



Implementing a Back-to-Back Swap Lending Program in an Intermediate-Sized Commercial Bank

**Stonier Graduate School of Banking
Capstone Project**

**Christopher Smith
March 15, 2026**

Table of Contents

EXECUTIVE SUMMARY.....	2
INTRODUCTION & BACKGROUND.....	4
History and Organizational Overview	4
Overview of Back-to-Back Swap Structure.....	8
STRATEGY & IMPLEMENTATION PLAN.....	10
Strategic Rationale	10
Alternative Options Considered.....	11
Competitive Advantages	11
Future Opportunities & Potential Risks.....	13
Role in Project (“Project Lead”).....	13
Resources Required	14
Stakeholders	16
Step-by-Step Implementation Plan	17
FINANCIAL IMPACT	20
Investment Requirements.....	20
Labor and Capital Considerations.....	21
Three-Year Pro Forma Analysis.....	22
Revenue and Expense Assumptions.....	22
Risk Identification.....	26
Risk Management Approach.....	28
Scenario Analysis.....	31
Financial Conclusion and Recommendation	33
NON-FINANCIAL IMPACT	36
Logistical and Organizational Challenges Foreseen in Implementation	37
Plan to Overcome Organizational and Logistical Hurdles.....	39
Stakeholder Impacts with Indirect or Difficult-to-Measure Profitability Effects	41
Non-Financial Measures to Evaluate Post-Implementation Outcomes	42
Long-Term Profitability Implications	44
CONCLUSION.....	46
BIBLIOGRAPHY.....	47

EXECUTIVE SUMMARY

This Capstone recommends that First Commerce Bank approve and implement a back-to-back swap lending program under a phased governance framework. The analysis concludes that the program will strengthen competitive positioning, diversify non-interest income, and enhance earnings stability while maintaining prudent risk management standards.

The purpose of this project was to evaluate whether introducing borrower-level interest rate hedging capabilities would provide strategic and financial value to First Commerce Bank, a \$1.55 billion community bank headquartered in Lakewood, New Jersey. As commercial borrowers increasingly seek fixed-rate certainty in volatile interest rate environments, many larger regional institutions have expanded their derivative-based lending solutions. First Commerce Bank currently offers traditional fixed- and floating-rate structures but does not provide swap-based fixed-rate alternatives that preserve a floating-rate asset profile. This project examines whether adopting a fully matched, dealer-executed back-to-back swap model aligns with the Bank's growth strategy and risk appetite.

Under the proposed structure, the Bank would originate a floating-rate commercial loan and simultaneously execute an interest rate swap with the borrower, converting the borrower's obligation to a fixed rate. The Bank would concurrently enter into an offsetting swap with a third-party dealer. Because the structure is fully offset through a dealer counter-swap, the Bank does not retain open market exposure. Borrowers obtain fixed-rate certainty while the Bank preserves a floating-rate asset and earns swap facilitation fee income.

The financial analysis indicates that the program requires a modest upfront investment in legal documentation, policy development, training, and system integration. While Year 1 reflects

implementation costs, the program is projected to achieve positive net contribution beginning in Year 2, with cumulative net benefits over a three-year horizon. In addition to incremental non-interest income, the program supports margin resilience by maintaining asset sensitivity in changing rate environments.

Strategically, the initiative enhances First Commerce Bank's value proposition in commercial lending, enabling it to compete more effectively against larger institutions offering sophisticated risk-management solutions. It strengthens borrower relationships by providing payment certainty without requiring loan syndication or balance-sheet duration exposure. The program also expands internal capabilities across Lending, Finance, Risk Management, and Compliance, positioning the Bank for continued disciplined growth.

The primary risks are operational rather than market based. Execution discipline, documentation integrity, borrower suitability oversight, and compliance controls will determine program success. With appropriate governance and vendor support, these risks are manageable and consistent with regulatory expectations for community bank derivative activities.

Accordingly, Executive Management should advance the proposal to the Board of Directors for formal approval and authorize initiation of Phase I implementation. Management should finalize the Loan Hedging Policy, complete vendor selection and ISDA documentation, conduct staff training, and prepare for pilot execution. Ongoing reporting to ALCO and the Board Risk Committee should be established prior to initial transaction execution.

Implementation of this initiative is expected to enhance earnings stability, strengthen client relationships, and support long-term franchise value while preserving disciplined risk oversight.

INTRODUCTION & BACKGROUND

History and Organizational Overview

First Commerce Bank is a community-based, full-service commercial bank that emphasizes the banking needs of small to medium-sized businesses, professional entities and individual consumers throughout New Jersey and part of the New York trade areas. In 2006 the Bank was established as Northern State Bank, a state-chartered banking institution. In December of 2010, The Bank was recapitalized primarily by a group of local businesspeople located in Ocean County who were seeking an investment and an outlet to service what appeared to be an ever-growing population growth in Lakewood and the surrounding communities. The Bank was renamed at that time to First Commerce Bank with the main office relocated to Lakewood, NJ.

The Board of Directors was restructured to include several of the existing Board members of Northern State Bank with the addition of (11) new Board members primarily from the Ocean/Monmouth/Mercer County area for a total of fifteen (15) board members. With Recapitalization, First Commerce Bank finished the 2010 fiscal year with \$77.6 Million in total assets and \$21.6 Million in total capital. In 2016, the Bank completed another Capital Offering during 2016, which effectively raised \$34.8 million in new capital to further bolster the balance sheet and position the institution for the strategically controlled growth. Since then, the Bank has grown to over a billion dollars in assets, finishing the most recent fiscal year 2024 with \$1,551.1 million in total assets, \$172.3 million in total capital.¹⁰

In 2023, First Commerce Bank (“Bank”) and First Commerce Bancorp, Inc. (the “Holding Company”) (OTC: CMRB) today announced that they have completed the Bank’s reorganization into a bank holding company structure, effective on May 31, 2023. As a result of the completion of the reorganization, the Bank is now the wholly owned subsidiary of the Holding Company. Subsequently, the Bank adopted a program to repurchase up to 5% of its outstanding shares of common stock, or approximately 1.2 million shares, which in 2024 was later increased by an additional 5% or 1.2 million shares, for a total buyback of 10% or 2.4 million shares of common stock. At the start of 2024, the Banks Board of Directors was reduced and now stands at a total of ten (10) board members.¹⁰

Financial Information

<u>Date</u>	<u>Deposits</u> \$ In Millions	<u>Loans</u> \$ In Millions	<u>Capital</u> \$ In Millions	<u>Total Assets</u> \$ In Millions	<u>Net Income</u> \$ In Millions
December 31, 2010	\$55.7	\$54.7	\$21.6	\$77.8	(\$1.4)
December 31, 2011	\$131.4	\$113.2	\$21.8	\$154.6	(\$0.56)
December 31, 2012	\$191.7	\$191.8	\$27.6	\$226.0	(\$0.83)
December 31, 2013	\$287.4	\$285.0	\$41.6	\$342.0	\$3.5
December 31, 2014	\$484.1	\$453.3	\$46.5	\$511.0	\$4.5
December 31, 2015	\$588.5	\$620.1	\$57.4	\$669.2	\$7.6
December 31, 2016	\$756.3	\$782.3	\$103.8	\$867.4	\$11.7
December 31, 2017	\$857.3	\$912.1	\$118.0	\$1,015.4	\$13.6
December 31, 2018	\$823.9	\$771.4	\$131.7	\$962.3	\$12.9
December 31, 2019	\$846.9	\$793.5	\$142.9	\$1,007.5	\$9.4
December 31, 2020	\$869.9	\$858.3	\$154.2	\$1,041.7	\$10.6
December 31, 2021	\$941.9	\$909.3	\$172.3	\$1,134.4	\$16.7
December 31, 2022	\$1,026.7	\$1,100.3	\$180.4	\$1,292.1	\$16.6
December 31, 2023	\$1,097.8	\$1,236.7	\$184.0	\$1,436.1	\$13.9
December 31, 2024	\$1,174.9	\$1,224.2	\$172.3	\$1,551.1	\$4.7

First Commerce Bank prides itself on being efficient, responsive, and relationship driven. The Bank's mission is dedicated to relationships, providing people, businesses, and communities in markets with high-quality products and services and superior customer service. First Commerce Bank is not about earnings, which is a short-term objective, as its mission is to build franchise value.

