Frontier Savings Bank

Memo

To: Fellow Community Bankers

From: Gary H. Matters

Date: 3/31/2009

Re: FDIC Assessment

As we all know, we are currently facing significantly higher quarterly FDIC assessments along with potential additional assessments based on quarter ending deposit balances starting on 6/30/09. The initial assessment was originally proposed as .20% of total domestic deposits. The FDIC also will consider additional .10% assessments each quarter thereafter to return the DIF reserve ratio back to adequate standards. I know we all agree that the reserve needs to be funded, but the FDIC's current plan will severely impact the short term earnings of community banks. It may even cause more banks to be unprofitable and/or fail. As a community banker I always try to find a win/win solution when faced with situations like this. My proposal would be to go ahead and fund the FDIC insurance pool, but give community bankers a tax break at the same time. My suggestion would be to allow community banks to increase their loan loss reserves up to a 4.0% level and deduct the increase for Federal income tax purposes. This would take some of the sting out of the increased assessments while making the banking system stronger overall. It would increase the capital levels of the banks while building loan loss reserves, keep more profits in the banks and meet the FDIC's objective of restoring the FDIC insurance pool to a more comfortable level. Increasing your own bank's loan loss reserve would be strictly voluntary, but it would give you a tax deduction you currently are not afforded if you elected to do so. Once our financial crisis is over, each bank could eventually reduce their loan loss reserve to historical levels by not adding to the reserve as you experienced normal losses. The government could also revert back to not allowing banks to deduct increases to their loan loss reserve above actual losses. This plan would not be a direct burden to taxpayers and by putting the money into the loan loss reserve, a bank could not dividend it back out to shareholders. I realize my proposal will also appear to impact earnings, but we all know that capital is currently king and we all need to retain as much as we can to ensure our industry survives.

Example:	Frontier Savings Bank
Assets:	$29,000,000.00
Deposits:	$25,000,000.00
.20% Assessment:	$50,000.00
LLR Increase:	$150,000.00
Tax Deduction:	34% = $51,000.00