the LEDGER

economic education newsletter

A Sure Thing

People who visit the Federal Reserve Bank of Boston often ask if the Fed and FDIC are one and the same. In response to their questions, this article describes how the FDIC helps to promote and maintain a sound banking system. Future Ledger articles will focus on the Federal Home Loan Bank Board and its deposit-insurance arm, FSLIC; as well as on the National Credit Union Administration.

Several passages in this piece are taken directly from two excellent sources: **FDIC, Symbol of Confidence,** *a clearly written 26-page pamphlet published by FDIC; and* **American Banker,** *a daily banking newspaper. Many thanks to both.*

Bank run in the early 1900s *Courtesy, Library of Congress*

The Federal Deposit Insurance Corporation has protected bank deposits since 1934. In all that time, no one has lost money in an FDIC-insured account.

Prior to the advent of Federal deposit insurance, however, bank failures claimed the savings of all too many depositors. Money in the bank was protected by little more than the bank manager's expertise and good name. Prudent souls often kept part of their savings buried in the backyard or hidden in the mattress.

Between 1886 and 1933, there were several unsuccessful attempts to introduce national deposit insurance. Despite tragic and widespread losses, the public seemed willing to live with the status quo.

Then came the Great Depression of the 1930s. Hard times and financial pressures triggered an unprecedented number of bank failures. Panic swept the country. Anxious depositors lined-up outside their banks and waited for a chance to convert their deposits to cash. Many waited in vain. Thousands of banks closed their doors forever, and losses ran into the millions of dollars.

The human suffering was incalculable. Panic turned to despair, and a stunned nation looked to Washington for help.

In response to the crisis, Congress passed the Banking Act of 1933, a landmark piece of legislation that chartered the Federal Deposit Insurance Corporation and established deposit insurance on a national basis. This action, along with other changes in the law, helped to restore public confidence in the banking system. Bank failures declined from approximately 4,000 in 1933 to 61 in 1934.

When the FDIC opened for business on January 1, 1934, Federal law provided deposit insurance coverage of up to $2,500 per depositor. Since then, the level of coverage has kept pace with the changing times. Today some 15,000 commercial banks and mutual savings banks display a sticker that reads, "Each depositor insured to $100,000." If an FDIC-insured bank fails, a depositor's savings, checking, and other deposit accounts are added together and protected up to $100,000. Joint accounts and individual accounts are separately insured. Holders of Keogh Plan Retirement Accounts and Individual Retirement Accounts receive separate $100,000 coverage as well. A depositor may obtain additional coverage by opening accounts at different insured banks but not at different branches of the same bank.

Depositors in FDIC-insured banks automatically receive deposit insurance protection at no extra charge. Each bank pays for the cost of insur-

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ance through annual assessments based on its deposit volume. (Since 1961, the annual effective net assessment rate has ranged between 1/30 and 1/24 of one percent of average deposits.) These assessments are paid into a deposit insurance fund and invested in U.S. Government securities. Interest income from these investments is added to the insurance fund. In December 1981, the fund balance stood at approximately $12.2 billion.

Money from the deposit insurance fund covers losses sustained only through the closing of an FDIC-insured bank. Over the years, FDIC supervisory operations have helped to keep such closings to a minimum. From 1934 to 1981, fewer than 600 FDIC-insured banks closed because of financial difficulties. (By comparison, bank failures averaged 588 **per year** during the pre-FDIC 1920s.)

The general policy of FDIC is to examine each bank under its jurisdiction at least once every 18 months. Banks with known supervisory or financial problems receive a full-scale examination at least once every 12 months. In either case, examiners pay particular attention to adequacy of a bank's capital, the quality of its assets, the availability of adequate funds, the use of sound accounting procedures, and the overall quality of a bank's management. Each examination report also notes any unacceptable banking practices or violations of law and suggests corrective steps.

Should a bank persist in following unsound or illegal practices, the FDIC may initiate proceedings to issue a cease-and-desist order against the bank or one or more of the bank's officers. In certain cases, the FDIC may even initiate proceedings to terminate a bank's insurance. However, termination of a bank's insurance is extremely rare, and even if insurance is terminated, existing deposits continue to be insured by the FDIC for two years.

By keeping a close watch on each insured bank, the FDIC seeks to avert situations that might lead to bank closings. Banks, however, are subject to many of the same uncertainties that confront other business enterprises, and sometimes they are forced to close. Should a bank fail, the FDIC is ready to respond as soon as a bank's chartering authority closes the institution. (The chartering authority is either the State, or in the case of a national bank, the Comptroller of the Currency.)

PAYOUT — Penn Square Bank, N.A. — Oklahoma City, Oklahoma

Friday, July 2, 1982
American Banker

Reports were circulating in Oklahoma City Thursday that the Federal Deposit Insurance Corporation is dispatching examiners to review the financial condition of Penn Square Bank, N.A.

