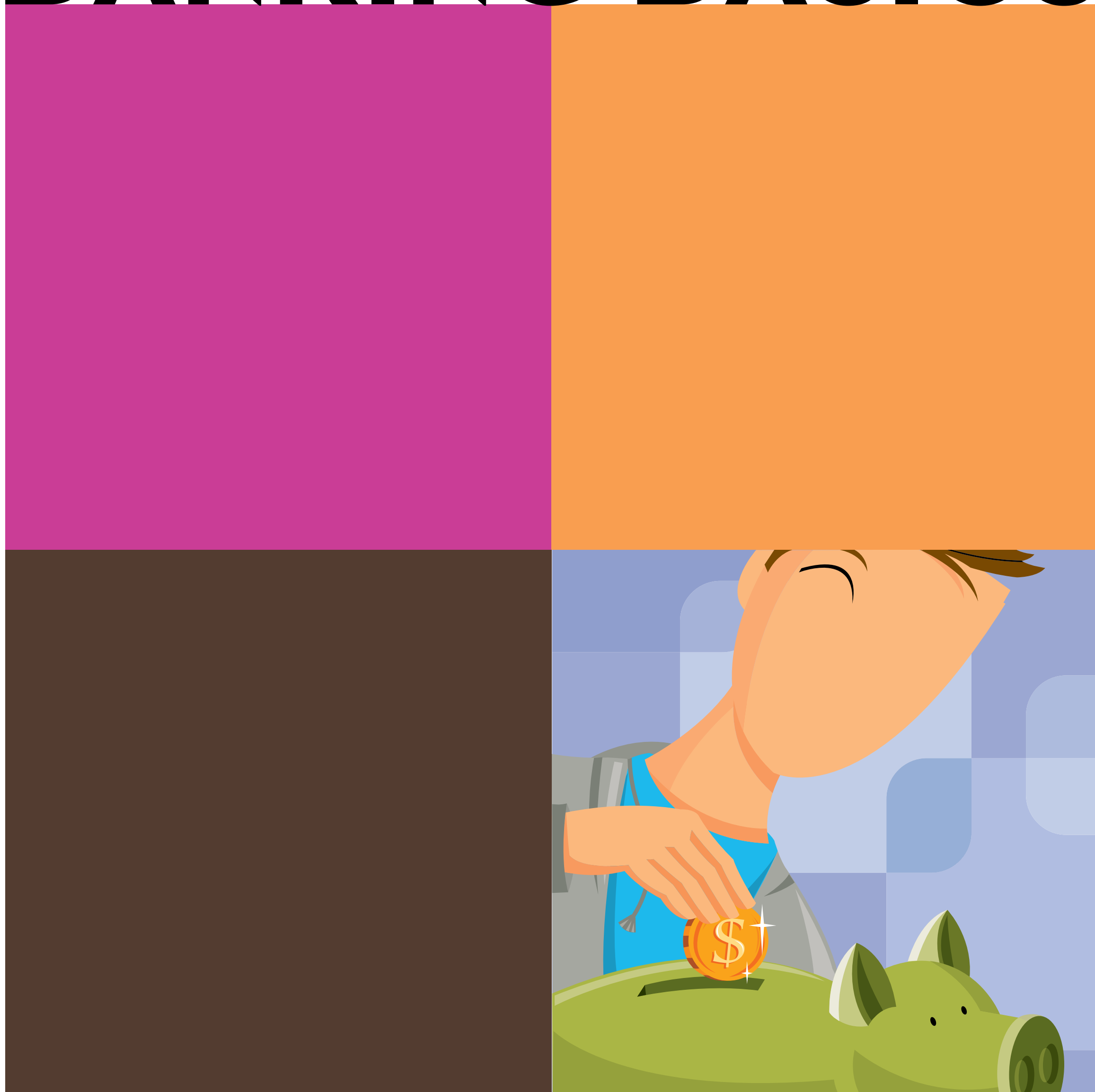
Banking Basics



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Introduction

Some young savers stash their cash in shoe boxes or jelly jars. Others use "piggy banks," which today look more like spaceships or cartoon characters.

In any case, the same problem arises. Sooner or later, the piggy bank or jelly jar fills up, and you have to make a decision: Should I spend the money or continue to save? And if I continue to save, should I open a bank account or just find a bigger jar?

Maybe you've had to face such a decision yourself. If you decide to keep your money at home, it will just sit there and won't earn any extra money for you. You also run the risk that a burglar, a fire, or some other disaster will wipe out your savings in the wink of an eye.