The Bank has continued to grow and expand its branch network with twelve (12) branches in all, located as follows:

FIRST COMMERCE BANK FACILITY NETWORK

<u>NORTHERN REGION FACILITY ADDRESS</u>	<u>CITY</u>	<u>STATE</u>	<u>ZIP</u>	<u>FACILITY TYPE</u>	<u>OPEN DATE</u>
530 Piermont Road	Closter	NJ	07624	Branch & ATM	2006
1008 Teaneck Road	Teaneck	NJ	07666	Branch & ATM	2013
44 Engle Street	Englewood	NJ	07631	Branch & ATM	2014
280 Passaic Avenue	Fairfield	NJ	07004	Branch & ATM	2017

<u>CENTRAL REGION FACILITY ADDRESS</u>	<u>CITY</u>	<u>STATE</u>	<u>ZIP</u>	<u>FACILITY TYPE</u>	<u>OPEN DATE</u>
105 River Avenue	Lakewood	NJ	08701	Branch & ATM	2011
40 North Main Street	Allentown	NJ	08501	Branch & ATM	2013
118A Schanck Road	Freehold	NJ	07728	Branch & ATM	2015
1412 Route 130	Robbinsville	NJ	08520	Branch & ATM	2016
789 Farnsworth Avenue	Bordentown	NJ	08505	Branch & ATM	2018
2080 W County Line Road	Jackson	NJ	08527	Branch & ATM	2023
1700 Avenue of the States, STE 301	Lakewood	NJ	08701	Corporate Office	2025
1700 Avenue of the States, STE 110	Lakewood	NJ	08701	Branch & ATM	2025

The above locations provide the Bank with a presence in and around Ocean, Monmouth, Mercer, Burlington, Bergen and Rockland Counties to service community needs in New Jersey and New York. The Bank's primary entire state of New Jersey and Rockland County in NY. The loan products consist of a more traditional suite which include Commercial Mortgages, Commercial Loans, Construction Mortgages, 1-4 family investment properties and multi-Family funding. First

Commerce Bank is proud to be a Preferred Lender in the SBA 7(a) and Express Loan Programs and the NJ EDA Premier Lender Program that assist existing and new start-up businesses in accessing funding that may not be available on a conventional basis.

As of December 2024, the Bank has over \$1.2 billion in outstanding loan balances with an average loan amount of \$1 million. Currently, the Banks typical loan size/sweet spot is in the range of \$250,000-\$750,000 for small business loans and \$1,500,000-\$4,500,000 for commercial real estate loans, however, with a legal lending limit of over \$28 million, there is room for larger deals should the credit and yield warrant it. The Bank's primary interest is in secured and unsecured commercial loans to businesses and investors principally in the communities it serves. Each loan must meet the test of a prudent loan and will comply with the Banks loan policies.

First Commerce Bank, once New Jerseys fastest growing bank through organic means, now faces larger competitors as many local rivals have been acquired. With increased interest rate volatility over the past several years, First Commerce Bank, like many intermediate-sized institutions, faces challenges in managing net interest margins and meeting borrower expectations for long-term fixed-rate financing. Larger regional competitors, such as OceanFirst Bank and Provident Bank, have introduced sophisticated hedging solutions to help borrowers manage rate risk, giving them a competitive advantage. Implementing a back-to-back swap lending program would enable First Commerce Bank to offer a similar, risk-managed solution that enhances both borrower value and balance sheet stability.²

Overview of Back-to-Back Swap Structure

A back-to-back swap structure involves two simultaneous and offsetting transactions that enable a borrower to effectively fix their interest rate, while allowing the bank to maintain a floating rate asset on its balance sheet. The process operates as follows:³

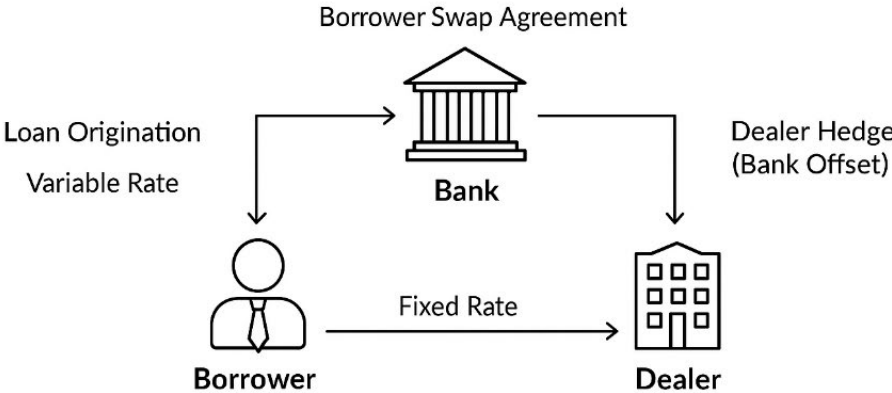
1. **Loan Origination:** The Bank originates a standard commercial loan to the borrower at a variable interest rate, typically tied to a benchmark index such as SOFR or Prime.
2. **Borrower Swap Agreement:** At the same time, the borrower enters into an interest rate swap with the Bank. Under this swap, the borrower agrees to pay the Bank a fixed rate and receives a floating rate from the Bank that matches the loan's index. The borrower's loan payments, when combined with the swap, result in an overall fixed-rate obligation.
3. **Dealer Hedge (Bank Offset):** To neutralize its exposure, the Bank simultaneously executes a mirror-image swap with a third-party swap dealer (usually a correspondent bank). In this second transaction, the Bank pays the fixed rate it receives from the borrower to the dealer, and in return, receives a floating rate from the dealer that matches its funding costs. Additionally, the Dealer pays or passes on a hedge fee ("swap fee") to the Bank, which is typically significant and is booked directly to income as opposed to amortized over the life of the loan.

The result is a perfectly hedged structure:¹

- The borrower enjoys the stability of a fixed-rate loan.
- The Bank retains a floating-rate asset and earns swap facilitation fees.
- The dealer provides the market hedge that eliminates the Bank's rate exposure.

All transactions are typically documented under industry-standard ISDA (International Swaps and Derivatives Association) agreements, ensuring compliance, transparency, and consistency across counterparties. A simplified visual overview of this transaction structure can be viewed in the diagram below.³

Back-to-Back Swap Transaction Flow Diagram



This structure provides several key advantages. For borrowers, it delivers rate certainty and predictability in cash flows, which is a valuable feature in volatile markets. For the Bank, it allows continued floating-rate earnings while providing a sophisticated risk management solution that strengthens client relationships and diversifies revenue through swap fee income. From a balance sheet perspective, it prevents the buildup of long-duration fixed-rate assets that could compress margins during rising rate cycles.¹³

Introducing a back-to-back swap lending product aligns directly with First Commerce Bank’s mission to provide high-quality, relationship-driven financial solutions. It combines prudent risk management with an innovative service offering that strengthens borrower relationships, supports

balance sheet stability, and contributes to long-term franchise growth. This initiative not only reinforces the Bank's reputation as a trusted financial partner but also represents a natural evolution in its commercial lending strategy, which helps to position the institution for sustainable success in a competitive and volatile rate environment.²

STRATEGY & IMPLEMENTATION PLAN

Strategic Rationale

The project under consideration is the design and launch of a back-to-back swap lending program at First Commerce Bank, a \$1.55 billion community-focused commercial bank headquartered in Lakewood, New Jersey. Under this program, the Bank will offer commercial and real-estate borrowers the ability to convert variable-rate loan obligations into fixed-rate payments, while the Bank maintains a floating-rate asset profile and executes mirror interest rate swaps with a third-party dealer. Specifically, the Bank will originate a floating-rate loan (typically indexed to SOFR) to the borrower, simultaneously enter into a fixed-payer/floating-receiver swap with the borrower, and concurrently execute a counter-swap (floating-payer/fixed-receiver) with a swap dealer. This creates a hedged structure such that the Bank's net interest rate exposure is neutral, the borrower obtains fixed-rate certainty, and the Bank can generate incremental non-interest income via swap facilitation. The expected achievements include enhanced competitive positioning within the commercial lending market, diversification of fee income, and improved earnings stability in a volatile interest-rate environment.¹

Alternative Options Considered

Several alternatives were considered before selecting the back-to-back swap model:

- **Direct fixed-rate lending (on balance sheet):** The Bank could continue offering long-term fixed-rate commercial loans funded internally. While this approach meets borrower demand for rate certainty, it exposes the Bank to duration risk and may compress net interest margins when rates rise.¹
- **Sell or syndicate fixed-rate loans:** The Bank might originate fixed-rate loans and immediately syndicate or sell them to retain limited interest-rate risk. While this reduces exposure, it weakens ongoing customer relationships and forfeits servicing and fee income.¹
- **Macro portfolio hedging:** The Bank might hedge interest-rate risk at the aggregate portfolio level (e.g., via caps, swaps on securities or deposits). Although this addresses balance-sheet risk, it does not serve individual borrower needs for fixed-rate financing or generate borrower-level fee income.¹

Competitive Advantages

The back-to-back swap model was selected because it delivers a dual benefit: it meets borrower demand for fixed-rate payments while enabling the Bank to maintain floating-rate assets and generate fee revenue. In addition, it aligns with the strategic goal of deepening borrower relationships, preserving net interest margin, and enhancing the Bank's value proposition against larger competitors. Studies note that interest-rate swaps can be particularly effective in community bank settings to manage earnings volatility and competitive pressures.¹²

This initiative aligns strongly with First Commerce Bank’s mission of providing high-quality, relationship-driven financial services, building franchise value, and maintaining prudent asset-liability management. The Bank with ~\$1.55 billion in assets, strong local presence and growth aspirations, is positioned it to benefit from enhanced product offerings. By introducing a swap-based lending product, the Bank will differentiate itself from peer institutions of similar size that may not offer hedging capabilities and better compete with larger regional banks already offering such solutions.

Competitive advantages include³

- **Enhanced borrower value proposition:** Commercial clients often seek fixed rate borrowing for predictable cash flow; by offering this, the Bank improves retention and attracts new customers.
- **Fee income diversification:** Swap facilitation fees add to non-interest revenue, reducing dependency on traditional net-interest margin.
- **Earnings stability and risk mitigation:** The back-to-back structure keeps fixed-rate exposure off the Bank’s balance sheet, reducing interest-rate risk and supporting margin resilience.
- **Strategic positioning:** This product enables First Commerce Bank to evolve beyond “vanilla” commercial lending, aligning its community banking model with more sophisticated risk-management capabilities.

Research indicates that while many community banks shy away from swaps due to perceived complexity, those that adopt well-designed hedging programs can mitigate interest-rate risk, improve earnings stability and broaden their competitive set. By executing this project, First

Commerce Bank can achieve strategic differentiation, deeper borrower relationships and a stronger risk-adjusted earnings profile.³

Future Opportunities & Potential Risks

Successful deployment of a swap lending program opens subsequent strategic choices. The Bank could expand into derivative-based solutions such as interest-rate caps, collars, or forward-starting swaps, and potentially offer advisory services to middle-market clients seeking customized rate-risk management. The program may also enhance deposit acquisition and cross-selling of treasury services. Over time, First Commerce Bank could position itself as a community bank with sophisticated product capability, attracting higher-quality borrowers.⁵

The initiative carries operational complexity, regulatory and accounting oversight, counterparty credit risk, and borrower suitability risk. If the program is poorly executed, it could expose the Bank to value-mark losses, reputational risk or regulatory criticism. Research shows many community banks avoid hedging due to cost, complexity and perceived regulatory burden.⁴

Role in Project (“Project Lead”)

As Vice President – Commercial Loan Officer in the Lending Department, the writer’s role spans strategic design, cross-functional coordination and product launch leadership. Key responsibilities include:

- Collaborating with Lending/Credit, Accounting/Finance, Risk Management and Compliance to draft the Hedging Policy and required amendments to Credit and ALM policies.

- Assisting in the identifying, vetting and selection of a swap dealer partner through vendor due diligence and negotiation.
- Leading lender training workshops and creating borrower-facing educational materials.
- Coordinating internal reviews, preparing status reports and proposals for senior management and presenting program updates to the Board Risk Committee, ALCO and Board of Directors.
- Overseeing the transition from pilot to full rollout and monitoring early-stage implementation results.

This leadership role supports cross-functional coordination and expands institutional expertise in capital markets and structured lending, enabling enhanced exposure to capital markets, risk management and strategic product development within the Bank.

Resources Required

The project will require coordinated financial, organizational, and technological resources. Financially, the bank will allocate a modest upfront investment for legal documentation, ISDA counterparty onboarding, and system integration with its loan origination platform as applicable. A swap dealer or correspondent bank partner will provide execution infrastructure, deal-pricing, documentation templates and valuation support. The Bank must conduct vendor due diligence and negotiate service and pricing terms. Additional funding will support staff training and marketing efforts to introduce the new product. Vendor relationships may also be leveraged to provide back-office swap processing and valuation support to ensure accuracy and efficiency.¹⁷

Organizationally, implementation will involve cross-functional collaboration between the Commercial Lending, Accounting, Finance, Risk Management, and Compliance departments.

Educational sessions and tools will support adoption within each department. There will also be dedicated commercial lenders trained in swap mechanics, and back-office personnel to manage documentation and settlements. A modest marketing campaign will introduce the product to existing and prospective commercial clients.¹⁶

The project necessitates significant process enhancements. A new Loan Hedging Policy will be adopted, with amendments made to the Commercial Loan and Credit Policy frameworks. A formal workflow will be established linking loan origination, swap execution, documentation, settlement and valuation.⁴

The Bank will implement a coordinated process between Lending, Accounting/Financing, Operations and Counter Party/Dealer to manage the following key components:

- Eligibility screening at loan-origination for swap suitability.
- Documentation review (loan plus swap confirmation) and cross-default/cross-collateralization.¹
- Swap execution with dealer and simultaneous borrower-bank swap.
- Daily mark-to-market monitoring and counterparty exposure reporting as applicable.
- Quarterly reporting to the Asset-Liability Committee (ALCO) and quarterly audit.

Beyond the workflow, the process improvements enhance transparency, reduce manual risk, improve internal controls and data flow, and align the Bank with best practices for derivative usage.

Stakeholders

The successful implementation of the back-to-back swap lending program will require collaboration and approval from several key stakeholders across First Commerce Bank. Each plays a distinct role in ensuring the program's regulatory compliance, operational readiness, and strategic alignment.

- **Board of Directors and Executive Management:** Final approval authority for the project will rest with the Board of Directors, based on recommendations from the Chief Credit Officer (CCO), Chief Lending Officer (CLO) and Chief Financial Officer (CFO). The Board's Risk Committee and Audit Committee will review the proposal for consistency with enterprise risk appetite and policy compliance. Executive management's endorsement is essential to secure budget allocation, staffing resources, and cross-departmental cooperation.¹⁸
- **Finance Department:** The Finance team will be responsible for executing and managing swap transactions with the external dealer, daily mark-to-market valuations, and ensuring alignment with ALCO (Asset-Liability Committee) objectives. Finance will also lead the setup of reporting systems to monitor exposure and counterparty performance.
- **Commercial Lending Division:** Frontline relationship managers and commercial loan officers will originate and structure eligible loans for the swap program. They will be trained to explain swap mechanics and risk considerations to clients, ensuring full borrower understanding and disclosure compliance.
- **Risk Management and Compliance:** The Risk Management Department will oversee counterparty risk assessment, exposure monitoring, and compliance with regulations for

customer suitability and swap documentation. Compliance will verify adherence to derivative transaction rules, including swap dealer registration as applicable.²

- **Legal Counsel and Documentation:** Internal and external legal teams will draft and review all relevant contracts, including the **ISDA Master Agreement, Master Servicing Agreements** and borrower-side documentation. Counsel will ensure proper disclosure language, fair dealing, and compliance with applicable federal and state lending regulations.
- **Operations and Accounting:** Operations staff will manage settlement and confirmation of swap payments. Accounting will ensure proper recognition of derivative fee income, valuation adjustments, and alignment with GAAP hedge accounting standards.
- **External Partners:** The Bank will partner with a registered swap dealer, such as SouthState Bank, Chatham Financial, Derivative Path, or another reputable provider, to facilitate market access, trade execution, and back-office support. The partnership will include staff training, trade processing tools, and compliance reporting.

Stakeholder buy-in will be achieved through a phased communication plan that includes preliminary presentations to senior management, detailed proposal submission to ALCO and the Risk Committee, and formal approval by the Board of Directors prior to launch.

Step-by-Step Implementation Plan

The implementation of the back-to-back swap lending program will be executed over a structured seven-month timeline designed to ensure operational readiness, risk management alignment, and regulatory compliance. This milestone-based rollout allows for a controlled transition from concept to execution while providing multiple checkpoints for validation and management review.

