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Introduction

IN THE spring of 2023, Silicon Valley Bank (SVB), a major player in the tech and venture capital world (but little known outside it), announced that it needed to raise more equity capital from investors. Such announcements from banks are usually not very good news for bank stakeholders. It suggests at best that current shareholders will be “diluted,” that is, see the relative value of their investments diminished by the inclusion of more investors for the same firm; at worst, it suggests that some terminal financial illness is consuming the bank from within. In the case of SVB, it was the latter, and it arose from a seemingly innocuous bet. At the height of the COVID-19 pandemic in 2020, the bank, awash in liquidity from a flush venture capital industry, thought that interest rates, near 0 percent, would stay that low for a long time. SVB invested most of its portfolio in very safe, liquid securities like U.S. Treasuries that paid more than what the bank paid its depositors but not much more. The bank needed time to digest what had been a period of explosive growth—from about \$70 billion in deposits in 2019 to \$212 billion in 2022—and these safe securities seemed like the prudent strategy.¹

SVB bet big, and it lost. In March 2022, the Federal Reserve began raising interest rates more quickly than it had in forty years, seeking to combat rising inflation that few had anticipated. SVB was stuck. Rising rates slashed the market value of its low-yielding investments while requiring SVB to pay more to its depositors. At the same time, trouble in the start-up ecosystem meant that SVB depositors were running down their balances, portending a reckoning when the bank would have to realize losses on its bond portfolio. What had once been safe, boring sources of positive income turned into stranded assets that were underwater on essentially every dimension.

Hence the need to raise more equity. SVB’s capital call was not met by disaffected investors wondering about the consequences of shareholder dilution.

It was met by all hell breaking loose. After the 2008 global financial crisis, the federal government promised not to bail out another bank. SVB's depositors, whose holdings were well above the federal deposit insurance line, began hasty withdrawals. Within days, \$42 billion left the bank. Depositors who couldn't get their money out before government officials closed SVB clamored to be made whole, despite no plausible legal claim in their favor. On March 12, 2023, Treasury Secretary Janet Yellen vowed that there would be no federal rescue: "The reforms that have been put in place [after 2008] mean that we're not going to do that again." Hours later, the federal government sidestepped those reforms and provided precisely that bailout, especially to SVB's depositors who in some cases held billions of dollars more than the deposit insurance limit. The Federal Reserve even invoked its "unusual and exigent" emergency authority. The country had a proper banking crisis, just fifteen years after the last one that was, in Barack Obama's famous words, supposed "to put a stop to taxpayer bailouts once and for all."²

In the months thereafter, given the profound repudiation of the government's anti-bailout commitments, commentators pointed fingers in many directions for the bank's spectacular failure. Almost everyone agreed that the failure was one of risk management, with plenty of condemnation for the bankers at SVB's helm who had mismanaged these risks. But another group that became the focus of SVB's failure were those who never owned a share of the bank's stock, never cashed a bank's check, almost certainly did not hold an account, and if they ever attended a bank board meeting, did so as a not-very-welcome guest. These were the bank supervisors that worked for various federal agencies, not for the bank itself, but who knew more about the risks the bank had taken than many of the banks' own employees.

The Federal Reserve's own postmortem took it for granted that this private bank's failure was in fact an indictment of public governance, concluding that "supervisors did not fully appreciate the extent of the vulnerabilities as Silicon Valley Bank grew in size and complexity."³

Of course, blaming politicians for corporate failures is not new to the United States in 2023. But in an avowedly capitalist society, it may seem odd to affix blame for day-to-day risk management failures not on careless bankers but on mostly unknown civil servants. The regional banking crisis that SVB helped initiate did not lead to a national cataclysm and did not suggest any deeper, systemic public policy failures. Why, then, did such a broad consensus develop that SVB's risk-taking was the responsibility not of this private bank but of public officials whose job it was to prevent such risk-taking in the first place?

It is a good question, and we can start with the answer. These public officials are responsible because that responsibility is a cornerstone of modern finance. The truth is that the system of banking in the United States is composed of private finance, backed inescapably by public power. Even though banks are private institutions with private shareholders, boards of directors, profit motives, customers, and competitors, they aren't managed that way. Banking is private finance, to be sure; yet, it is public power that we ultimately expect to manage those risks, even when public officials would like to shift responsibility to the private sector. Public institutions, plural and often in conflict, play foundational roles in deciding what risks banks take, how and when they take them, and to what end.

The expression of and responsibility for the public power that manages the risks of private finance has a name. It is called bank supervision. It is unusual in American society, and it is unusually American, at least in origin. This book is a history of what this striking and curious institution of financial risk management is and how it came to be.

Supervision, Not Regulation

The first question a book on bank supervision must address is the definitional one: What does bank supervision even mean? Scholars, policymakers, and other stakeholders have not reached a consensus on this question. One reason is that supervision is often conflated as a synonym with a much more common term, "regulation," the rules that govern banking. To those closer to the action, the two terms often travel as close companions in a single phrase—"supervision and regulation," or "soup and reg" for short. The Greeks called this kind of pairing a hendiadys, a double noun joined by a conjunction that provides extra emphasis for a single idea. In this case, the idea is that public officials create rules for risk management (and other purposes), with supervision and regulation as the mechanism to ensure compliance with those rules. At some level of abstraction and in some contexts, the two terms function in precisely this way, especially in contrast to other ways that the government manages systemic risk (for example, through national defense, monetary policy, food safety, or other mechanisms).