Then again, if you open a bank account, you can't "visit" your money as easily as you can when it sits in your dresser drawer. You can't just walk into a bank in the middle of the night to count your cash. You can't run the coins through your fingers or toss the bills in the air and let them rain down on your head.

Opening a bank account is a big step because you are putting your money in someone else's hands. You're counting on someone else to handle your money responsibly. Before you do that, it might be a good idea to understand how banks operate.

That's the purpose of this pamphlet. It won't tell you everything there is to know about banks and banking, but we hope it will be a good basic introduction.

What is a bank?

A bank is a business. But unlike some businesses, banks don't manufacture products or extract natural resources from the earth. Banks sell financial services such as car loans, home mortgage loans, business loans, checking accounts, credit card services, certificates of deposit, and individual retirement accounts.

Some people go to banks in search of a safe place to keep their money. Others are seeking to borrow money to buy a house or a car, start a business, expand a farm, pay for college, or do other things that require borrowing money.

Where do banks get the money to lend? They get it from people who open accounts. Banks act as go-betweens for people who save and people who want to borrow. If savers didn't put their money in banks, the banks would have little or no money to lend.

Your savings are combined with the savings of others to form a big pool of money, and the bank uses that money to make loans. The money doesn't belong to the bank's president, board of directors, or stockholders. It belongs to you and the other depositors. That's why bankers have a special obligation not to take big risks when they make loans.

How do people start banks?

The process of starting a bank varies from state to state, but, in general, here's how it goes:

1. A group of individuals decides to start a bank. Their first step is to apply for a charter from their state banking commission.* The charter sets out the rules for how they must operate their bank.

2. The banking commission reviews the application to make sure it is complete and then schedules a hearing.

3. The commission looks at the financial condition and the character of the applicants.

4. After that, the banking commission will either approve the application or deny it.

5. If approved, the group that applied to start the bank will then have a certain amount of time to raise the necessary capital, put together a full management team, and obtain federal deposit insurance.

6. When that's done, the group will notify the banking commission, which will then review the list of proposed investors. If the commission has no objection to the list, if the bank is insured, and if an acceptable management team is in place, the commission will issue its final approval and the bank may open for business.

How did banking begin?

Imagine for a moment that you are a merchant in ancient Greece or Phoenicia. You make your living by sailing to distant ports with boatloads of olive oil and spices. If all goes well, you will be paid for your cargo when you reach your destination, but before you set sail you need money to outfit your ship. And you find it by seeking out people who have extra money sitting idle. They agree to put up the money for your voyage in exchange for a share of your profits when you return . . . if you return.

The people with the extra money are among the world's first lenders, and you are among the world's first borrowers. You complain that they're demanding too large a share of the profits. They reply that your voyage is perilous, and they run a risk of losing their entire investment. Lenders and borrowers have carried on this debate ever since.

Today, people usually borrow from banks rather than wealthy individuals. But one thing hasn't changed: Lenders don't let you have their money for nothing.

Lenders have no guarantee that they will get their money back. So why do they take the risk? Because lending presents an opportunity to make even more money.

For example, if a bank lends $50,000 to a borrower, it is not satisfied just to get its $50,000 back. In order to make a profit, the bank charges interest on the loan. Interest is the price borrowers pay for using someone else's money. If a loan seems risky, the lender will charge more interest to offset the risk. (If you take a bigger chance, you want a bigger pay-off.)

But the opportunity to earn lots of interest won't count for much if a borrower fails to repay a loan. That's why banks sometimes refuse to make loans that seem too risky. Before lending you money, they look at:

- how much and what types of credit you use, such as credit cards, auto loans, or other consumer loans;
- whether or not you have a history of repaying your loans, and
- how promptly you pay your bills.

Banks also use interest to attract savers. After all, if you have extra money you don't have to put it in the bank. You have lots of other choices:

- You can bury it in the backyard or stuff it in a mattress. But if you do that, the money will just sit there. It won't increase in value, and it won't earn interest.
- You can buy land or invest in real estate. But if the real estate market weakens, buildings and land can take a long time to sell. And there's always the risk that real estate will drop in value.
- You can invest in the stock market. But like real estate, stocks can also drop in value, and the share price might be low when you need to sell.
- You can buy gold or invest in collectibles such as baseball cards, but gold and collectibles fluctuate in value. Who knows what the value will be when it's time to sell? (In 1980, gold sold for $800 an ounce. By1983, the price had sunk below $400.)

Or you can put the money in a bank, where it will be safe and earn interest. Many types of bank accounts also offer quick access to your money.

INTEREST IS THE PRICE BORROWERS PAY FOR USING SOMEONE ELSE'S MONEY.

Why are there so many different types of banks?