Phase 1: Project Initiation and Feasibility (Month 1) will begin with the formation of a Project Steering Committee consisting of representatives from Lending, Finance, Compliance, and Risk Management. The committee will conduct a feasibility analysis assessing projected swap volume, target borrower profiles, and potential fee income generation. Benchmarking will be performed against peer institutions offering similar hedging products to validate market competitiveness. Initial findings will be compiled into a formal feasibility report and presented to Executive Management for approval to proceed to policy drafting. Key deliverables for this phase include the Feasibility Report, Preliminary Project Charter, and Management Presentation.

Phase 2: Policy Development and Vendor Selection (Months 2–3) will focus on establishing the governance framework for the new product. The Loan Hedging Policy will define eligible loan types, pricing structures, documentation standards, and counterparty criteria. Vendor due diligence will be conducted to evaluate potential swap dealer partners, reviewing reputation, platform capabilities, regulatory compliance, and pricing transparency. Once a preferred dealer is identified, the Bank will begin negotiations and the ISDA agreement review process. Policy drafts will be submitted to the Asset Liability Committee (ALCO) and Risk Committee for approval. Deliverables include finalized policy documents, a selected swap dealer, and a draft ISDA agreement.

Phase 3: System Integration and Staff Training (Months 4–5) will involve integrating the dealer-provided trading platform with the Bank's core operating system to enable automated trade capture and position reporting. Internal accounting procedures will be developed for swap fee income recognition and daily mark-to-market valuation. Comprehensive training sessions will be held for lenders, finance, and operations teams, covering product mechanics, compliance requirements, and borrower communication standards. Borrower-facing educational materials and

disclosures will be prepared to ensure transparency regarding fixed-versus-floating rate implications and termination risk. Deliverables for this phase include completed system integration, training certifications, and finalized client disclosure materials.

Phase 4: Pilot Program and Controlled Launch (Month 6) will serve as a proof-of-concept period. Pilot transactions will be executed with one or two selected commercial borrowers to test workflow efficiency, documentation accuracy, and reporting integrity. The pilot will also verify the Bank's risk assessment, accounting treatment, and dealer coordination processes. Following the pilot, a "Go/No-Go" Evaluation Report will be presented to ALCO and Executive Management, supported by input from internal audit and risk management teams. Deliverables will include the Pilot Execution Report, Go/No-Go Decision Memorandum, and Process Refinement Recommendations.

Phase 5: Full Program Rollout (Month 7) will commence upon successful pilot approval. The Bank will formally launch the back-to-back swap lending program across all eligible divisions, supported by a marketing campaign emphasizing rate stability and borrower flexibility. A continuous monitoring framework will be implemented through reporting dashboards to track fee income, counterparty exposure, and borrower participation. Quarterly reviews with ALCO and annual internal audits will ensure ongoing oversight. Deliverables for this phase include the Official Program Launch, Monitoring Dashboard, and Marketing Materials.

The **Pilot Testing and Evaluation** phase is integral to the implementation strategy, providing critical validation of operational readiness, risk controls, and client communications. The objectives of the pilot include confirming process efficiency, verifying accounting accuracy, testing swap pricing and dealer coordination, and assessing borrower comprehension of the hedging product. At completion, the Project Steering Committee will submit a Go/No-Go Decision

Memo to ALCO and the Board Risk Committee. Approval will be based on successful execution without material exceptions, validated hedge accounting treatment, positive feedback from both staff and clients, and satisfactory audit results. If deficiencies are identified, corrective measures will be implemented before the full rollout proceeds.

FINANCIAL IMPACT

Investment Requirements

The implementation of a back-to-back swap lending program at First Commerce Bank requires a moderate but meaningful upfront investment that is primarily operational in nature rather than capital-intensive. Unlike banks that operate proprietary derivatives trading desks, First Commerce Bank will leverage a dealer-executed hedge structure, which significantly reduces regulatory capital needs and eliminates the need for market-makers, pricing engines, or collateral posting. As a result, the investment focuses on technology integration, legal documentation, compliance oversight, and staff training, areas critical to establishing a safe, scalable, and regulatorily compliant derivatives offering.⁵

The monetary investment consists of one-time expenditures associated with policy development, ISDA negotiation, dealer platform integration, and lender training, along with modest ongoing costs for compliance monitoring and audit functions. These investments are consistent with national community bank benchmarks cited by derivative advisory firms and OCC community-bank swap program guidance, which emphasize the need for proper governance and system connectivity rather than capital markets infrastructure. The table below summarizes the estimated cost structure for program implementation at First Commerce Bank.⁶

Exhibit 1: Estimated Investment Requirements *(Rounded to nearest dollar)*

Category	Year 0–1 Cost	Ongoing Annual Cost
ISDA Documentation & Legal Review	\$75,000	\$25,000
Dealer Platform / Technology Integration	\$120,000	\$40,000
Compliance Program Enhancements & Audit	\$40,000	\$25,000
Staff Training (Lending, Treasury, Operations)	\$50,000	\$15,000
Marketing & Borrower Education	\$20,000	\$10,000
Total Estimated Investment	\$305,000	\$115,000 annually

Labor and Capital Considerations

Labor and Time Commitments: The investment also includes internal personnel time across Commercial Lending, Treasury/Finance, Operations, IT, Compliance, and Credit Administration. Collectively, the implementation period is estimated to require 1,000–1,200 labor hours, distributed over a seven-month timeline. This includes system configuration, staff training, workflow validation, and policy development. Time commitments follow industry practice, where swap program implementation relies on cross-functional coordination and enhanced governance structures.⁶

Capital Requirements: Because the program uses a fully hedged back-to-back structure, the Bank does not incur market value volatility or require risk-weighted capital allocation. The dealer counterparty assumes market exposure, and standard community bank ISDA arrangements typically include no collateral posting, reducing liquidity and capital strain. Therefore, the investment is categorized as operational infrastructure rather than balance-sheet expansion. This structure preserves capital for core lending growth while enabling the Bank to introduce an advanced pricing tool for commercial borrowers.⁶

Three-Year Pro Forma Analysis

The financial evaluation of the swap program reflects First Commerce Bank's recent performance trends, including loan growth, interest margin pressures, and the strategic need to diversify non-interest income. The Bank's net interest margin increased from 2.20% at year-end 2024 to 2.61% as of September 30, 2025, but remains below historical years and peer levels. Introducing a back-to-back swap offering supports margin stability, enhances customer retention, and generates fee-based revenue without increasing credit exposure.¹⁶

The pro forma analysis presented in Exhibits 2–4 reflects the selected modeling assumptions:

Full Rollout Scenario

- Annual commercial loan production: **\$250 million**
- Swap attachment rate: **10%**
- Annual swap notional: **\$25 million**
- Upfront hedge fee: **25 basis points**¹²³
- SWAP loan terms: **10 Year SWAP SOFR + 225 bps**⁵
- NIM benefit range (modeled at mid-point): **6 basis points**¹²³
- Technology amortization: **5-year straight-line**⁶
- Rate environment assumption: **Stable to slightly declining**, consistent with late-2025 forward guidance⁵

Revenue and Expense Assumptions

The three-year financial projections quantify the economic impact of implementing a back-to-back swap lending program at First Commerce Bank under a full-rollout scenario. The model incorporates the Bank's recent performance trends, including rising net interest income, improving

net interest margin, and sustained commercial loan growth. Revenue is generated primarily through upfront hedge fees, interest margin stabilization, and cross-selling opportunities. Below describe how each revenue source was calculated. ¹

1. Hedge Fee: A swap hedge fee isn't a single fee but the extra cost (spread) added to the market's mid-rate, reflecting credit risk, profit, and other factors, calculated by a bank/advisor as the difference between the rate they offer and the mid-market rate (e.g., 3.75% quote vs. 3.50% mid-rate), essentially pricing in the cost of hedging the underlying risk. The core calculation involves discounting future cash flows using forward rates to find the fair swap rate and then adding the margin. The end swap purchaser pays a premium for that higher fixed rate in the form of a hedge fee, which is the present value of future cash flows of the additional spread built into the loans fixed rate. The spread, index, loan amount, loan term and hedge fee spread all impact the fee income amount the Bank earns.
 - a. For ease of compiling pro-forma analysis, this program is utilizing the following standard loan terms: 25-year amortization fixed for 10 years at 10-year SWAP SOFR + 225 bps, with a 25-bps hedge fee, which equates to approximately \$17,000 in hedge fee income for every \$1 million loan originated.¹⁵
2. Net Interest Margin (NIM) Preservation benefit: With floating rate loans the source of funding can be matched more quickly to adjust to rising or falling interest rates. As such, with more adaptability to fluctuations in rates, a 6-basis point benefit is based on mid-point range (5-8 bps) of modeling projections for a stable to slightly declining rate environment.
*The preservation benefit is only attributed to the actual swap notional amount of \$25 million per year and not the entire loan portfolio.¹⁶

3. Cross-sell Revenue: Given that back-to-back swap loans have historically been at more competitive rates for longer durations and come equipped with a required yield maintenance prepayment penalty, the Bank is able to leverage these more aggressive terms and the negative consequences of paying off to entice borrower to utilize more products that can ultimately generate additional income.

