

Questions & Answers on the 'Banking Crisis'

Source: 2008 ABA Issue Summary, 'Safety and Soundness of the Banking Industry', 7/15/08

QUESTION: Is there a banking crisis?

ANSWER: Let's set the record straight: The banking industry – traditional federally insured, federally regulated depository institutions which include your local commercial bank, thrift or savings bank -- is safe and sound. And your account in commercial banks, thrifts and savings banks carry FDIC insurance.

QUESTION: How do we know that?

ANSWER: Federally regulated banks are required to employ underwriting practices to avoid losses and to promote safe and sound operations. And when they do not operate appropriately, their regulators, who visit them annually, will take exception to such practices and require corrective action.

QUESTION: Who regulates banks?

ANSWER: That depends on the bank's charter. There are four federal regulators – the Federal Reserve Board; the Comptroller of the Currency; the Office of Thrift Supervision; and the Federal Deposit Insurance Corporation. The FDIC also insures deposits in its member banks up to ~~\$100,000~~ **\$250,000 (Effective October 3, 2008 through December 31, 2009, the FDIC Insurance coverage has been increased from \$100,000 to \$250,000)** for regular accounts and continues to be up to \$250,000 for retirement accounts. That insurance applies to accounts in FDIC member banks that are commercial banks, thrifts and savings banks.

QUESTION: But I'm hearing and seeing so much news that keeps talking about the "banking" crisis. What gives?

ANSWER: The problem is that words matter. And when one word is used to mean several different things, it inevitably creates confusion. For example, we know what a bank is. But sometimes a business that wants to add status to its name will call itself a "bank" even though it is not an insured depository institution—such as a commercial bank, thrift or savings bank.

Bear Stearns, the investment house headquartered in New York City, was not a commercial bank. It was an investment "bank."

The word "bank" is also applied to mortgage firms. Their function, their purpose and their regulation differ from federally insured depository institutions. And in this time of market turmoil, it is worthwhile remembering that only commercial banks, thrifts and savings banks carry FDIC insurance.

QUESTION: Market turmoil makes me nervous. What's the banking system – the federally regulated banks you mentioned – doing about it?

ANSWER: They are providing stability. Having a safe and sound banking system to rely on shows the importance of the role banks play in our local communities and in our nation's economy. They are the source of stability and of growth. That is true regardless of their asset size, their charter or their business plan. And the vast majority of federally regulated, federally insured banks today hold more capital than the law requires.

QUESTION: So, how did those other institutions get in trouble?

ANSWER: Today's crisis underscores the fact that there are two ways financial institutions can fail. They can fail due to capital insolvency, or because they are liquidity insolvent. What many of those institutions are experiencing now is a lack of liquidity, not a lack of capital. Capital remains strong -- strong for investment banks as well as for commercial banks and thrifts.

The liquidity crisis that we have seen on Wall Street comes from a crisis of confidence. In the 1930s, before deposit insurance, banks failed because of a crisis of confidence that led to liquidity insolvency. That can also happen to an investment "bank" such as Bear Stearns. There is a crisis of confidence, lending lines are pulled, liquidity evaporates and insolvency is inevitable.

QUESTION: What's being done to help those other institutions, and to help the economy?

ANSWER: We all know that our financial system is being tested. But let us also remember that the system is showing its resiliency. Let me give you some examples:

- The Federal Reserve Board has acted to help restore liquidity by assuring everyone that they are responding to the problems in a measured way. The Fed's action in regard to Bear Stearns is one example. In addition, the Fed opened up its lending facility known as the discount window to Wall Street firms, and is taking steps to restore liquidity to the markets.
- In addition, the Office of Federal Housing Enterprise Oversight has reduced the capital surcharge imposed on Fannie Mae and Freddie Mac so they can buy an additional home mortgages.
- And the Federal Housing Finance Board will allow the nation's 12 Federal Home Loan Banks to provide greater liquidity in the mortgage markets.

QUESTION: I keep seeing headlines and hearing news reports that repeat the word "crisis" – the "subprime crisis."

ANSWER: Keep in mind that those reports overlook the fact that the subprime lending crisis was caused by unregulated brokers and Wall Street institutions themselves, sometimes using the title "bank," and not by regulated, insured banks.

Our banking system is strong. This crisis will pass, as have all the others, and the result will be a stronger financial system with fewer unregulated players and a reminder that liquidity and capital are both important to solvency.

Excerpts from: 'Bank Safety & You. Federally insured banks and savings institutions offer safety and security for your savings. Here's what you need to know.'
Source: American Bankers Association, 2008

- Deposits in an FDIC-insured bank or savings institution couldn't be safer.
- The FDIC insurance fund is well-capitalized.
- Capitalization of the Deposit Insurance Fund is now over \$50 billion in reserves.
- **Not even one penny of insured savings has ever been lost by a customer of a federally insured bank!**
- The fund protecting federally insured banks and savings institutions is backed by the full faith and credit of the United States Government. Congress created the Federal Deposit Insurance Corporation in 1933 to restore public confidence in the nation's banking system.
- Banks and savings institutions maintain capital reserves and observe lending policies that aid in protecting those reserves. This is one reason why they continue to hold up well in periods of tight credit and financial turmoil.
- The FDIC insures deposits at the nation's 8,560 banks and savings associations and it promotes the safety and soundness of these institutions by indentifying, monitoring and addressing risks to which they are exposed.
- The FDIC receives no federal tax dollars – insured financial institutions fund the FDIC's operations.

Wondering if all your bank deposits are covered by insurance?

Let EDIE provide the answer at <http://www.fdic.gov/edie/>. The FDIC provides this interactive application that can help you learn about deposit insurance. It allows you to calculate the insurance coverage of your accounts at each FDIC insured institution.

Also, to help respond to customer questions about FDIC insurance, consumers may call the FDIC's consumer hotline at 877-275-3342. This is a toll-free line to reach a live FDIC representative who can answer questions about deposit insurance.