Not all banks are exactly the same. There are commercial banks, savings banks, savings and loan associations (S&Ls), cooperative banks, and credit unions. Today they offer many of the same services, but at one time, they were very different from one another.

Commercial banks originally concentrated on meeting the needs of businesses. They served as places where a business could safely deposit its funds or borrow money when necessary. Many commercial banks also made loans and offered accounts to individuals, but they put most of their effort into serving business (commercial) customers.

Savings banks, S&Ls, cooperative banks, and **credit unions** are classified as thrift institutions or "thrifts," rather than banks. Originally, they concentrated on serving people whose banking needs were ignored or unmet by commercial banks.

The first **savings banks** were founded in the early 1800s to give blue-collar workers, clerks, and domestic workers a secure place to save for a "rainy day." They were started by public-spirited citizens who wanted to encourage efforts at saving among people who did not earn much money.

Savings and loan associations and **cooperative banks** were established during the 1800s to help factory workers and other wage earners become homeowners. S&Ls accepted savings deposits and used the money to make loans to home buyers. Most of the loans went to people who did not make enough money to be welcome at traditional banks.

Credit unions began as a 19th-century solution to the emergency needs of people who were unable to borrow money from traditional lenders. Before the opening of credit unions, ordinary citizens had no place to turn when they faced unexpected home repairs, medical expenses, or other emergencies. Credit unions were started by people who shared a common bond such as working in the same factory, belonging to the same house of worship, or farming in the same community. Members pooled their savings and used the money to make small loans to one another.

Although there are still differences between banks and thrifts, they now offer many of the same banking services to their customers. Most commercial banks now compete to make car loans. Many thrift institutions have begun to make commercial loans, and some credit unions make loans to home buyers.

Credit unions were started by people who shared a common bond. Members pooled their savings and used the money to make small loans to one another.

How do I choose a bank?

Back in the 1950s, banks often gave away toasters to new depositors, and that made choosing a bank simpler. You went to the one that gave away the best toaster.

Today banks rarely give away toasters, and choosing a bank is a little more complicated. For starters, you should shop around to find out which banks offer the best services and the lowest fees. Some banks charge a monthly fee if your account falls below a certain level, and that fee can be higher than the interest your account earns. Other banks may charge fees for many types of transactions. You don't want that.

In certain states, such as Massachusetts, the law prohibits banks from charging fees on savings accounts held by people under the age of 18 or over the age of 65. Find out if your state has such a law.

Other things you might want to consider:

1. Does your bank pay depositors a competitive interest rate?

2. Is the bank in a convenient location and are its business hours convenient for you?

3. Is your deposit insured by the FDIC (Federal Deposit Insurance Corporation)?

4. Is the bank a good corporate citizen? Does it invest in your neighborhood?

5. And last, but certainly not least, does your bank provide courteous and efficient service?

Before you open an account, ask a few people if they are happy with their bank. And do some comparison shopping because all banks are not the same.

What types of accounts do banks offer?

People use banks for different purposes. Some have extra money to save; others need to borrow. Some need to manage their household finances; others need to manage a business. Banks help their customers meet those needs by offering a variety of accounts.

Savings accounts are for people who want to keep their money in a safe place and earn interest at the same time. You don't need a lot of money to open a savings account, and you can withdraw your money easily.

Certificates of deposit (CDs) are savings deposits that require you to keep a certain amount of money in the bank for a fixed period of time (example: $1,000 for two years). As a rule, you earn a higher rate of interest if you agree to keep your money on deposit longer, and there is usually a penalty if you withdraw your money early.

Individual retirement accounts (IRAs) are savings deposits that offer an excellent way to save for your later years. You don't have to pay tax on the money you deposit in your IRA until you withdraw it. But there is often a significant penalty if you withdraw your funds before you reach a specified age (usually 59 or older).

Checking accounts offer safety and convenience. You keep your money in the account and write a check when you want to pay a bill or transfer some of your money to someone else. If your checkbook is lost or stolen, all you need to do is close your account and open a new one so that nobody can use your old checks. (When cash is lost or stolen, you rarely see it again.) Another attractive feature of a checking account is that your bank sends you a monthly record of the checks you have written, and you can use that record if ever need to prove that you've made a payment. Banks sometimes charge a fee for checking accounts, because check processing is costly.

Many banks also offer no-fee checking and checking accounts that earn interest if you agree to keep a certain amount of money—a minimum balance—in the account. But these accounts are limited to non-business customers. Banking laws almost always require businesses to use regular checking accounts that do not pay interest.

Money market deposit accounts are similar to checking accounts that earn interest, except that they usually pay a higher rate of interest and require a higher minimum balance (often $2,500 or more). They also limit the number of checks you can write per month.

