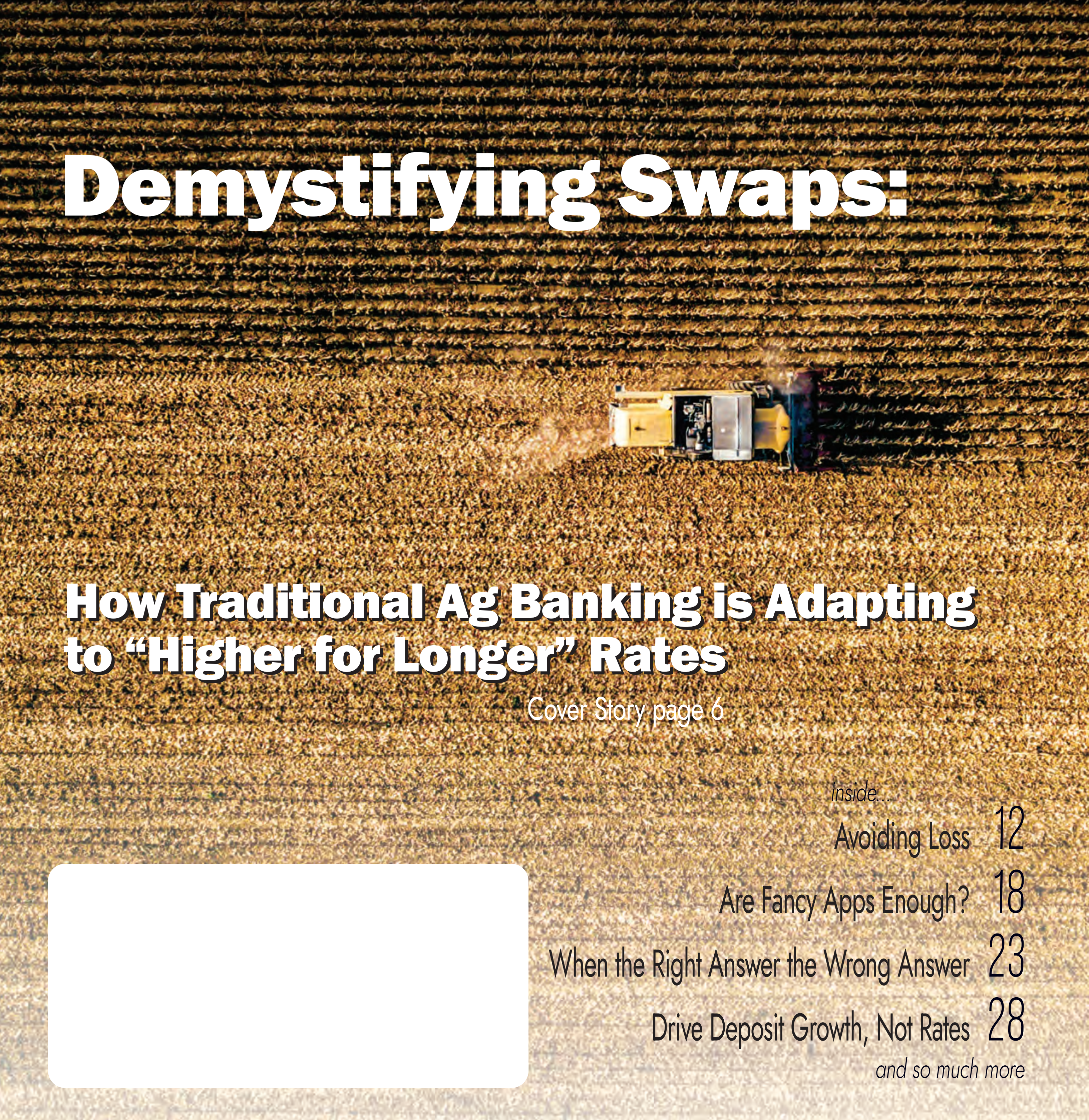

Demystifying Swaps:

How Traditional Ag Banking is Adapting to “Higher for Longer” Rates

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COVER STORY

Demystifying Swaps:

How Traditional Ag Banking is Adapting to “Higher for Longer” Rates

By Josh Cannington

In the heart of America’s breadbasket, where the fortunes of farmers and the banks that serve them are inextricably linked, the specter of rising interest rates looms large.

For one community bank, deeply rooted in the agricultural landscape of the Midwest, the challenge was stark: how to continue providing the stable, long-term financing that farmers need to thrive, without taking on unsustainable risk in a volatile rate environment.

The bank’s leadership team recalled all too well the stories of the 1980s, when soaring interest rates had pushed many farmers to the brink of bankruptcy and beyond. They had seen the toll it had taken on families, on communities, and on the banks that served them.

Farmers seek stability in uncertain times

But this was a new era, with new challenges and new opportunities. The bank’s customers, like Allen, a seasoned farmer and respected voice on the local co-op board, were looking for more than just a loan. They were looking for a partner who could help them navigate the uncertainties of a changing world.