As shown in the tables that follow, revenues remain consistent across the three-year horizon, reflecting a steady annual swap notion of approximately \$25 million. Expenses reflect legal documentation, technology investments, program oversight, and borrower education; however, they decline significantly after Year 1 as one-time implementation costs are replaced by lower recurring oversight and technology maintenance requirements. The resulting net financial contribution becomes more measurable beginning in Year 2 and remains stable thereafter.⁵

Exhibit 2. Pro Forma Revenue Summary

The projected revenue streams are summarized below.

Revenue Category	Year 1	Year 2	Year 3
Upfront Swap Fee Income	\$427,000	\$427,000	\$427,000
NIM Preservation Benefit	\$15,000	\$15,000	\$15,000
Cross-Sell Revenue	\$20,000	\$20,000	\$20,000
Total Revenue	\$462,000	\$462,000	\$462,000

The revenue profile reflects modest but reliable earnings sources that are typical of loan-level hedge programs at community and regional banks. Upfront fees represent the majority of revenue, while NIM preservation and cross-selling contribute incremental but strategically meaningful benefits. Because these are non-interest sources, they support earnings diversification and mitigate sensitivity to balance sheet funding costs.¹⁶

Exhibit 3. Pro Forma Expense Summary

The expense structure assumes that Year 1 includes all startup and integration costs.

Expense Category	Year 1	Year 2	Year 3
Technology & Platform	\$120,000	\$40,000	\$40,000
Legal & Compliance	\$75,000	\$25,000	\$25,000
Training & Staff Development	\$50,000	\$15,000	\$15,000
Audit & Oversight	\$40,000	\$25,000	\$25,000
Marketing & Borrower Education	\$20,000	\$10,000	\$10,000
Total Operating Expenses	\$305,000	\$115,000	\$115,000

Year 1 expenditures are intentionally front-loaded to address compliance, technology integration, and internal capacity building. These investments create the framework for a scalable, repeatable swap program that can expand in subsequent years at materially lower incremental cost.⁵

Exhibit 4. Net Financial Impact Summary

Metric	Year 1	Year 2	Year 3
Total Revenue	\$462,000	\$462,000	\$462,000
Total Expenses	(\$305,000)	(\$115,000)	(\$115,000)
Net Financial Impact	\$157,000	\$347,000	\$347,000

This analysis demonstrates a modest initial profit in Year 1, followed by strong recurring profitability in Years 2 and 3. The total cumulative financial benefit over the three-year time horizon is approximately \$851,000, supporting a payback period of approximately 12-18 months, which is consistent with community bank hedge-program benchmarks.⁸

The Bank's ability to generate a positive financial return beginning in Year 2 reflects three structural advantages of the back-to-back swap model:

1. The program does not require balance sheet allocation, allowing revenue to scale independently of deposit growth or capital consumption.
2. Non-interest income increases predictably, providing a stabilizing offset to net interest margin pressure, which is one of the Bank's most significant strategic challenges, as evidenced by its decline from 2.92% (2023) to 2.20% (2024) before partially rebounding to 2.61% in 2025.¹⁶
3. Ongoing costs remain low, once initial legal agreements, platform integrations, and training have been completed.

Because the Bank experiences ongoing margin compression due to funding cost dynamics and competitive loan pricing, a program that both enhances customer retention and preserves margin is strategically valuable. These financial projections indicate that the swap program contributes incrementally to profitability while positioning the Bank more competitively against peers offering structured financing products.

Risk Identification

The implementation of a back-to-back swap lending program introduces several financial, operational, and regulatory risks that must be carefully evaluated as part of the Bank's broader investment justification. Although these risks are manageable and consistent with industry norms, they require thoughtful identification to ensure that the Bank's governance and control environment remains sufficiently robust. The risk areas outlined below reflect common derivative program exposures documented across community banks and incorporate regulatory guidance from the OCC, Federal Reserve, and industry swap advisory practices.²

One significant category of risk is volume risk, which arises from uncertainty in borrower adoption levels. The financial projections for the program assume a 10 percent attachment rate on eligible commercial loan production; however, borrower demand may decline if interest rates fall sharply, if competitors lower fixed-rate pricing, or if borrowers' express reluctance to engage in derivative contracts. Lower swap utilization would reduce projected fee income and slow the program's payback period. While historical market behavior suggests strong demand for fixed-rate certainty in volatile environments, loan-level hedging programs remain sensitive to overall rate trends.⁸

The program also introduces operational risk, particularly related to trade execution, documentation accuracy, mark-to-market valuation, and payment reconciliation. Swaps require additional processing beyond standard commercial loan servicing, and errors in trade capture or settlement could result in financial loss or internal control findings. Because First Commerce Bank will rely on a dealer platform for trade execution, operational risk includes the need for effective integration between the Bank's internal systems and the dealer's reporting infrastructure.

A third area of concern is compliance and regulatory risk. Banking regulators have increasingly scrutinized derivative activities in community banks, emphasizing the need for robust policies, borrower suitability assessments, disclosure standards, fair value measurement controls, and Board approved governance frameworks. Examiners will expect the Bank to demonstrate not only technical accuracy in swap processing but also a clear understanding of derivative risk, consistent with supervisory expectations under the regulatory authorities. Failure to meet these standards could result in supervisory criticism or increased oversight.

Counterparty risk is another factor, given the Bank's reliance on a third-party dealer to execute offsetting swaps. Although the Bank itself assumes no open market position, the program depends

on the dealer's ability to price, execute, and settle swaps without interruption. Any deterioration in the dealer's financial condition, operational capacity, or credit rating could impair execution and expose the Bank to temporary position mismatches. While this risk is limited under the back-to-back structure, it nonetheless warrants consideration.

Finally, the program carries margin compression risk, particularly in environments with rapidly declining interest rates. The program's financial benefit partly derives from preserving a modest uplift in net interest margin on swapped loans. A sharp downward shift in rates may reduce the relative advantage of the floating rate asset profile and diminish the NIM preservation component of the financial model. Although the core fee-income component remains relatively unaffected, a reduction in NIM stabilization benefits could narrow the program's overall financial contribution.¹

Taken together, these risks form a manageable but essential component of the program evaluation. Each risk category introduces potential variability in financial outcomes and operational performance, underscoring the importance of the Bank's governance, monitoring, and control structures.

Risk Management Approach

Effective risk management is essential to ensuring that a back-to-back swap lending program operates safely, aligns with regulatory expectations, and supports the Bank's strategic objectives. Due to the program introducing new processes, valuation requirements, documentation standards, and counterparty dependencies, a comprehensive control framework is required to mitigate associated risks. The following risk management elements reflect industry standards for community banks and incorporate supervisory themes from the regulatory agencies and advisory firms.

A foundational component of the risk management framework is enhanced governance, which establishes Board level and management level oversight. The Bank will adopt a Board approved Hedging Policy outlining the program's purpose, eligible transaction types, risk appetite parameters, counterparty requirements, and reporting expectations. Governance will also include bi-annually reporting to the Asset-Liability Committee (ALCO), detailing swap exposure levels, counterparty concentrations, valuation trends, borrower performance, and any policy exceptions. In addition, the Internal Audit Department will conduct an annual review of the program's operational workflow, trade accuracy, and compliance with accounting standards. These governance layers ensure that derivative activity remains transparent and appropriately monitored across all levels of the organization.¹⁴

Borrower suitability controls will serve as another critical risk mitigation tool. To ensure that borrowers fully understand the structure, costs, risks of interest rate swaps, including early termination fees, the Bank will implement a standardized suitability assessment. This assessment will evaluate the borrower's financial sophistication, risk tolerance, asset-liability structure, and hedging objectives. Borrowers will receive disclosures explaining fixed-to-floating mechanics, breakage cost scenarios, and the impact of market rate movements. Loan officers will follow a structured communication script to promote consistency, and all disclosures will require signed borrower acknowledgment. These measures reduce the risk of borrower confusion or disputes and ensure compliance with regulatory expectations.