Finally, banks do not always call their accounts by the same names. Often, they choose distinctive names in hopes of attracting customers. But there can be a real difference between one bank's accounts and another's, so shop around.

BANKS SOMETIMES CHARGE A FEE FOR CHECKING ACCOUNTS, BECAUSE CHECK PROCESSING IS COSTLY.

Is it difficult to open a bank account?

You've finally decided to take the plunge. With your cash tucked deep in your pocket, you walk into the bank and ask to open a savings account.

The bank's receptionist directs you to a desk where a customer service representative will help you with the paperwork. To your surprise, the only form you need to fill out is a signature card, which requires you to sign your name and then print your name, address, telephone number, date of birth, social security number, and your mother's maiden name (as a means of further identification). After you complete the signature card, you receive a bank book (sometimes called a passbook) that lists your account balance (the total amount of money in your account).

Whenever you make a deposit (put money in) or a withdrawal (take money out), the transaction is recorded in your bank book. It is very important for you to keep track of the activity in your account.

You don't need lots of money to start a savings account. Some banks let you open one with as little as $20. Nor do you need to wait until you are 18 years old. In most cases, you can open a savings account as soon as you are old enough to sign your name, or even earlier than that if you open the account with a parent or guardian.

What happens to money after you deposit it?

What happens to a $10 bill after you deposit it in your savings account? Does the bank teller take it to a vault and put it into a separate compartment or cubbyhole marked with your name and account number? No.

The bank begins by adding $10 to the amount that is already in your account (your existing balance). Your $10 deposit and your new balance are then recorded in your bank book and in the bank's computer system. The $10 bill you deposited is mixed in with all the other cash your bank receives that day.

When you and other customers deposit money in a bank, the bank "puts most of it to work." Part of the money is set aside and held in reserve, but much of the rest is loaned to people who need to borrow money in order to buy a house or a car, expand a business, buy farm equipment, or do any of the other things that require people to borrow money.

Of course, banks do not lend money just to provide a service. They do it to make money. Here's how it works.

When you keep your savings in a bank, the bank pays you extra money, which is called interest. The interest is added to your account on a regular basis, usually once a month.

Let's say a bank pays its depositors interest of 3 percent a year on their savings. In simple terms, that means if you keep $100 in your savings account, the bank will add $3 to your account balance during the course of a year.

But, there is another side to interest. When someone borrows money from a bank, the bank charges interest, and it charges borrowers a higher rate than it pays savers. For example, it might pay savers 3 percent and charge borrowers 8 percent. The difference, 8 percent minus 3 percent, goes to the bank. Charging interest on loans is one of the main ways for a bank to make money.

The rate of interest a bank charges depends largely on two things:

- how many people want to borrow money, and
- how much money banks have available to lend.

If a bank has plenty of money to lend, and the demand to borrow money is not particularly strong, interest rates will tend to be low in order to attract borrowers. But when banks have a smaller amount of money to lend, and the demand to borrow is fairly strong, interest rates will rise. As a depositor, you want interest rates to be high, but as a borrower, you want them to be low.

When it comes to paying interest on savings deposits, there usually isn't a big difference between banks. They pay just enough to stay competitive with one another and attract depositors. So, if one bank is offering a much better (higher) rate than most other banks, try to find out why. And remember the old saying: *If something sounds too good to be true, it probably is.*

AS A DEPOSITOR, YOU WANT INTEREST RATES TO BE HIGH, BUT AS A BORROWER, YOU WANT THEM TO BE LOW.

What happens when you apply for a loan?

Last week your mechanic advised you not to spend any more money on the faithful old car that has carried you over many miles of highway. The time has come to shop around for a new one. But cars were a lot cheaper when you last bought one. This time you'll have to take out a big loan.

You don't necessarily have to borrow from the bank where you have an account. You should shop around for a lender that offers the best deal, including the lowest interest rate. Sometimes car companies offer low-interest, or even no-interest loans. And don't forget the internet. You can research a wealth of online resources from the comfort of your home or office.

Your first step is to figure out how much you can afford to borrow. You will not know if you can afford the new car—or if a lender will let you borrow the amount want—until after you complete a loan application. In addition to routine personal information such as your name, address, telephone number, and Social Security number, a loan application also asks for information on how much money you earn, how long you have worked at your current job, and how much money you already owe on credit card bills and other debts.