Tuesday, July 6, 1982
American Banker

The controversy surrounding Penn Square Bank, N.A. of Oklahoma City heated up Friday, as reports circulated about high-level regulatory meetings taking place to assess the need for possible supervisory action. . . . Informed Washington banking sources said a high-level meeting took place Friday in Washington involving representatives of the Office of Comptroller of the Currency and the Federal Deposit Insurance Corporation.

Wednesday, July 7, 1982
American Banker

In a move that has occurred only twice before in the 50-year history of the Federal Deposit Insurance Corp., the deposit insurance agency Monday formed the Deposit Insurance National Bank, this time to assume the deposits of the failed $460 million-deposit Penn Square Bank, N.A. . . .

The new institution opened at 9:00 a.m. Tuesday to begin paying off insured depositors and will remain open until that is accomplished.

Penn Square, which had about 80% of its own portfolio in energy loans and which sold more than $2 billion in participations to several large banks, was declared insolvent at 7:05 p.m. Monday, by Comptroller of the Currency, C.T. Conover, who named the FDIC receiver.

It thus became the largest payout in the history of FDIC and the fourth largest commercial bank failure in history. It was the 16th commercial bank failure this year. . . .

One elderly woman, asked if she had any concern about her money, said, "I have confidence in what the gentleman said on TV this morning." The gentleman was William M. Isaac, chairman of the Federal Deposit Insurance Corporation, who called a 7:30 a.m. news conference to reassure the public that their deposits up to $100,000 would be safe . . .

. . . however, the insurance agency said it would guarantee full payment only up to the $100,000 insurance limit. Larger depositors have been put on the same footing with the failed bank's creditors and, in all likelihood, will receive less than 100% on the dollar.

In most cases, the FDIC tries to arrange a "purchase and assumption" transaction. A new or existing bank takes over many of the failed bank's assets and assumes its deposits. The FDIC then takes over any assets the acquiring bank may not want (bad loans and investments, for example) and tries to liquidate those assets. Purchase and assumption transactions often take place with no interruption of banking services.

If a purchase and assumption cannot be arranged, the FDIC immediately pays each depositor up to the insurance limit. A payout begins within days of a bank's closure. Deposits in excess of the insurance limit are unprotected, but holders of these deposits are sometimes paid out of proceeds realized from liquidation of the bank's assets.

During 1982, two bank closings figured prominently in the news. One involved a direct payout. The other involved a purchase and assumption transaction. Both cases illustrate how the FDIC works to maintain the stability of the American banking system.

the LEDGER

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Monday, July 12, 1982
American Banker

The FDIC has customarily arranged for another bank to assume the deposit liabilities of a failed institution, in effect guaranteeing all deposits - even those in excess of the fund's $100,000 insurance limit.

The FDIC said several factors made this impossible in the Penn Square situation: the extreme financial weakness of the bank; the likelihood that the bank had substantial contingent liabilities that will surface in the future; and the fact that, as a unit banking state, Oklahoma does not have many banking companies that could absorb a half-billion dollar company.

PURCHASE AND ASSUMPTION — Abilene National Bank — Abilene, Texas

Thursday,
July 14, 1982
American Banker

Abilene National Bank - a $428 million deposit energy lender in Abilene, Texas - nearly became a casualty of the fallout from the failure of Penn Square Bank.

Depositor nervousness, coupled with rumors and local press coverage, caused a run on the bank that drained almost 10% of its deposits since Friday. . . .

The bank was hurt because of public comparisons of its energy loan portfolio with that of the Oklahoma City bank.

Tuesday,
August 10, 1982
American Banker

The latest commercial bank to fail was the $450 million-asset Abilene National Bank in Abilene, Texas. Its failure, the second largest of a commercial bank this year, occurred less than six weeks after the collapse of Penn Square Bank of Oklahoma City . . . .

. . . the Federal Reserve Board late Friday was approving the acquisition of Abilene National Bank by the Mercantile Texas Corp., a $6.8 billion-asset, Dallas based holding company.

The Federal Deposit Insurance Corp., at that time announced that it would provide financial assistance to facilitate the acquisition. . . .

The FDIC board acted to grant financial assistance for the acquisition by Mercantile following notification by the Comptroller of the Currency that the bank was in imminent danger of failing.

The federal insurer decided to help keep the bank open rather than close it and pay off the depositors, because the former option was less costly.

The assistance to Mercantile consists of a five-year, $50 million deposit. The bank does not have to pay interest on the deposit for the first two years; during the final three years, interest must be paid semiannually at the prevailing rate on one-year Treasury bills.

MEMBERS OF A ROCK GROUP decide on the best way to save money for new outfits in "Let's Save/Opportunity Costs," Give & Take, Program 3.