Mitigation of counterparty risk is achieved through diversification and strict vendor due diligence. Although one primary swap dealer will be used for the initial rollout, the Bank will maintain eligibility with at least one secondary dealer to provide redundancy in pricing and execution. The

Bank will conduct annual financial reviews of each dealer, including an analysis of capital adequacy, regulatory standing, and operational performance. ISDA and Credit Support Annex (CSA) terms will be reviewed periodically to ensure that margin provisions, termination events, and credit support language continue to reflect the Bank's needs and the broader market environment. Diversifying counterparty options protects the Bank from operational delays or pricing disadvantages arising from dealer specific issues.

Operational risk will be mitigated through strong internal control and procedures. Under the back-to-back swap loan program, closings and trade executions shall require dual authorization, ensuring that no swap is processed without review by both Treasury and Lending. Settlement controls will include monthly reconciliation of cash flows, automated alerts for payment mismatches, and segregation of duties between trade initiators and settlement staff. These processes reduce operational vulnerabilities and support accurate financial reporting.

Finally, the Bank will implement ongoing monitoring and stress evaluation to identify emerging risks. ALCO will review swap activity under different rate environments, evaluating how rising or declining rates affect borrower behavior, hedge effectiveness, and NIM stability. Annual stress scenarios will assess the impact of shifts in loan production, dealer pricing spreads, and borrower prepayment patterns on program profitability. These evaluations allow the Bank to refine program strategy, adjust pricing assumptions, and update governance as needed.¹⁶

Through this comprehensive risk management approach, the Bank can confidently manage the risks associated with back-to-back swap lending. These practices position the Bank to operate the program safely, meet regulatory expectations, and maintain long-term program sustainability.

Scenario Analysis

A scenario-based evaluation provides an essential framework for understanding how varying interest rate environments and borrower behaviors may influence the financial performance of a back-to-back swap lending program. Because the core value proposition of loan-level hedging is closely tied to rate expectations, market volatility, and borrower demand patterns, projecting outcomes across multiple rate environments allows management to assess the resiliency and strategic value of the program. The following analysis evaluates the expected financial results under three distinct scenarios: the Most Likely Case (stable to slightly declining rates), the Best-Case Case (rising rate environment), and the Worst-Case Case (sharp rate decline). Each scenario incorporates changes in fee revenue, swap adoption rates, NIM preservation benefits, and overall borrower behavior.¹

Most Likely Case — Stable to Slightly Declining Rates (Base Case): Under the base-case scenario, which aligns with late-2025 industry forecasts projecting stable or modestly lower interest rates, demand for fixed-rate certainty remains steady, resulting in swap adoption consistent with the Bank's projected 10% attachment rate. Due to borrowers valuing lower rates for longer periods and predictable payment structures in an environment of economic uncertainty, hedge utilization remains strong enough to support fee income generation at expected levels. In this scenario, the program generates approximately \$851,000 in cumulative net financial benefit over the first three years, with the majority of gains realized in Years 2 and 3 after the initial investment phase.⁷

The net interest margin (NIM) preservation benefit remains in the 5–8 basis point range on swapped loan balances, consistent with historical results observed at similarly positioned

community banks. Technology and legal expenses decline materially after Year 1, allowing program profitability to improve quickly. The scenario confirms that the program modestly enhances earnings stability even in an environment without substantial rate movement. This moderate and predictable performance profile makes the base case a reasonable model for management expectations.¹⁶

Best-Case Scenario — Rising Rate Environment: In a rising rate environment, borrower demand for interest rate protection typically increases as borrowers seek to mitigate the risk of higher future borrowing costs. This behavioral shift has been documented across peer institutions during periods of monetary tightening, where swap utilization and fee income consistently outperform initial projections. Under this scenario, the Bank experiences swap volumes exceeding the baseline assumption, resulting in stronger fee generation and improved spread income from NIM preservation.⁷

Specifically, the NIM benefit increases to the range of 8–12 basis points on swapped loans, reflecting both the higher economic value of hedged pricing and the stabilization effect that swaps provide relative to traditional balance sheet fixed-rate lending. These results highlight the program's upside potential with relatively nominal risk, whereas, financial gains increases meaningfully when rates rise, while risk to the Bank remains limited due to the fully hedged, back-to-back structure.³

Worst-Case Scenario — Sharp Rate Decline: A sharp and sustained decline in interest rates represents the most challenging environment for program performance. In this scenario, borrower preference shifts toward traditional fixed-rate loans instead of interest rate swaps, resulting in

significantly lower swap adoption. Due to lower rates diminishing the perceived value of hedge instruments, upfront hedge fee income may fall meaningfully below baseline assumptions.⁷

In addition, the NIM preservation benefit narrows to a range of 0–3 basis points, reducing the stabilizing impact swaps may otherwise provide. Although the Bank incurs minimal market risk due to the offsetting nature of back-to-back trades, program economics weaken considerably. Under this scenario, cumulative net financial contribution could fall to breakeven or slightly positive levels, depending on the severity of the decline and borrower demand.³

Even in the worst case, however, the Bank’s downside exposure remains operational rather than financial. Because swaps are executed only when matched to a borrower transaction, the Bank does not face unhedged derivative exposure or capital-at-risk. This ensures that the worst-case outcome is limited to lower-than-expected earnings rather than portfolio losses.

Comparative Scenario Summary: Across the modeled scenarios, results demonstrate that the program exhibits a favorable risk-reward profile: the downside is limited to weaker earnings contribution, while the upside potential under rising rates is substantial. The stable-to-slightly declining environment (the most probable scenario) still yields a measurable positive financial outcome, confirming the program’s resilience and the appropriateness of its implementation.

Financial Conclusion and Recommendation

The comprehensive financial, operational, and strategic analysis conducted throughout this Capstone demonstrates that implementing a back-to-back swap lending program offers measurable and sustainable value to First Commerce Bank. The program provides a structurally hedged method for delivering fixed-rate pricing to commercial borrowers without compromising the

Bank's net interest margin or exposing the balance sheet to interest rate volatility. While the financial justification alone confirms the program's merit, its broader implications for relationship development, competitive positioning, and long-term franchise growth further strengthen the case for implementation. Based on the findings presented in the preceding sections, adoption of this program is strongly recommended.¹⁶

From a financial standpoint, the projected three-year performance of the program is favorable, even under conservative assumptions. The base case scenario, which reflects expected market conditions, generates a cumulative net benefit of approximately \$851,000 over the initial three-year horizon. This includes an anticipated 12–18-month payback period, consistent with community bank experiences documented by industry swap advisors and derivative service providers. Stronger outcomes are achievable in rising rate environments, where borrower demand for interest rate protection increases meaningfully. Although worst-case conditions, such as a rapid decline in interest rates, may slow swap adoption and compress revenue, the Bank does not incur market losses due to its fully offsetting hedge structure. In such a scenario, financial results may fall to breakeven, but no material downside risk to earnings, capital, or liquidity emerges. The payoff profile, having limited downside with significant upside, represents an attractive financial proposition for First Commerce Bank given its size and balance sheet composition.¹⁵

Operational feasibility has also been clearly established. The Bank can implement the program without adding trading staff, significantly modifying existing lending processes, or undertaking substantial core system redevelopment. The investment is primarily operational rather than capital-intensive, requiring modest technology integration, legal documentation, training, and compliance oversight. Importantly, the labor commitment is both finite and manageable, with approximately

1,000–1,200 staff hours concentrated over a seven-month rollout. These requirements align well with the Bank’s scale and existing operational structure, particularly given the availability of vendor-supported platforms and the reliance on a dealer counterparty for valuation, execution, and risk-neutralization. Furthermore, the institution's strong culture of disciplined credit underwriting and regulatory compliance provides a solid foundation for administering a derivative product in a safe and sound manner.⁵

Risk management considerations reinforce the appropriateness of the program. The identified risks consisting of volume risk, operational errors, compliance concerns, counterparty reliability, and margin compression, are all controllable through straightforward governance practices. These include board-approved hedging policies, standardized borrower suitability assessments, independent model validations, routine ALCO reporting, and strong vendor due diligence. The controls embedded within the implementation plan ensure that internal audit, compliance, and risk management functions remain actively involved throughout the life of the program.