The next step is for the lender to evaluate your application and decide if you are a "good risk." Before they lend you money, lenders want to be as certain as possible that you will be able to pay them back. Do you earn enough money to keep up with your loan payments? Do you have a history of paying your debts on time? To answer these questions, lenders rely heavily on credit bureaus and credit reports. There are approximately 1200 local and regional credit bureaus in the United States. All are private companies (not government agencies), and most are linked by computer to three nationwide credit bureaus. They provide much of the information that lenders need to evaluate loan applications.

When you apply for a loan, your bank contacts a credit bureau and asks for a copy of your credit report, which is basically a summary of your payment habits—information about loans, charge accounts, credit card accounts, bankruptcies, and court judgments that might require a potential borrower to pay a large sum of money as a settlement. How the information gets into your credit report is no mystery. When you apply for a new charge account or credit card, clerks transfer information from your application to electronic records that are forwarded to one or more of the nationwide credit bureaus. If you are late in paying your bills, or if you miss a payment, the information goes into your credit report. Lenders then evaluate your report and try to decide if you are a "good risk."

After weighing all the information, your bank will either approve or deny your loan request. If your request is denied, the bank must notify you in writing within 30 days, and the letter must state the reason for denying your loan. If your loan is approved, the bank will give you a check made out to your auto dealer or transfer the funds to your account. To protect itself in case you fail to repay the loan, your bank will hold the legal title (ownership papers) to your purchase until you pay off the loan.

Before applying for a loan, you should request a copy of your credit report. If there are any issues or questions, you may be able to address them before processing a loan application. You are entitled to a free copy of your credit report, at your request, once every 12 months. For more information on how to request a copy, visit the Federal Trade Commission website at http://www.ftc.gov

Before applying for a loan, you should request a copy of your credit report.

What are checks, and how do they work?

You reach for your wallet and it's not there. Panic gives way to despair when you realize that your wallet is gone and so is your cash. Chances are you'll never see the cash again.

The consequences are not nearly as serious if you lose your checkbook. All you do in that case is close your checking account and open a new one. After that, your lost or stolen checks are worthless to anyone who might try to use them.

Because they are safe and convenient, checks have become a popular method of paying for things or transferring money. But what exactly is a check?

In simple terms, a check is a written set of instructions to your bank. When you write a check, you are instructing your bank to transfer a specific amount of money from your checking account to another person or an organization. You can even write a check to convert some of the money on deposit in your checking account into cash.

When you fill in the blank spaces on one of your checks, you are telling your bank three things: 1) how much of your money you want to transfer, 2) when you want to transfer it, and 3) to whom you want it to go. You authorize the transfer by signing the check.

So, if your favorite aunt sends you a $50 check for your birthday, she's actually telling her bank to transfer $50 from her account to you. But when you go to cash her check or deposit it in your account, how does your bank know if your aunt actually has enough money in her account to cover the check?

The answer to this question isn't what it used to be.

Up until 2004, the check had to travel all the way back to your aunt's bank by truck or by plane. If there was enough money in her account to cover it, her bank would "clear" the check. If there wasn't enough, her bank would stamp it "NSF"—Not Sufficient Funds—and "bounce" it back to your bank. And on top of all that, your aunt's bank had to send her cancelled checks back to her every month, along with her account statement.

All that paperwork might have been OK back in 1940, or even 1970, when Americans wrote fewer checks. But as checks became more popular, banks spent more and more time and money moving billions of pieces of paper around the country each year—not the best use of resources, especially when new technology offered a more efficient way to do things.

In 2004, Check 21 went into effect. The new federal law made it possible for banks to handle more checks electronically. Instead of physically moving checks from one bank to another, banks can now electronically transmit images of the checks they process. It's a lot faster and less costly.

For more information on checks, visit www.federalreserve.gov/paymentsystems.

Instead of physically moving checks from one bank to another, banks can now electronically transmit images of the checks they process.

What is electronic banking?

The bank closes in ten minutes. Even if you make it there in time to cash your check, your nerves will be frazzled. Isn't there an easier way?

Yes, there is. Electronics and computers have turned banking into a round-the-clock business. Automated teller machines (ATMs) now make it possible for you to do much of your banking whenever you choose.

ATMs are computers that are much like limited-service bank branches. You can use them to make a withdrawal, make a deposit, make a loan payment, transfer money from one account to another, or check your account balance. In many cases, automated teller machines of different banks are linked together in networks so you can use them when you travel to a different part of town, another state, or even another country. All you need is a plastic card from your bank and your own password.

Tired of rushing to the bank to cash your paycheck? Ask your employer about direct deposit, a banking service that makes it possible for you to have your money electronically added to your checking account every payday. Instead of receiving a paycheck, you receive a statement that tells you your money has been deposited in your account. Direct deposit is popular among people who receive Social Security checks or pension checks because it saves them the bother of standing in line at the bank, battling bad weather, or worrying about being robbed on the way home from the bank.

