

Fiftieth Anniversary of the Federal Reserve System – Bank Supervision*

The fundamental objective of bank supervision is to foster and maintain a sound banking system. One of the basic purposes of the Federal Reserve System, as stated in the preamble of the Federal Reserve Act, was “to establish a more effective supervision of banking” in the United States. “More effective” were the key words, because banking had long been under the supervision of state and Federal governments when the Federal Reserve Act was passed in 1913.

Some banks had been operating under varying degrees of state supervision since the early and mid-1800’s, when a number of states passed laws relating to bank chartering and operations. Indeed, the unique nature of banking tended to stimulate governmental supervision although many states were slow to react.

The National Bank Act was a major step toward improved supervision. Nevertheless, national bank examination methods had left something to be desired. In pre-Federal Reserve days, national bank examiners worked under a system of fixed fees for each examination, a faulty system in the opinion of John Skelton Williams who, as Comptroller of the Currency, was responsible for the administration of the National Bank Act. He observed in his

annual report for 1915 that, under this arrangement, “the examiner necessarily made either a very superficial and hasty examination of the bank or remained for closer consideration, at his own expense, to perform a gratuitous service for the Government”. The Federal Reserve Act authorized the Board of Governors of the Federal Reserve System, upon recommendation of the Comptroller of the Currency, to fix salaries for national bank examiners. Later the act was amended to direct the Comptroller to set these salaries. The act also gave the new Reserve Board the power to “examine at its discretion the accounts, books, and affairs of . . . each member bank and to require such statements and reports as it may deem necessary”.

The process of bank examination is primarily concerned with an evaluation of assets, procedures, policies, and the effectiveness of management. Examinations also provide the bank supervisory authorities with the basic information necessary to perform other functions such as issuance, interpretation, and enforcement of regulations; merger and branching decisions; and decisions concerning capital and corporate structure requirements. The intimate information on bank operations derived from bank examinations also is useful in the formulation of monetary policy.

Actually the System was slow to move into the field of supervision. Regular examinations of nationally chartered member banks were being made by national bank examiners. In 1917 the Federal Reserve Banks were specifically

* The twelfth and last in a series of historical vignettes appearing during the System’s anniversary year.

authorized to accept examinations by state authorities of state member banks in place of examinations made by Board-appointed examiners. The same year, the directors of the Federal Reserve Bank of New York authorized the acceptance of examinations and reports made by state authorities in the Second Reserve District.

For the next decade and a half, the Reserve Banks confined themselves largely to special credit investigations of member banks, generally undertaken in cooperation with state authorities but sometimes independently. These credit checks consisted mainly of a review of the quality of member bank loan portfolios. In addition to serving as a method of supervision, they provided the Reserve Banks with supplemental information that could be used when the member banks applied for discounts or advances.

In 1933, when it became apparent that a strengthening in supervision was necessary—especially with respect to trust operations—the Board asked the Reserve Banks to expand their examining facilities. The following year, the Board directed that at least one regular examination of each state member be made yearly by Federal Reserve examiners, independently or in conjunction with state authorities. Joint state-Federal Reserve examination of state member banks continues today, while national bank members are still examined by the Comptroller's national examiners.

The System's supervisory responsibilities as delineated by the Federal Reserve Act in 1913 have been expanded by various acts of Congress. The additional supervisory functions, to name a few, include the processing of merger applications of state member banks, the chartering and supervision of companies organized by banks to do a foreign banking and financing business, the registration of bank holding companies, and regulation of bank loans for purchasing or carrying listed securities.

The absence of restrictive definitions of the supervisory duties and responsibilities of the Federal Reserve System and the gradual broadening of the Congressional mandate have been helpful in permitting the System to adapt its

supervisory functions to the far-reaching changes in banking that have taken place since the passage of the Federal Reserve Act.

PER JACOBSSON FOUNDATION LECTURES

On November 9, 1964, in Basle, Switzerland, the Per Jacobsson Foundation presented the inaugural lectures of a series to be continued in future years and other cities. The Foundation thus honored the late Managing Director of the International Monetary Fund and began to carry out its principal purpose, which is to sponsor and publish regularly lectures on international monetary affairs by recognized authorities.

The first two lectures, both on the subject of "Economic Growth and Monetary Stability", were given by Maurice Frère, former Governor of the National Bank of Belgium and President of the Bank for International Settlements (viewing the subject from the standpoint of a developed country), and by Rodrigo Gómez, Director General of the Bank of Mexico (the view from a developing country).

The Foundation has now published the texts of these lectures. Because of the interest of many readers of this *Review* in international monetary affairs and in view of this Bank's sympathy for the Foundation's aims, we have arranged to have a limited supply of these texts available for distribution upon request.

Requests should be addressed to the Publications Section, Federal Reserve Bank of New York, New York, N. Y., 10045. Requests for French and Spanish versions of the lectures can also be filled.