Strategically, the back-to-back swap offering aligns directly with the Bank’s long-term objectives of strengthening client relationships, enhancing risk-adjusted earnings stability, diversifying non-interest income, and improving competitive positioning in the commercial lending market. Borrowers increasingly expect mid-sized and community banks to offer the same sophisticated interest rate tools available at larger institutions. By enabling commercial clients to obtain fixed-rate protection while maintaining a floating-rate balance sheet asset, the Bank can more effectively retain high-quality borrowers, deepen relationships, and differentiate itself from peer institutions. Additionally, this capability supports the Bank’s overarching mission of providing customized

financial solutions that promote business growth and community development across its geographic footprint.

In conclusion, the totality of evidence presented in the financial analysis, risk assessment, operational feasibility review, and strategic alignment evaluation strongly supports the recommendation that First Commerce Bank proceed with implementing a back-to-back swap lending program. The initiative advances both near-term financial performance and long-term strategic positioning, with limited downside risks and meaningful opportunities for enhanced shareholder value.

NON-FINANCIAL IMPACT

The financial impact analysis demonstrates that the program can generate incremental non-interest income, strengthen pricing flexibility, and support balance sheet risk management through a matched, offsetting swap structure. However, the durability of those benefits depends on operational execution, stakeholder trust, and a control environment that aligns with supervisory expectations for derivative activities in community and intermediate-sized banks.

First Commerce Bank's mission emphasizes relationship-driven banking, superior service, and the long-term building of franchise value. Introducing loan-level hedging capabilities through a back-to-back swap structure represents a meaningful evolution in product capability. Non-financial impacts affecting employees, customers, regulators, investors, and external partners, can materially influence franchise value and profitability over time, even when immediate financial effects are difficult to measure.

Logistical and Organizational Challenges Foreseen in Implementation

Implementing a back-to-back swap lending program introduces organizational challenges that extend beyond the technical execution of individual swaps. While the matched nature of the structure is intended to neutralize the Bank's market risk, the program requires new procedures, documentation standards, and cross-functional coordination that differ from traditional commercial loan origination and servicing. The most material challenges expected during early-stage adoption are described below.

Change Management and Adoption Friction: A primary non-financial challenge is change management. First Commerce Bank has historically operated with a conventional commercial lending model and a relationship-driven culture. Derivative-based solutions can be perceived as complex, even when the Bank's structure is risk-neutral and supported by a third-party dealer. Internal resistance may appear as reluctance to propose swaps to qualified borrowers, inconsistent messaging, or over-reliance on a small number of staff members who become informal "experts." These factors can reduce program consistency and slow adoption, which may adversely affect customer experience and internal confidence during the pilot and early rollout period.

Cross-Functional Workflow Complexity: The back-to-back swap process introduces additional steps and handoffs that must be executed consistently. Key workflow components include borrower eligibility screening, suitability documentation, dealer quote coordination, swap confirmation, settlement instruction verification, and ongoing monitoring. In intermediate-sized banks, staffing models are typically leaner than those of larger regional institutions, which heightens the importance of clear ownership and documented procedures. Absent standardization,

transaction timelines may lengthen and the Bank may experience operational exceptions that can affect borrower satisfaction and increase compliance workload.¹⁴

Training, Capability Development, and Key-Person Risk: A third challenge is the training burden and the risk of knowledge concentration. Effective program administration requires baseline competency across Lending, Treasury/Finance, Operations, Compliance, and Internal Audit. Loan officers must communicate the product accurately, including termination economics, while Treasury and Operations must maintain disciplined controls over trade execution, reconciliation, and recordkeeping. If training is insufficient or isolated to a small subset of employees, the program can become vulnerable to key-person risk, execution errors, and inconsistent customer communication.⁵

Compliance and Supervisory Sensitivity: Derivative activities often receive heightened supervisory attention because they combine market conventions, specialized documentation, fair value monitoring, and suitability expectations. Even when a program is designed to be fully hedged, examiners generally expect board-approved policies, ALCO oversight, internal controls, independent testing, and evidence that staff possess the competency to administer the activity safely and soundly. Early-stage examination sensitivity can increase management burden and documentation demands. If not anticipated, this may divert operational attention from customer-facing execution and slow the pace of expansion.⁸

Customer Perception, Suitability, and Reputational Considerations: The program also introduces reputational risk if borrowers misunderstand the transaction structure or termination risk. Although the back-to-back swap is structured to meet legitimate borrower hedging needs, some customers may associate derivatives with speculative activity or assume that a swap

functions identically to a conventional fixed-rate loan. If expectations are not set clearly, borrowers may react negatively to market-based breakage costs in a payoff or refinance event, even when disclosures were provided. This risk is particularly relevant in relationship banking models where trust and transparency form the foundation of franchise value.¹¹

Third-Party Dependence and Vendor Oversight: Because the program relies on a dealer-executed hedge model, the Bank will depend on external partners for execution infrastructure, pricing, valuation support, and reporting feeds. Vendor responsiveness, platform reliability, and reporting accuracy directly influence transaction cycle time and internal control quality. Dependence on a single vendor may introduce concentration risk and operational disruption risk, particularly during periods of elevated market volatility when borrower demand for hedging tends to increase.⁴

Plan to Overcome Organizational and Logistical Hurdles

To reduce change resistance and strengthen execution consistency, the Bank should continue using the governance framework outlined in the Strategy and Implementation Plan, emphasizing the program's core purpose. The Bank's Hedging Policy should clearly articulate purpose, scope, eligible transaction types, counterparty standards, escalation protocols, and reporting requirements. A policy-led approach reduces internal ambiguity, reinforces that the program is designed for risk management rather than speculation, and provides a consistent foundation for lender training and examiner communications. Formal reporting through ALCO and Board-level committees also strengthens program legitimacy and reduces the likelihood of unnecessary decision-making during early-stage execution.¹⁵

To address workflow accountability, the Bank should implement a standardized end-to-end workflow with clear accountability for each step, from borrower screening through post-close monitoring. A documented process reduces cycle time variability, strengthens internal controls, and enables scalable execution across lending teams. The Bank should maintain a centralized closing checklist that incorporates both loan and swap requirements, including suitability documentation, disclosure acknowledgement, dealer confirmation, and settlement instructions. Standardization also improves auditability and supports consistent examiner responses.¹⁸

Training should be role-specific and reinforced with durable job aids, rather than a one-size fits all approach. Commercial lenders require competency in product positioning, risk explanation, and documentation sequencing, while Treasury/Finance and Operations require deeper competency in execution controls, reconciliation, and valuation review. Compliance and Internal Audit require an understanding of suitability, disclosure, and testing expectations. Training materials should be retained in a centralized repository and updated annually to reduce key-person risk and support continuity in the event of staffing changes.³

To mitigate customer misunderstanding, the Bank should adopt consistent borrower communications, including standardized disclosure language and suitability procedures that ensure borrowers understand core mechanics and termination economics. A plain-language borrower education summary, coupled with documented borrower acknowledgements, reduces the likelihood of future disputes and strengthens the Bank's reputational posture. Consistent borrower communications also support relationship managers by providing a defensible script and escalation path for complex questions.¹⁴

Finally, the Bank should maintain a disciplined vendor oversight process and practical contingency planning. This includes formal due diligence, service-level expectations, periodic performance review, and documented escalation procedures. To reduce concentration risk, the Bank may maintain secondary dealer readiness, even if primary execution remains with one provider. This enhances resilience and mitigates the operational risk of delayed quotes or platform disruption.³

Stakeholder Impacts with Indirect or Difficult-to-Measure Profitability Effects

For employees, the program increases competency expectations but also creates professional growth opportunities. Lenders who can offer hedged fixed-rate outcomes may become more effective in competitive situations, while Treasury, Operations, and Compliance teams develop skills aligned with broader industry evolution. If supported properly, this capability expansion can improve engagement and retention. Conversely, inadequate training or unclear workflows may increase frustration, reduce productivity, and elevate turnover risk, which are outcomes that can harm long-run profitability through higher operating costs and lower execution quality.

For customers, the most material non-financial impact is improved access to long-term payment certainty through a relationship lender. Many commercial borrowers seek fixed-rate outcomes for cash flow predictability; enabling this outcome through a swap-based structure may strengthen retention and deepen trust. Over time, the Bank may be perceived as a more capable and advisory-oriented partner, which can improve referral flows and relationship longevity. These benefits can be difficult to measure immediately but influence lifetime value and franchise strength.