Another electronic banking service is called electronic funds transfer, or EFT. By using EFT, a bank can transfer large amounts of money to another bank by sending an electronic message. Electronic transfers take only an instant. An electronic message instructs a computer to deduct a certain amount of money from one bank account and then add the same amount to another bank account. The message is sent, and the appropriate amount is transferred. No cash or paper changes hands, but money is transferred just the same.

Technology has made it possible to bank from the comfort of your own home. Banks offer software packages that allow customers to debit or credit their accounts, check their account balances, or even apply for a loan. Consumers can make these transactions online.

There are also "virtual banks" that have no physical bank office in a traditional way. They provide all of their services to their customers over the internet.

Technology has made it possible to bank from the comfort of your own home.

Credit cards, debit cards, stored value cards: What's the difference?

Credit cards are not a form of money, even though people often refer to them as "plastic money." When you use a credit card you are actually taking out a loan—buying something now and agreeing to pay for it later—and sooner or later you will have to pay the bill for all those things you've bought.

Many banks issue credit cards, even to people who aren't regular customers. Before issuing you a credit card, a bank will require you to complete an application form and will examine your credit record to see if you have a history of paying back your debts on time.

Sometimes people run up credit card bills that are too big to pay off every month. When that happens, they must pay a monthly finance charge that can sometimes top 20 percent a year. In addition, banks (and other companies that issue credit cards) sometimes charge their cardholders an annual fee.

They also charge merchants a fee for making the credit card service available. Finance charges, annual fees, and merchant fees have become an important source of income for banks.

Debit cards look like credit cards, but they are very different. When you use a debit card at the gas pump or at a store, the amount of the purchase is electronically deducted from your bank balance. It will show up on your monthly bank statement, but there's no monthly bill because the amount of each purchase is deducted almost immediately from your account.

Some merchants offer you the opportunity to get additional cash back when you pay for a purchase with your debit card. You can also use your debit card at an ATM if you need to withdraw cash from your account, but if the ATM is not part of your bank's network, you may have to pay a fee.

One other major difference between debit cards and credit cards is that you don't have as much legal protection if your debit card is lost or stolen. On a lost or stolen credit card, the most you're responsible for is $50. But if someone steals your debit card, you could be responsible for up to $500 in fraudulent charges or transfers unless you report the loss or theft of your card within two business days. You risk unlimited loss if an unauthorized charge or withdrawal appears on your statement, and you don't report it within 60 days. So always be sure to check your monthly bank statements!

The card that may come closest to being "plastic money" is the **stored value card**. Gift cards and phone cards are the two types that most people know best. The cards are "loaded" with a certain dollar amount—$10, $50, $100, or any other amount—and that amount decreases with each use. For example, if someone gives you a $50 gift card to Bob's Big Buy, and you buy something there for $30, you will still have $20 "stored" on the card. Two things to keep in mind about stored value cards: 1) You can't use them in as many places as credit cards or debit cards. If you receive a gift card to Bob's Big Buy, that's the only place you can use it, and 2) They really are "just like cash" in that you're pretty much out of luck if they are lost or stolen.

WHEN YOU USE A CREDIT CARD YOU ARE ACTUALLY TAKING OUT A LOAN—BUYING SOMETHING NOW, AND AGREEING TO PAY FOR IT LATER.

Do banks keep large amounts of gold and silver in their vaults?

Today, banks rarely keep gold or silver in their vaults. That's because our paper money is no longer backed by gold or silver, and our coins don't contain precious metal.

The U.S. government still holds millions of ounces of gold and silver, but citizens and foreign governments can no longer exchange their U.S. paper money for it. The government's gold and silver are considered valuable assets rather than forms of money. Today's coins and paper money are backed by the "full faith and credit" of the U.S. government.

If that makes you a little uneasy, try the following exercise. Put a ten-dollar bill and a blank piece of paper on a tabletop, and ask people to choose between the two. Chances are everyone will choose the ten-dollar bill. Why? After all, neither the ten-dollar bill nor the blank piece of paper is backed by gold or silver.

The difference is that people all over the United States will accept the ten-dollar bill as payment if you want to buy something. But you would have a hard time finding someone willing to accept the blank piece of paper. That's because the ten-dollar bill is backed by the promise of the United States government, and to most people, that promise is as good as gold.

Why do banks fail?

A bank is a business, and like other businesses, they can fail. Sometimes they fail because the people who run them make poor business decisions such as expanding too quickly or putting too much money into one type of loan.

