



Private Finance, Public Power: A History of Bank Supervision in America

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Federal Reserve Overhauls Its Approach to Supervision

By [John Heltman](#)

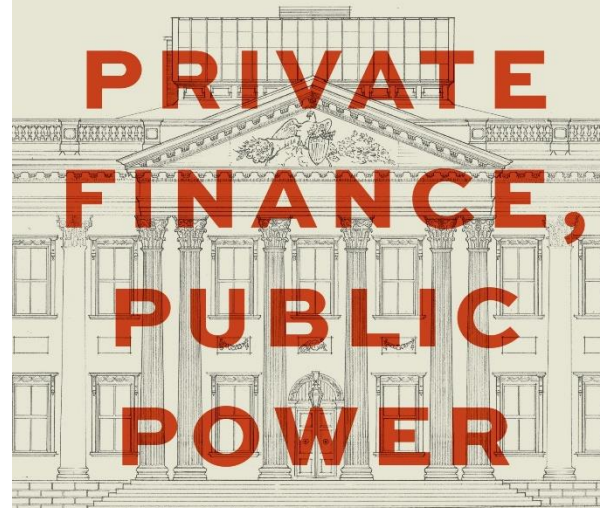
Published March 26, 2026, 8:15 p.m. EDT

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IN AMERICA

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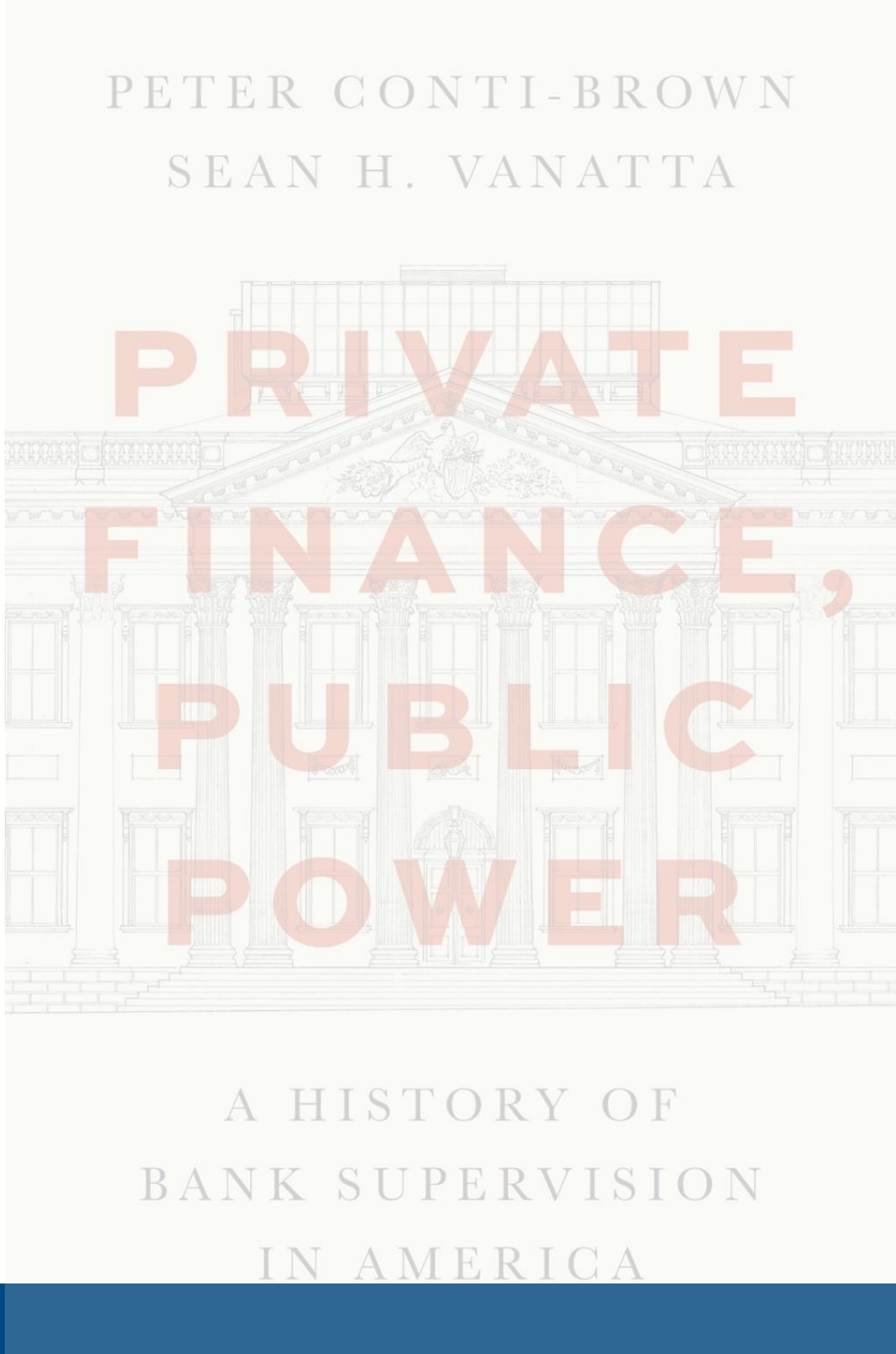
**PRIVATE
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A HISTORY OF
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Institutional Focus in Banking and Finance

