President's message

Is your bank account safe?

With the recent rise in bank failures and the increasing media coverage of banking and financial issues, many consumers are understandably taking a closer look at where they put their money. At the Federal Reserve Bank of Kansas City it is not uncommon for us to receive a call from someone wanting to know if their bank, and more directly, their money, is safe.

We do not talk about the status of specific financial institutions or offer our opinions about the likelihood of their success.

However, I can tell you that if you are asking the question: "Is my money safe in my bank?" the answer is almost always, "Yes."

For many people, especially those whose first interaction with finance or banking came during the market boom of the 1990s, these seem to be unprecedented times. Unfortunately, that is not the case. In fact, you don't have to look back far to find another period where banks were under extreme pressure.

I joined the Federal Reserve Bank of Kansas City in 1973, working in bank supervision. I stayed in the division as an economist and eventually a senior officer, until I was named president in 1991. If you were involved in banking or business during that time, there is a period you likely remember well. I know I do.

Between 1980 and 1994, more than 1,600 banks nationwide either failed or received financial assistance amid turbulence in agriculture, energy and real estate markets. The number of banks involved in that crisis is far larger than what we are seeing today, so we do have some experience with these kinds of issues to help guide us through today's challenges.

In its quarterly banking profile for the period that ended June 30, the Federal Deposit Insurance Corporation said 117 institutions were on its "Problem List." The number is out of a field of approximately 8,500 commercial banks and savings institutions nationwide. Those institutions represent only a little more than 1 percent of all banks.

That number, although small, certainly has its significance. The FDIC says those "problem" banks hold a total of about $78.3 billion in assets and it should also be noted that the "Problem List" has been growing since it hit a historic low of 47 institutions in September 2006. And certainly, if your bank is one of those on the list, the fact that the other 99 percent of banks is doing fine offers little comfort.

But the numbers also make it clear that banks remain a good place to store your money. Moreover, even if your bank fails, you will get all your money back up to $100,000 immediately. That is no accident. The nation's banking regulators play an important role in ensuring that consumers are well-protected, regardless of the conditions. I hope that more information about

this system—and the backstops it provides in the instance of bank failure—will provide consumers with more confidence in the nation's banks, even in challenging times.

So, what happens when a bank fails?

Decisions about closing banks are made by the individual bank's chartering agency after the bank is determined to be insolvent, which generally means the bank is unable to meet the demands of its depositors under normal operating conditions. For national banks, the chartering agency is the Comptroller of the Currency. State banks are chartered by state banking authorities.

Generally, in the case of a bank approaching failure, a banking regulator has determined that the bank's capital is inadequate. The regulator will ask the bank's directors to increase the capital to certain specifications within a certain period of time, often between 30 and 90 days, depending on the bank's condition and any applicable state laws. At that point, the chartering agency may decide to formally declare the bank insolvent and place it into receivership.

As far as the customers of a failed bank are concerned, the FDIC is the insurance agency. For banks that are FDIC-insured, accounts of up to $100,000 are guaranteed, meaning customers will get their money the next business day. And, in instances where accounts are greater than $100,000, recent history has shown it is highly likely depositors will get most of their money back and some chance they will get it all.

Although the FDIC could take steps such as creating a "bridge bank" to carry on the functions of the closed bank, there are essentially two options considered by the FDIC in the case of a failed bank. One is to simply pay off the insured deposits, liquidate the bank's holdings and then use that money to pay off uninsured deposits, along with any other creditors, in a manner similar to a typical bankruptcy.

History, however, has indicated this course of action is usually not the one followed. The FDIC is required to protect the consumers but at minimal cost to the insurance fund. Most likely, the FDIC's first step will be to attempt to reach a purchase-and-assumption agreement where another financial institution takes over the failed bank, purchasing its assets and assuming some or all of its liabilities including the insured deposits. These efforts are generally successful.

“ More recently, changes are being considered that could be helpful to uninsured account holders. ”

The FDIC holds a list of banks that have indicated they would be interested in bidding to acquire a failing institution. When it becomes clear that regulators will be closing a bank, the FDIC begins a bidding process with these institutions. To offset any difference between assets and liabilities, the FDIC may offer an interest-bearing note to the successful bidder.

In any case, the bid process moves extremely quick in a matter of a few days. Generally, the announcement of a bank's closing and the finalized purchase-and-assumption transaction are announced after the bank closes on a Friday.

insured deposits

Regulators and bank staff then work through the weekend to have the bank ready to open for regular business, under a new name, the following Monday. The terms of any accounts will be unchanged. In fact, the only difference is that customers will now have a new name on their checks and will be doing business with a stronger financial institution—one that has been reviewed by regulators and deemed up to the challenge of acquiring, and turning around, a failed business.

The purchase-and-assumption transactions can be structured in various ways. For example, the acquiring institution does not necessarily need to assume uninsured deposits. In fact, the acquiring institution must pay a premium for the uninsured deposits, which suggests they need to be judged as deposits that are unlikely to depart the new owner soon after the acquisition.

More recently, changes are being considered that could be helpful to uninsured account holders. It is also noteworthy that when Mutual of Omaha Bank was selected to acquire First National Bank of Nevada and First Heritage Bank of Newport Beach, Calif., earlier this year, it included all the liabilities, even those deposits above the insurance limit. A Mutual of Omaha executive told *American Banker* the bank was concerned about the negative impact it would suffer if it did not include all deposits.

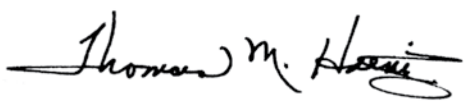
There are other benefits for an acquiring bank to include all deposits under a purchase-and-assumption transaction. The fact that those with accounts exceeding $100,000 may be more likely to be major customers of the bank, and more likely to take all of their business elsewhere if they lose some of their funds, is certainly a consideration.

Although I have offered a general overview of the process involved with a failing bank, I would advise those who may have questions about FDIC coverage to seek more information.

There is an old story about a man who saw on the news that his bank was insolvent and the matter was being handled by the FDIC. He went to the bank excited, telling the cashier that he was there for his money. He was disappointed when the cashier gave him only the $200 he had in his account. He'd heard each account was insured for several thousand dollars and had expected that payout instead of what he had deposited.

There are some complexities in the FDIC rules. For example, a married couple could actually hold three accounts (one under each individual name and one joint account) and have $300,000 in coverage, while IRAs can be eligible for $250,000 in coverage. The FDIC has a feature on its website called the Electronic Deposit Insurance Estimator that you can use to enter your specific information and see what coverage you are afforded. You can find it at http://www.fdic.gov/edie/

I would also encourage you to learn as much as you can about your bank. Most likely you are going to find out you are well-protected.



THOMAS M. HOENIG, PRESIDENT
FEDERAL RESERVE BANK OF KANSAS CITY