Sometimes they fail because of fraud. Maybe the president makes questionable loans to friends or hires unqualified relatives and pays them huge salaries. But banks also go out of business because changing economic conditions make it difficult or impossible for borrowers to repay their loans. Here's an example.

Gusher National Bank Slips on Falling Oil Prices

Falling energy prices mean cheaper gasoline and lower home heating bills. So, falling oil prices must be good, right?

Not for everyone! Take the case of Gusher National Bank. Gusher was very aggressive in making loans to oil and natural gas companies that had no problem repaying their loans when energy prices were high. The loans spelled big profits for Gusher, and everyone agreed that Gusher's executives were smart business people who really knew how to make money.

Then the economy slowed down, and the demand for energy fell. Factories burned less oil and natural gas. Truck drivers, commuters, and vacationers drove fewer miles and burned less fuel. As a result, energy prices dropped sharply, and many energy companies fell behind on their loan payments. Some even stopped making payments altogether.

Months passed, oil prices remained low, and more energy companies fell behind on their payments. Finally, Gusher lost so much money to bad loans that government regulators had to step in and close the bank. Gusher had fallen victim to changing economic conditions—falling energy prices and a high concentration of loans to energy companies.

Or take the case of Bedrock Bank . . .

Bedrock Bank Gets Too Big Too Fast

Bedrock Bank's new president was determined to turn his bank into the region's biggest lender. Bedrock's loan officers got the message and started making as many loans as they could for condominium developments, shopping centers, office buildings, and high-priced suburban housing developments. Loan applications were not always checked as closely as they had been in the past, and some of the loans were approved more quickly than they had been in the old days. But nobody seemed concerned because the local economy was strong and real estate values were rising rapidly.

Everything seemed fine; everyone was making money. But then the economy slowed down, and things took a turn for the worse. The weak economy forced many businesses to close, leaving lots of vacant office space. Real estate values plummeted, and many developers fell behind on their loan payments.

In the end, Bedrock Bank was losing so much money on bad real estate loans that government regulators were forced to step in and close it. The regulators tried to find a buyer for Bedrock, but no other bank wanted to get stuck with all the loans that had gone bad. Eventually, another bank agreed to buy Bedrock if the federal government would agree to keep many of the problem loans.

Do you lose money if your bank fails?

The Federal Deposit Insurance Corporation (FDIC) has protected bank deposits since 1934. In all that time, no one has lost money that was FDIC-insured. Federal deposit insurance covers most types of deposits, including savings deposits, checking deposits, and certificates of deposit. The basic insured amount is $250,000.

In the days before federal deposit insurance, the U.S. banking system was plagued by bank "runs" or "panics." At the slightest hint of trouble, depositors would run to the bank and line up to withdraw their money. All too often, only the first few people in line had any hope of ever seeing their money again; others lost everything. Even healthy banks sometimes failed after rumors caused depositors to panic and withdraw their money.

For many years, the public seemed willing to accept the losses. But then came the Great Depression of the 1930s, and financial pressures forced thousands of banks to close their doors forever. Losses ran into the hundreds of millions of dollars, and many people lost their life savings.

The wave of bank failures shattered public confidence in the banking system, and Americans looked to the federal government for help. Congress responded by establishing the FDIC, which provided deposit insurance coverage of up to $2,500 per depositor. Public confidence rebounded, and bank failures declined from approximately 4,000 in 1933 to 62 in 1934.

Over the years, the federal deposit insurance limit has increased, and federal deposit insurance has helped to maintain public confidence in the U.S. banking system. Bank failures have not been eliminated, but long lines of panic-stricken depositors have become an uncommon sight.

Do you lose money if your bank is robbed?

No. Nearly all banks have private insurance that covers them if they are robbed. (It is not the same as federal deposit insurance.)

In addition, most banks take elaborate measures to safeguard the cash and other valuable items left in their care. Bank vaults have long been protected by reinforced concrete walls, time locks, and metal alloy doors that resist drilling and explosions.

At one time, armed security guards stood watch over banks, but today most banks seem to have decided (wisely) that they would rather not expose their customers and employees to gunplay. Shotguns and revolvers have been replaced by closed-circuit television cameras that maintain a constant watch over everyone who enters or exits the bank.

Another innovation is the exploding dye pack. In certain cases, bank employees are able to place a package of red dye in with the robber's stash of stolen cash. Later, when the crook opens the stash, the concealed dye pack explodes, covering the robber and the ill-gotten money with dye that won't wash off.

Most banks take elaborate measures to safeguard valuables. Shotguns and revolvers have been replaced by closed-circuit television cameras that maintain a constant watch over everyone who enters or exits a bank.

How does the Federal Reserve fit into the U.S. banking system?