Allen had seen his fair share of ups and downs in his decades of farming. But the prospect of rising rates was different. He knew that the operating loans that kept his farm running could quickly become a burden if rates climbed too high. Allen needed a way to lock in a stable, predictable cost of financing, so he could focus on what he did best: growing the crops that fed the world.

Community banks face pressure from larger competitors

For the bank, the pressure was intense. Larger competitors, with their deep pockets and economies of scale, were offering long-term fixed-rate loans at rates that seemed impossible to match. The bank’s management team knew they needed to find a way to level the playing field, to offer their customers the stability they craved without putting the bank’s own financial health at risk.

A powerful tool for managing risk

The solution came in the form of a powerful but often overlooked tool: interest rate swaps. By hedging fixed-rate loans with swaps using StoneX, a leading financial services network, the bank realized it could transform its balance sheet, converting long-term fixed-rate assets into floating-rate exposures. It was a way to offer customers like Allen the stability of a fixed rate, while still allowing the bank to manage its interest rate risk.

But StoneX's solutions went beyond just helping the bank. For Allen's crop input loan, StoneX suggested hedging half of the loan balance with an interest rate swap, creating a balanced mix of floating and fixed-rate debt. This strategy allowed Allen to benefit from the stability of fixed rates while retaining flexibility with prepayment goals. StoneX's ability to explain this complex product in simple terms reassured Allen, who often joked that he was "as dumb as a post" when it came to financial products.

> I had no idea there was a hedging playbook for interest rates. Fixed rate swaps, floating rate swaps, options, there's an entire universe of risk management tools we were missing in our operations.
>
> –Allen, Farmer and Co-op Board Member

Implementing a hedging program

Implementing a hedging program was no small feat. It required a deep understanding of the complexities of swaps, a robust set of policies and procedures, and a partner who could guide the bank through the process. Enter StoneX.

As a leading swap dealer with a track record of helping community banks navigate the intricacies of hedging, StoneX was uniquely positioned to help the bank bring its vision to life. The StoneX team worked hand-in-hand with the bank's leadership to develop a comprehensive hedging plan, one that would allow the bank to offer competitive 15-year fixed-rate loans while still managing its interest rate exposure.

Ensuring successful implementation through training and education

StoneX helped the bank craft detailed policies and procedures, ensuring that every aspect of the hedging program was executed flawlessly. They provided extensive training and education, making sure that everyone from the frontline staff to the board of directors understood the mechanics and the benefits of the strategy.

And the results were transformative. With StoneX's guidance, the bank was able to offer Allen and other customers 15-year fixed-rate loans at a rate of 6.75%, a full percentage point lower than what Allen had been quoted by other banks. For Allen, it was a game-changer. With a stable, predictable cost of financing locked in, he could invest in his farm with confidence, knowing that he wouldn't be at the mercy of rising rates.

But the benefits went far beyond individual loans. By embracing hedging, the bank was able to fundamentally transform its balance sheet and its business model. Instead of being saddled with long-term fixed-rate assets

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in a rising rate environment, the bank was now able to enjoy the benefits of floating-rate income.

Further, by designating the swap as a fair value hedge, they were able to avoid any impact on the bank's income statement reporting. This not only improved the bank's financial performance, but it also allowed the bank to be more competitive in the marketplace, attracting new customers and deepening relationships with existing ones.

> By embracing hedging via interest rate swaps, we were able to fundamentally transform our balance sheet and our business model. It not only improved our financial performance but also allowed us to be more competitive in the marketplace.
>
> –Community Bank Leadership Team

Lessons for community banks: hedging with interest rate swaps

For other community banks facing similar challenges, the lessons are clear. In a world of rising rates and intense competition, the ability to offer long-term fixed-rate financing while managing interest rate risk is no longer optional. It's a strategic imperative. And while the path may seem daunting, with the right partner and a commitment to excellence, any bank can master the art and science of hedging.

As the bank looks to the future, it does so with a newfound confidence and a sense of optimism. It has weathered the storm of rising rates, and emerged not just intact, but thriving. It has shown that a community bank, deeply committed to its customers and its community, can not only survive but prosper in the face of even the most daunting challenges.

And for farmers like Allen, that makes all the difference. Because in the end, what matters most is not the rate or the term of a loan, but the relationship behind it. It's the knowledge that when the winds of change blow, you have a partner like StoneX standing beside you, ready to help you weather the storm.

About the Author

Josh Cannington is Vice President, Interest Rate Risk Management at StoneX. Scan for more or visit

stonex.com/foreign-exchange-market/interest-rates/

Interest rate swaps allow banks to manage risk while offering competitive fixed-rate loans. The bank enters a swap, exchanging fixed and floating-rate payments with a counterparty like StoneX.

This transforms the fixed-rate loan into a floating-rate asset, enabling stable, long-term financing for customers. Swaps improve the bank's performance and competitiveness without undue risk.

For ag customers, locking in predictable costs long-term is a game-changer. StoneX customizes solutions, often a 50/50 fixed/floating mix, hedging loans up to 10 years.