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Dear Valued Customer:

This is the latest update to your *Commercial Bank Investment Management Manual*. It includes new and updated material that is important to bank treasurers during these difficult economic times.

- **Chapter II-7A, Tax-Exempt and Tax-Preferred Obligations.** This is a new chapter that includes a discussion of the opportunities created by the \$787 billion *American Recovery and Reinvestment Tax Act* (ARRTA) of 2009 which was signed on February 17, 2009. This legislation has many impacts on community banks, governments and taxpayers. The material added to this chapter focuses on the impact of ARRTA on municipal bonds and how bank treasurers can realize a significant opportunity during 2009 and 2010. Effective upon passing the ARRTA banks were authorized to invest up to two percent of their total assets in general market municipals and have this investment treat as if it were a bank-qualified municipal loan. Then, with no ceiling on the amount that can be invested, ARRTA raised the ceiling on bank-qualified municipal debt from \$10 million to \$30 million.
- **Chapter IV-6, Managing Fair Values in ALM.** This is another new chapter that includes a discussion of interest rate risk measurement with uncertain asset values. Many financial institutions measure risk to Economic Value of Equity (EVE) by setting a base case value of equity and shocking the yield curve up and down in a parallel fashion. The percentage changes from the base case due to curve shocks represent interest rate risk. The greater the percentage of EVE changes from base case, the higher the level of interest rate risk. When performing this analysis, financial institutions often struggle to determine a fair value for illiquid assets. In cases where the value of a bank's assets is very uncertain, how do you derive a base value of equity to assess interest rate risk? The answer to this question is non-trivial. An overestimation of a bank's asset values will lead to an overestimation of a bank's equity value and a possible underestimation of interest rate risk. The new technique discussed in this chapter illustrates an alternative approach to measuring risk to EVE in those cases where a bank's asset values are highly uncertain.
- **Chapter IV-2, Bank Funding Strategies.** This chapter has been updated to include discussions about asset/liability management in a transitional interest rate environment. This new addition to this chapter examines the impact of the 2008-2009 credit crisis on bank funding. Although the severe recession and related credit crisis that occurred during this period will hopefully not be repeated any time soon, the impact of a credit crisis can be helpful in formulating a liquidity management strategy. In addition, this chapter discusses federal reserve discount window borrowings. Discount window borrowings have historically been a last resort funding option for most institutions. However, as a result of the subprime mortgage loan defaults during 2008 and 2009 and the resulting turmoil in financial markets, the Federal Reserve (the Fed) has become a standard source of funding for banks, investment banks, and insurance companies. In an unprecedented move, the Fed discount window no longer has the stigma as the lender of last resort and wants bankers of all sizes to view it as a regular funding alternative. The stigma of using the Fed no longer applies and should not prevent banks from using the discount window as a normal funding source.

Our goal is to make our *Commercial Bank Investment Management Manual* your favorite source book. If you have any suggestions regarding this manual, please let us know! You can email me directly

at jim.baker@sheshunoff.com. You can also call our customer service representatives at 1-800-456-2340, or visit our Web site at www.sheshunoff.com if you have any questions regarding any of our products.

Sincerely,

Jim Baker
Editor