Although the Federal Reserve is often in the news, not everyone understands what it is and what it does. Perhaps the best way to clear things up is to have a Federal Reserve "Q & A" to cover some of the most common questions that people ask.

What is the Federal Reserve?
It is the central banking system of the United States.

What does it do?
The short answer is that the Federal Reserve is:

- a bank for other banks,
- a bank for the U.S. government, and
- responsible for U.S. monetary policy, which influences how much money and credit will be available to the U.S. economy.

It also helps to:

- supervise and regulate banking institutions to ensure the safety and soundness of the nation's banking and financial system
- protect the credit rights of consumers, and
- maintain the stability of the financial system by helping to contain risks that may arise in financial markets.

When was the Federal Reserve established?
Congress created the Federal Reserve System in 1913 to help make the U.S. banking system safer and more efficient.

How many Federal Reserve Banks are there?
There are twelve Federal Reserve Banks. Each of the twelve Reserve Banks serves its own Federal Reserve District.

Where is the headquarters for the Federal Reserve?
The System's headquarters is in Washington, D.C. It is called the Board of Governors of the Federal Reserve System.

Does the Federal Reserve lend money to businesses and consumers?
No. The Federal Reserve does not lend money to private borrowers, but it sometimes lends money to banks when the need arises.

Does the Federal Reserve print U.S. paper money?
No. Although Federal Reserve Notes account for almost 100 percent of the U.S. paper money in circulation, the notes are actually printed by the Bureau of Engraving and Printing, which is part of the U.S. Treasury Department. The paper money is then shipped to the Federal Reserve Banks and their branches. When banks need cash for their customers' needs, they order it from the Federal Reserve Bank in their District. Also, since money gradually wears out, the Federal Reserve Banks process cash in order to determine its fitness. Worn out bills are shredded; new bills are introduced into the system to replace the old ones.

Do all Federal Reserve Banks store gold bars in their vaults?
Only the Federal Reserve Bank of New York has a working gold vault, and almost all of the gold in its vault is foreign-owned. The U.S. government's gold is held at Fort Knox, Kentucky, the U.S. Mints in Denver and Philadelphia, the San Francisco Assay Office of the U.S. Mint, and the U.S. Bullion Depository in West Point, New York.

Is the Federal Reserve responsible for regulating and supervising the entire U.S. banking system?

No. It shares this responsibility with other federal and state regulatory agencies.

Does the Federal Reserve set interest rates?

The Federal Reserve is responsible for U.S. monetary policy. This means it makes policies that influence how much money and credit will be available to the U.S. economy. Interest rates often go up or down in response to the Federal Reserve's monetary policy decisions, but only the discount rate is set directly by the Federal Reserve. The discount rate is the rate banks pay when they borrow from the Federal Reserve.

The Federal Reserve does not print money. U.S. paper money is printed by the Bureau of Engraving and Printing, which is part of the U.S. Treasury Department.

Resources for everyone

You can request hard copies of many of these publications through the Federal Reserve's online publications catalog: http://www.newyorkfed.org—Click "Publications Catalog."

Building Wealth, Federal Reserve Bank of Dallas
http://dallasfed.org/ca/wealth/index.cfm.

Consumer Information
www.federalreserve.gov/pubs/brochure.htm.

Consumer Guide to Check 21 and Substitute Checks, Board of Governors
http://www.federalreserve.gov/pubs/check21/consumer_ guide.htm.

How to Establish, Use, and Protect Your Credit, Federal Reserve Bank of Philadelphia
http://www.philadelphiafed.org/publications/economic-education.

In Plain English: Making Sense of the Federal Reserve, Federal Reserve Bank of St. Louis
http://www.stlouisfed.org/inplainenglish.

Paying for It: Checks, Cash, and Electronic Payments, Federal Reserve Bank of Atlanta
http://www.frbatlanta.org/pubs/overview.

What You Need to Know About Payment Cards, Federal Reserve Bank of Philadelphia
http://philadelphiafed.org/consumer-resources/publications.

What You Should Know About Your Checks, Board of Governors
http://www.federalreserve.gov/pubs/check21/shouldknow.htm

What Your Credit Report Says About You, Federal Reserve Bank of Philadelphia
http://www.philadelphiafed.org/consumers/creditreport.html

When is Your Check Not a Check?, Board of Governors
http://www.federalreserve.gov/pubs/checkconv/default.htm

Your Credit Rating, Federal Reserve Bank of Philadelphia
http://www.philadelphiafed.org/consumers/creditrating.html

Your Credit Report, Federal Reserve Bank of San Francisco
http://www.frbsf.org/publications/consumer/creditreport.html

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