1. Legislation
2. Regulation
3. Supervision

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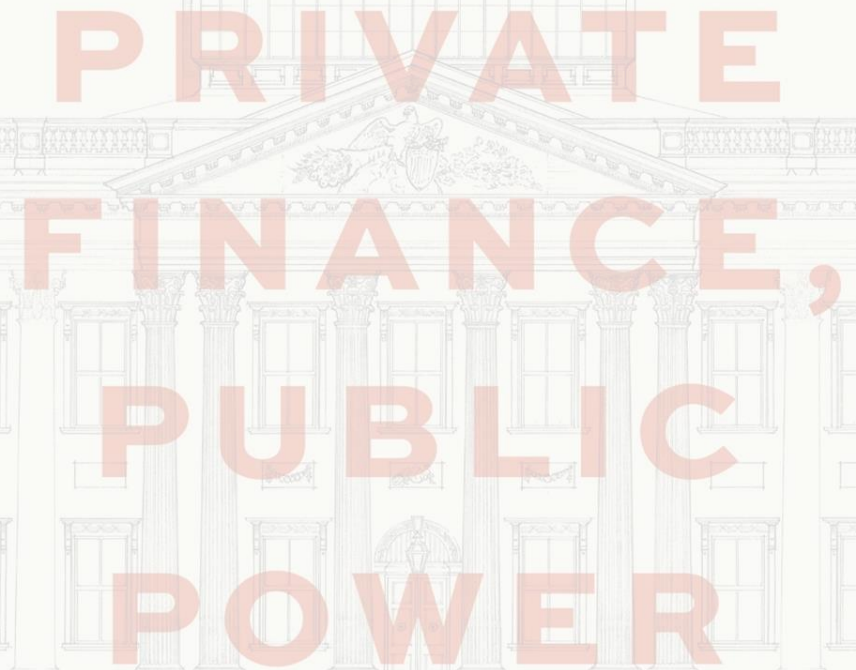
Defining Supervision: More than Compliance with Law

Bank Supervisory Functions

As a governmental activity, bank supervision encompasses a wide variety of technical functions relating to the operations of banks. These concern the issuance and enforcement of supervisory and other regulations; the organization and chartering of banks; the periodic examination of banks and the requiring of steps by bank management to correct unsatisfactory or unsound conditions found through such examination; the review and analysis of periodic reports of condition and of earnings and expenses; the rendering of counsel and advice on bank operating problems when requested, particularly in the case of smaller banks; the approval of proposed changes in the scope of corporate functions exercised by individual banks and of proposed changes in their capital structures; the authorization of branches and of the exercise of trust powers; in some instances, the approval of bank mergers and consolidations; the regulation of bank holding companies; and the liquidation of banks, including the appointment of a conservator under certain conditions or a receiver in other circumstances.

“issuance and enforcement of...regulations;...requiring of steps by bank management to correct...; the review and analysis of periodic reports...; the rendering of counsel and advice...”

Federal Reserve System, *The Federal Reserve System Purposes & Functions Explained* (1954), p. 166-7



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Private Finance, Public Power: A History of Bank Supervision in America

Introduction

Chapter 1: Origins, 1789-1863

Chapter 2: The National Banking System, 1863-1880

Chapter 3: Supervising the Panics of the Gilded Age, 1880-1907

Chapter 4: The Federal Reserve and Bank Supervision, 1907-1928

Chapter 5: The Bank Holiday and the Legitimacy of Supervision, 1929-1933

Chapter 6: The New Deal Supervisory Institutions, 1933-1945

Chapter 7: Supervising Concentration, 1945-1960

Chapter 8: The Ideologies of Supervision, 1960-1970

Chapter 9: Supervisory Discretion Unbound, 1970-1980

Origins: The Visitorial Power, Counter-Party Risk, Bank Wars, and Silver Sleds



Evolution: The National Banking System

- Uniform national currency backed by U.S. bonds
- Federal chartering and the first durable national bank supervisor
- Ad hoc examination converted into routine, periodic, surprise inspection
- A public information model: diagnose, warn, and ultimately close