For regulators, the program signals an increased level of product sophistication and therefore requires a consistent supervisory narrative. With strong governance and documentation, the Bank can demonstrate that the activity is customer-driven, matched, and controlled. This can strengthen

examiner confidence in management's risk discipline. If controls are weak or documentation is inconsistent, the program may become a recurring supervisory topic, increasing oversight burden and potentially constraining future product initiatives.⁵

For investors and the Board of Directors, the most significant non-financial outcomes include governance confidence, transparency of reporting, and the Bank's ability to innovate prudently. A well-controlled program can reinforce confidence that the institution is building franchise value through disciplined product expansion. Conversely, negative customer outcomes or regulatory criticism can reduce confidence and create reputational headwinds that influence long-run valuation perceptions.

Non-Financial Measures to Evaluate Post-Implementation Outcomes

To ensure that non-financial outcomes are monitored with the same discipline as financial results, the Bank should adopt a structured measurement approach after launch. The most effective measures are those that are practical to collect, directly tied to the program's success factors, and capable of highlighting early warning signs. Measures should be reviewed through management reporting channels, including ALCO, risk governance committees, and periodic operational review meetings.

Internal Process Measures: Internal process measures should focus on cycle time, error rates, documentation completeness, settlement exceptions, and policy exception frequency. Swap transactions can expose process weaknesses because they involve multiple handoffs and precise documentation requirements. Measuring quote-to-close time and the rate of operational exceptions provides early visibility into whether the program is scalable without materially increasing

overhead. Internal audit and compliance testing outcomes should be incorporated as a formal measure of process maturity.¹⁵

Learning and Growth Measures: Learning and growth measures should emphasize training completion, demonstrated competency, coverage depth, and staff confidence. Training hours per relevant employee group should be tracked annually, and the Bank should maintain at least two trained backups within each critical function to reduce key-person risk. Periodic competency validation, such as short assessments or scenario-based walkthroughs, can strengthen consistency and reduce the likelihood of incorrect borrower communications.

Customer Measures: Customer outcomes should be monitored through measures of satisfaction, retention, relationship depth, complaint trends, and product comprehension. A targeted swap-borrower feedback mechanism can assess whether borrowers understood the product, perceived transparency in disclosures, and believed the Bank's process was efficient. Complaint tracking should be categorized by root cause, including pricing expectations, termination economics, timeline delays, and documentation concerns. Tracking the percentage of eligible borrowers offered the product can also indicate whether frontline adoption is consistent across teams.

Risk and Governance Measures: Risk and governance measures should focus on policy compliance, reporting timeliness, vendor oversight completion, and the severity of internal audit findings. Regular reporting to ALCO and relevant Board committees should be timely and consistent, with clear summaries of notional levels, counterparty concentrations, valuation trends, and any operational or compliance exceptions. Vendor oversight measures should confirm that the Bank periodically reviews the dealer's performance and financial condition and documents escalation procedures.¹⁴

Long-Term Profitability Implications

Although the impacts described above are not captured directly in a pro forma income statement, they influence long-term profitability through customer lifetime value, operating efficiency, staff productivity, regulatory strength, and franchise value. Strong customer outcomes generally translate into improved retention and relationship depth, which lowers acquisition costs and stabilizes the loan portfolio. Operational discipline reduces error remediation, audit costs, and supervisory friction, enabling the Bank to scale the product without proportional overhead growth. Improved employee capability and confidence support lender effectiveness and increases the Bank's ability to compete for high-quality borrowers, which influences credit performance and relationship profitability over time.¹¹

Conversely, adverse non-financial outcomes can erode profitability even when short-term fee income is favorable. Borrower dissatisfaction or disputes, especially related to termination economics, can damage relationships, reduce referrals, and create reputational headwinds that slow organic growth. Operational exceptions and documentation gaps can increase compliance workload and elevate audit findings, while persistent supervisory concerns can constrain product expansion and divert management attention. For these reasons, non-financial measurement and governance should be viewed as core profitability drivers rather than secondary reporting items.

The non-financial impacts of implementing a back-to-back swap lending program are expected to be net positive for First Commerce Bank if managed with disciplined governance, standardized workflows, and consistent borrower communications. The program strengthens the Bank's relationship banking model by offering borrowers structured rate certainty while maintaining balance-sheet discipline. However, the program also introduces heightened expectations for

training, documentation integrity, vendor oversight, and supervisory readiness. When the Bank measures and manages these impacts proactively, the initiative can enhance franchise value and support long-term profitability through stronger customer retention, improved employee capability, and reinforced regulatory credibility.

CONCLUSION

This initiative aligns directly with First Commerce Bank's objectives of earnings stability, competitive differentiation, and disciplined growth. The proposed back-to-back swap lending program enables the Bank to provide fixed-rate certainty to commercial borrowers while preserving a floating-rate asset profile and minimizing interest rate exposure through a fully matched, dealer-executed structure.

The positive impacts are meaningful. Financially, the program diversifies non-interest income and supports net interest margin resilience. Strategically, it strengthens competitive positioning against larger institutions that already offer hedging solutions. Organizationally, it enhances internal capabilities and deepens borrower relationships, reinforcing long-term franchise value.

While the program introduces additional governance and operational responsibilities, including enhanced documentation standards, suitability oversight, and counterparty monitoring, these requirements are manageable within the structured policy framework and phased implementation plan outlined in this Capstone. The pilot program and formal Go/No-Go evaluation provide prudent safeguards prior to full rollout.

This initiative represents disciplined innovation rather than a departure from the Bank's conservative culture. As First Commerce Bank continues to grow, thoughtful product evolution is necessary to remain competitive while preserving sound risk management practices.

Accordingly, Executive Management should advance the proposal to the Board of Directors for formal approval and authorize initiation of Phase I implementation. With disciplined oversight through ALCO, internal audit, and Board reporting, the back-to-back swap lending program is expected to enhance earnings stability, strengthen client relationships, and support sustainable long-term growth.

BIBLIOGRAPHY

1. Abrigo. (2023). Loan Hedging: How Community Banks Use Back-to-Back Swaps to Remain Competitive. Abrigo Banking Insights. <https://www.abrigo.com>
2. ABA Banking Journal. (2023). Community Bank Interest Rate Risk Management Trends. <https://bankingjournal.aba.com>
3. Chatham Financial. (2022). Back-to-Back Swap Programs for Community Banks. Technical Whitepaper. <https://www.chathamfinancial.com>
4. Deloitte Advisory. (2021). Derivative Infrastructure and Operational Controls for Mid-Sized Banks. <https://www2.deloitte.com>
5. Federal Deposit Insurance Corporation (FDIC). (2019). Risk Management Manual of Examination Policies: Interest Rate Risk. <https://www.fdic.gov>
6. Federal Reserve. (2024–2025). Summary of Economic Projections. <https://www.federalreserve.gov/monetarypolicy.htm>
7. Fitch Ratings. (2024). U.S. Community Bank Stability Outlook. <https://www.fitchratings.com>
8. Financial Accounting Standards Board (FASB). (ASC 815). Derivatives and Hedging. <https://asc.fasb.org>
9. FFIEC. (2023–2025). Uniform Bank Performance Reports (UBPR). <https://www.ffiec.gov>
10. First Commerce Bancorp, Inc. (2025). Fourth Quarter and Year-to-Date 2024 Financial Results. <https://www.firstcommercebk.com>
11. J.D. Power. (2023). U.S. Commercial Banking Satisfaction Study. <https://www.jdpower.com>

12. McKinsey & Company. (2022). Middle Market Borrower Risk Appetite in Volatile Rate Cycles. <https://www.mckinsey.com>
13. Moody's Analytics. (2024). Commercial Loan Demand and Rate Volatility Outlook. <https://www.moodyanalytics.com>
14. Office of the Comptroller of the Currency (OCC). (2015). OCC Bulletin 2015-18: Risk Management of Financial Derivatives. <https://www.occ.gov>
15. Office of the Comptroller of the Currency (OCC). (2020). Comptroller's Handbook: Derivatives and Hedging Activities. <https://www.occ.gov>
16. Performance Trust Capital Partners. (2022). Derivative Strategies for Community Banks: Earnings Stability and Customer Solutions. <https://www.performancetrust.com>
17. S&P Global Market Intelligence. (2022–2024). Community Bank Derivative Program Cost Survey. <https://www.spglobal.com>
18. Derivative Path. (2023). Interest rate hedging programs for community banks: Policy, process, and governance. <https://www.derivativepath.com>