Courtesy, Joint Council on Economic Education

Multi-Media

GIVE & TAKE IN THE SCHOOLS

Some students will see a lot of **Give & Take** in the classroom this fall, thanks to another combined effort by the Joint Council on Economic Education, the Canadian Foundation for Economic Education, and the Agency for Instructional Television. The creators of **Trade-offs,** the widely acclaimed economic education video series for fifth and sixth graders, recently completed extensive testing on **Give & Take,** a new video series designed to "improve the economic reasoning and decision-making skills," of eighth, ninth, and tenth graders.

The $1.7 million project applies economic principles to everyday problems. Twelve 15-minute programs concentrate on such areas as managing personal resources and making career choices. Each program presents students with an open-ended economic problem or situation. "We're not teaching answers," explains Dr. Phillip Saunders, chief consultant for **Give & Take.** "We do hope that as a result of the series, students will be more equipped to debate these economic issues intelligently in terms of analysis rather than slogan."

The series' design allows teachers and students considerable flexibility. They need not use every program, nor view the programs in sequence. Each program has independent instructional objectives.

Program Three, for example, focuses on members of a rock band who must determine the best way to save money for new outfits. The program is called "Let's Save," and its goal is to help students apply the concepts of opportunity costs and trade-offs to the areas of spending and saving. The objectives for "Let's Save" stipulate that students will, among other things: 1) "define opportunity costs as the loss of the next most desirable alternative when limited resources are used for one purpose instead of another," and 2) "describe how saving involves foregoing spending in hopes of having larger amounts of money to spend tomorrow." Students are also asked to give examples of various forms of saving and explain how all savings decisions involve trade-offs among risk, liquidity, and return.

The people who developed **Give & Take** also recognize that the series' suc-

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cess hinges on how teachers use the program in the classroom. As part of an overall effort to promote effective use of **Give & Take,** the Economic Education Council of Massachusetts will offer regular in-service workshops at no charge. Teachers may choose between a basic, half-day session and a more extensive 15-20 hour workshop.

The half-day session uses a four-part instructional videotape from the Agency for Instructional Television to introduce teachers to "the rationale, objectives, and content, of **Give & Take.**" The session also explores ways to integrate **Give & Take** programs into other parts of an existing curriculum.

The more comprehensive 15-20 hour workshop consists of twelve modules, one for each program in the **Give & Take** series. Module B, for example, allows workshop participants an opportunity to view "Let's Save" (Program 3) and then review key concepts related to saving and investing. In Massachusetts, the longer workshops will be conducted by the Center Directors at the Centers for Economic Education.

For more information on either the 15-20 hour workshop or the half-day session, please contact:

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Outside Massachusetts, please contact your state Economic Education Council:

- Connecticut Joint Council on Economic Education
  U-55 University of Connecticut
  Storrs, CT 06268
  (203) 486-3565

- Maine Council on Economic Education
  University of Maine at Orono
  30 Coburn Hall
  Orono, ME 04469
  (207) 581-7069

- New Hampshire Council on Economic Education
  State of New Hampshire Dept. of Education
  64 N. Main Street
  Concord, NH 03301
  (603) 271-3609

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  Rhode Island College
  Dept. of Economics & Management
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- Vermont Council on Economic Education
  Vermont Economic Education Project
  Vermont State Dept. of Education
  Montpelier, VT 05602
  (802) 828-3111

New England Update

CONNECTICUT

The Center for Economic Education/Central Connecticut State College will begin a "Distinguished Speakers Series" on October 18 at the Center's 33rd annual meeting. The series will focus on *Socio-Economic Issues of Our Times.* Frank E. Morris, President of the Federal Reserve Bank of Boston, is the inaugural speaker. His topic is "Economic Issues - Election '82." The series will also feature:

February 7, 1983	Lester C. Thurow Author, ***Zero Sum Society*** "Economic Survival in the '80s"
April 4, 1983	Lindley H. Clark Economic News Editor, ***Wall Street Journal*** "Recording America's Priorities"

For more information please contact the Center for Economic Education, Marcus White Hall, Room 117, Central Connecticut State College, New Britain, CT 06050.

MASSACHUSETTS

The Economic Education Council of Massachusetts will hold its fall meeting on Monday, November 8, 1982 at the 4-H Center in Ashland. The program will feature Ed Berger, stock market consultant and well-known radio/TV financial reporter. Mr. Berger, a trustee of the Council, will share his views on the communication of economic concepts in the 1980s.

In addition, Program Committee chairperson Dick Barrows, will discuss plans for teacher training in the use of **Give & Take,** the new economic education video series. Trustee Bob Littlefield of the Bancroft School in Andover will describe the Children's Economy curriculum he developed for 5th and 6th graders. Loren Robbins, art education coordinator in the Carlisle Public Schools will also be on the program.

Dinner will cost $8.00 per person. For more information, please contact the Economic Education Council of Massachusetts, 19 Fort Hill Street, Hingham, MA 02043, (617) 749-8466.

Bob Reinke recently became director of the National Center of Economic Education for Children at Lesley College in Cambridge, MA.

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