The Panics of the Gilded Age: From Notes to Deposits

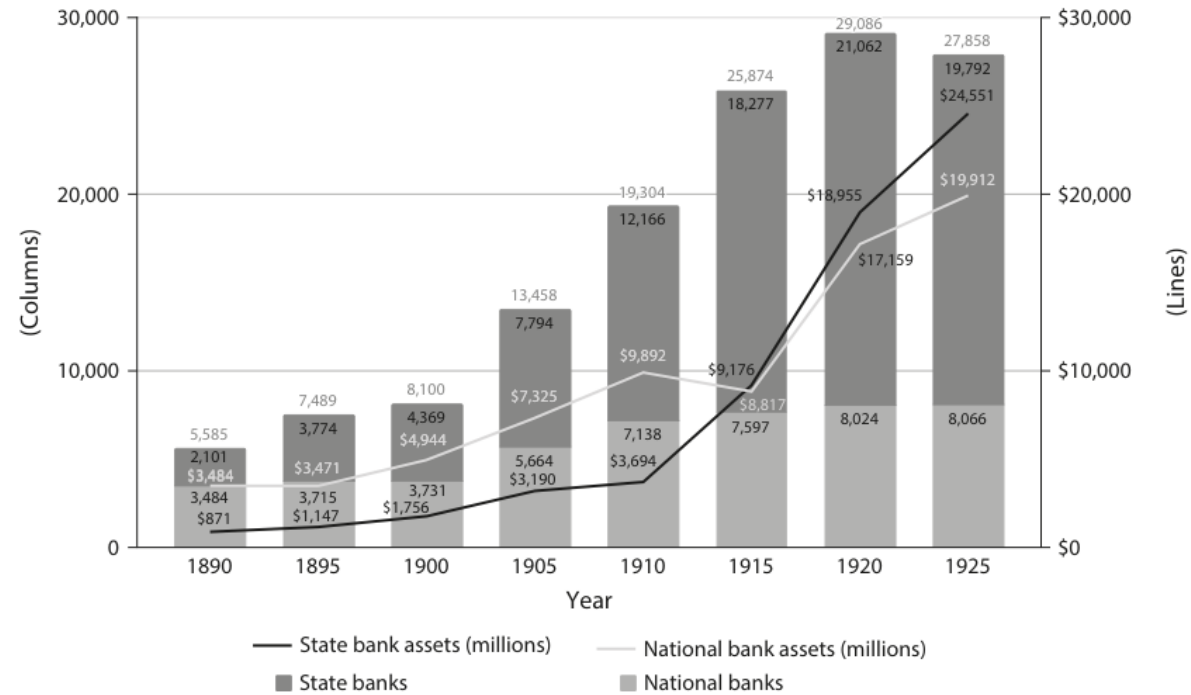


FIGURE 5.1. Banks by charter and assets, 1890–1925
 Source: Eugene Nelson White, *The Regulation and Reform of the American Banking System, 1920–1929* (Princeton University Press, 1983), 12–13, 132 (after 1914, deposits substituted for assets).

The Gilded Age: deposits quietly became money

\$1.70

\$ deposits per \$1 currency in 1867

\$5

\$ deposits per \$1 currency by 1890

\$10+

\$ deposits per \$1 currency by 1914

- Runs became monetary contractions: depositors converted abundant bank liabilities into scarce currency.
- Private clearinghouses, not public supervisors, often became the first line of systemic risk management.
- The Panic of 1907 exposed the limits of private liquidity and fragmented public oversight.

The Birth of the Federal Reserve as Supervisor



The Panic that Defines them All: The Bank Holiday of 1933



(Dis)organizing Supervision

1. States
2. OCC
3. Federal Reserve
4. RFC
5. FDIC

(Dis)organizing Supervision

1933–34 did not create a single supervisor. It created an ecosystem of rival public risk managers.

OCC

Chartering, examination, closure, conservatorship, national-bank franchise.

Federal Reserve

Liquidity, membership, discounting, macro-stability, member-bank surveillance.

