FDIC Closes Four More Banks, Making 84 This Year

The losses resulted from the FDIC making good on the banks' bad investments, mostly related to real estate, that went sour during the recession. Under current rules, depositors were made whole if their accounts were valued at $250,000 or less.

The banks just closed were Decatur First Bank in Decatur, Georgia; Community Capital Bank in Jonesboro, Georgia; Old Harbor Bank in Clearwater, Florida; and Community Banks of Greenwood, Colorado. The banks picking up the remains included State Bank and Fidelity Bank in Georgia, First United Bancorp in Florida, and Bank Midwest out of Kansas City, Missouri. Georgia now leads the country in failed banks during the recession with a total of 21, while Florida has had 12 banks closed so far. More than 400 banks have been closed by the FDIC since 2007, compared to an average of four bank closings per year prior to the start of the recession.

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Before the creation of the FDIC in 1933, when a bank's finances were questioned by its depositors they could withdraw their funds and move them to another safer institution. If withdrawals gained momentum, a "run" on the bank could ensue, causing the bank to run out of cash and forcing it to close. The primary cause at the time was the bank taking advantage of the fractional reserve mechanism whereby a depositor's funds could legally be loaned out many times to many different customers. Under normal circumstances, the bank was safe from a run because most depositors left their funds alone. But fractional reserve banking is risky, and if more than a small percent of a bank's customers demand their deposits back, the bank can be forced to close. This mechanism in the free market was one way to keep bankers honest and allow customers to choose the safest bank for their purposes.

As explained by Professor Murray Rothbard,

> This means that the depositor who thinks he has $10,000 in a bank is misled; in a proportionate sense, there is only, say, $1,000 or less there. And yet, both the checking depositor and the savings depositor think that they can withdraw their money at any time on demand. Obviously, such a system, which is considered fraud when practiced by other businesses, rests on a confidence trick: that is, it can only work so long as the bulk of depositors do not catch on to the scare and try to get their money out. The confidence is essential, and also misguided. That is why once the public catches on, and bank runs begin, they are irresistible and cannot be stopped.

When 5,000 banks failed during the early years of the Great Depression, the temptation of the government to “do something” was too great to resist, and the FDIC was born. Allegedly installed to protect the customer, in fact the FDIC protects the bank itself against its own bad judgments through the use of taxpayer money. As Rothbard noted, “Now bank runs are over, and we have been paying and will continue to pay the horrendous price of saving the banks: chronic and unlimited inflation” as the Federal Reserve and the FDIC continue to bail out banks from their own bad judgments.

With the apparent slowing down of the rate of failure of banks (84 so far this year compared to 154 for all of last year), a fair question may be asked: How many more banks will the FDIC close before this unhappy chapter is written? Because the FDIC doesn’t publish a “troubled banks” watch list, private sources, such as Weiss Ratings, have developed such a list covering the 7,500 remaining banks in the country. To each of the four banks closed over the weekend Weiss had assigned a rating of E- (Very Weak). In fact more than 95 percent of the banks the FDIC has closed so far this year held either an E or an E- rating.

At the present time, Weiss rates another 420 banks and thrifts as “Very Weak” with a rating of E+, E, or E-. If predictions that another recession has just started are correct, then many of those 420 banks will likely find themselves belonging to another stronger bank in the next year or so, courtesy of the enabler, the FDIC and, of course, the American taxpayer.