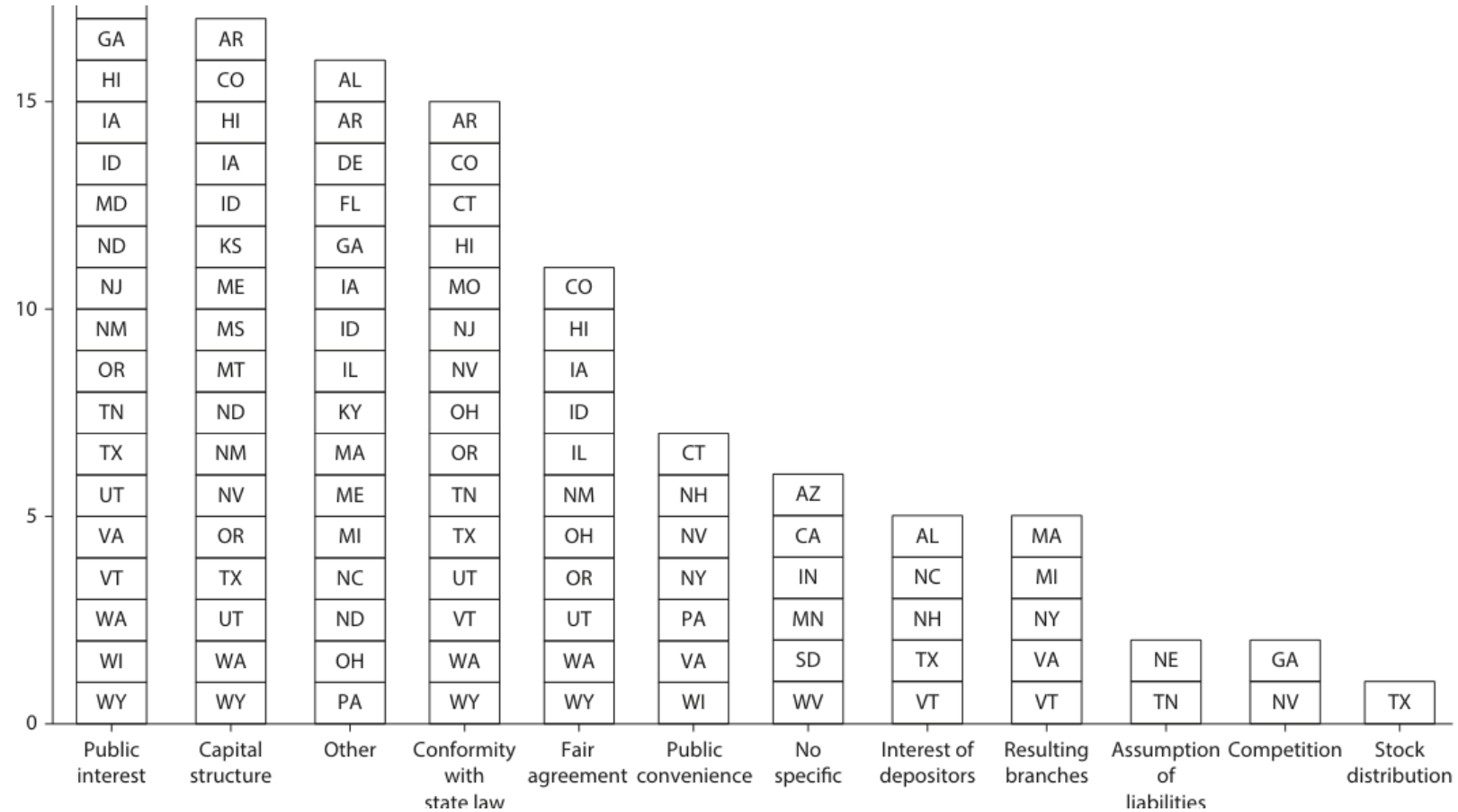
FDIC

Insurance underwriting, depositor protection, fund preservation.

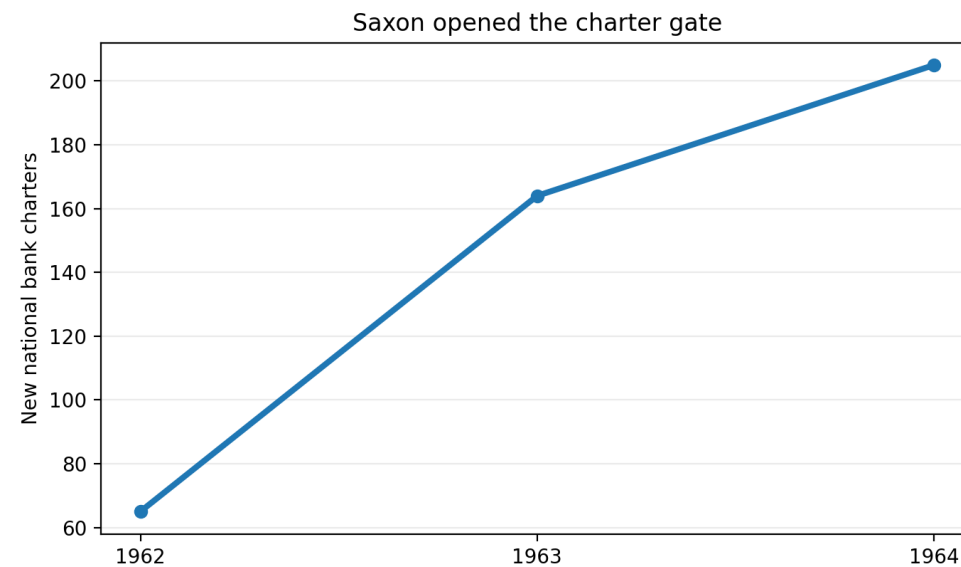
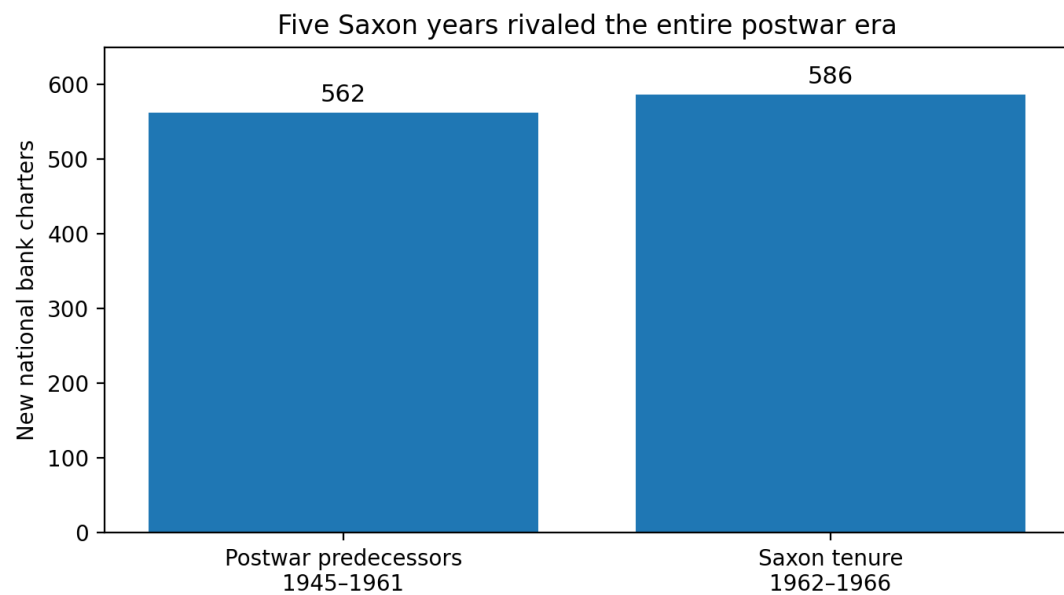
RFC

Capital injections, public ownership, recapitalization as supervisory leverage.

Supervising Concentration



James Saxon and the Philosophy of Supervision as Calculated Risk



Once supervision became the machinery for managing residual risk, Congress kept adding residual risks.

War finance and foreign property

Examiners helped freeze, manage, and liquidate enemy and foreign-owned property in World War II.

Consumer protection

Truth in Lending and related statutes pushed disclosure and compliance into examination systems.

Civil rights and reinvestment

HMDA and CRA made geography, race, and community credit needs supervisory questions.

Three key themes

1. Public vs. Private
2. Rules vs. Discretion
3. Institutional Design and Institutional Change

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Public vs Private



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Rules vs Discretion



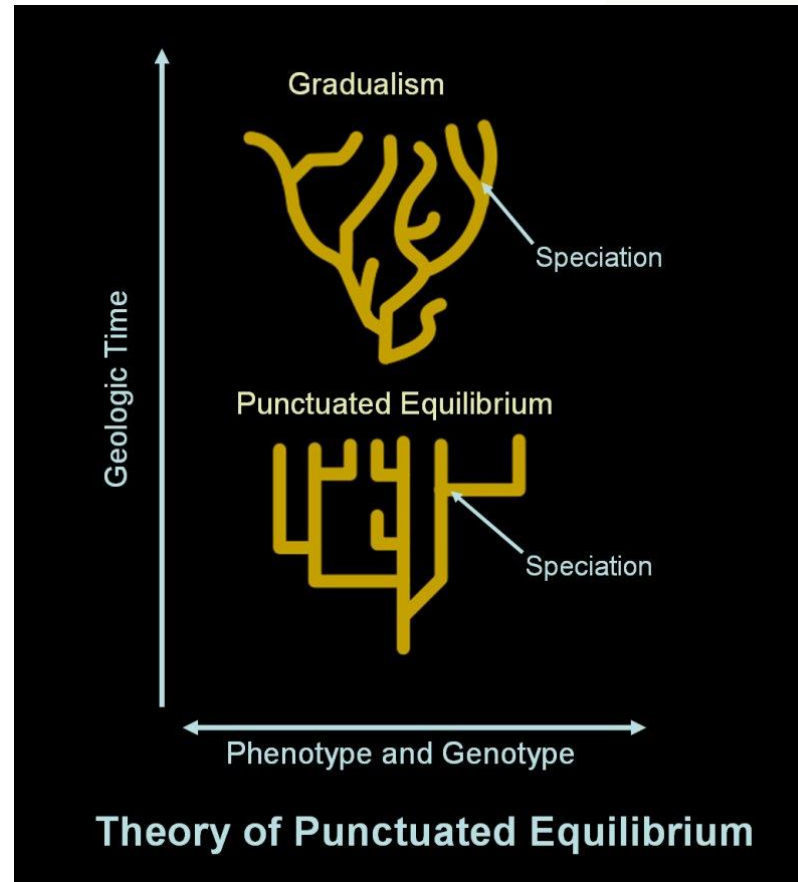
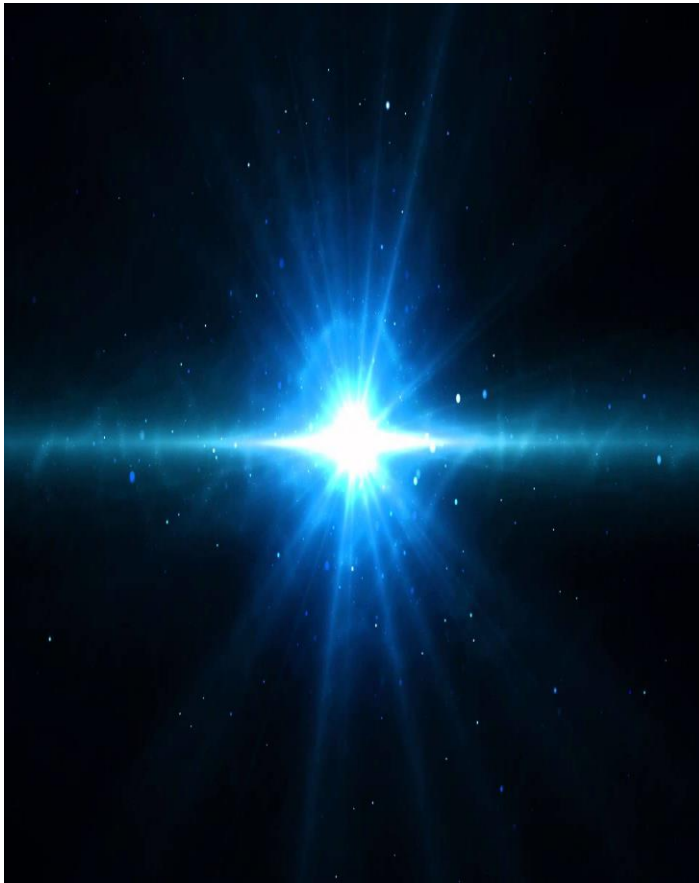
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Institutional Design and Institutional Change



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Original title: The Banker's Thumb



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Four key insights

1. Supervision is (1) about the relationship between individual actors in government and individual financial institutions, where the rubber hits the road of government and market power
2. It is further defined by (2) evolutionary processes and resistant to efforts to impose a single defining ethos
3. This leaves supervisors—and Congress—to use (3) supervisory discretion choose among competing conceptions of what that individual relationship should be.
4. This system has (4) proved so resilient to change, and so amenable to expansion, because supervisory discretion functions as a risk absorber for the entire financial system.

Questions?