However, if the intent is to understand how, precisely, these practices function—and where they come from—then the conflation and companionship of regulation and supervision are errors that obscure what makes public supervision distinct within our system of nominally private finance. What

supervisors do in fact is manage situations that require active policy tradeoffs pursued through official discretion, and in such cases supervision and regulation might have very little to do with each other. Those who want to understand the intersection of public power and private finance need to know better not only what the rules say but also what the curious institution of supervision is, how it has evolved, and for what purposes.

This book isolates American bank supervision as a unit of study and accounts for its historical evolution. As developed here, supervision is bilateral institutionalized discretion that the government uses to identify, monitor, manage, and resolve the residual risks that private actors generate through the financial system. It is not simply the synonym of writing the rules that implement congressional actions, the pith of “regulation.” Nor is it the basic verification that those rules are being followed by individual banks, though some supervision operates as compliance. It is much broader than this. Sometimes bank supervisors look like cops on the beat, issuing fines, enforcing laws, and even assisting the real police in hauling crooked bankers off to jail. Sometimes bank supervisors look more like fire wardens, alerting banks when their risks are a threat to themselves and their customers and calling for the public fire engine to bring relief when those downside risks ignite. Sometimes they act like accountants and auditors, sometimes as the tormentors of bankers hoping to innovate and experiment, and sometimes as those bankers’ loyal collaborators. Sometimes they are public officials, duly endowed with public power. And in others, supervisors are private actors, exercising discretionary oversight in service of bankers’ individual or collective self-interest.

Above all else, bank supervision is the space between public and private, where government actors work with private bankers to manage the risks thrown into the economy and society through the basic, foundational, and vital enterprise of banking. This definition is a broad but important one. It reflects no specific pinpoint in history, no ability to say what the relationship between the government and private banks was always about. It describes instead a middle ground, a negotiated space where the private and public sometimes contest power, sometimes collaborate in it, but always manage that power together in a way that is more extensive and more pervasive than in other parts of American society. Bank supervision is, in short, institutionalized discretion used to manage residual financial risk as it occurs in individual private banks and across the private banking system.⁴

In our account, bank supervision is therefore a dynamic space. Some supervisory tools, such as chartering, gained and lost discretionary power at

different points in time. Others, such as bank examination, became more consistently dynamic in the risks that examiners evaluated and in the methods that they used, even as the examiners and the content of examinations changed. In defining bank supervision as institutionalized discretion to manage bank risk, we seek to understand who used discretion, for what kinds of risks, using what tools, for what purposes, and how the complex of institutionalized decision-making evolved. *Private Finance, Public Power* therefore offers a positive theory of how bank supervision works now and explains how, through experimentation, error, and the slow building of sometimes redundant, often warring institutions, that same machinery that sprang to the rescue of Silicon Valley Bank came to be.⁵

The Layered and Evolving Institutions of Bank Supervision

That process of building redundant, warring, but ultimately effective institutions to co-manage private risk is a remarkable but mostly ignored instance of what political scientists call “institutional layering,” or the process by which “new elements are attached to existing institutions and so gradually change their status and structure.” After Congress created a system of federally chartered banks during the Civil War, federal officials sought to provide robust public support to the new national banking system. The Comptroller of the Currency, the first federal bank supervisor, offered the new national banks under its supervision everything from practical banking advice to fraud detection. Yet supervisors lacked the institutional capacity to realize their ambitions. After the 1870s, individual and systemic bank failures, along with official corruption and scandalous fraud, led federal officials to shift risk management away from the public and onto private shareholders and bank directors. This occurred at the level of individual banks, through corporate governance and shareholder liability, and through private clearinghouses that could provide liquidity in moments of strain. Supervisors gathered and mobilized information, continuing to steer banks toward safety with the latent threat of closure if they detected insolvency or fraud, but private liability management anchored the system.⁶

Across the late nineteenth century, the rise of bank deposits as a major component of the national money supply, combined with decennial banking panics that endangered those deposits, gave rise to deposit insurance and central banking as alternative risk management strategies to the Comptroller’s information model. The last of these Gilded Age panics, that of 1907, led to the

embodiment of those strategies as institutions—the Federal Reserve System and state deposit insurance schemes—but not at the exclusion of the Comptroller, state bank examiners, or private clearinghouses. Contemporaries largely understood these as competing frameworks—deposit insurance *or* central banking; public examination through the Comptroller *or* private examination through the clearinghouses. And in this competitive mode, supervision—public and private—unambiguously failed during the 1920s agricultural depression, the 1930s banking crises, and the Great Depression that followed from these catastrophes. The first half of *Private Finance, Public Power* tells the story of these origins, evolutions, and failures, each of which contributed to the mostly durable system of bank supervision that emerged from the critical period in the 1930s.

The second half tells the story that evolved from there. During the New Deal, complementarity eclipsed competition, so that, notwithstanding their Depression-era failures, the public supervisory institutions not only evolved but expanded. Modern bank supervision emerged in the wake of these central, pivotal moments of intense experimentation. Franklin Roosevelt's administration forged information provision, central banking, deposit insurance, and public ownership into a reinforced supervisory structure that would, once and for all, stabilize the unstable financial economy. In the face of new public institutions, each layered on top of the others, the New Dealers curtailed but did not eliminate the institutions of private risk management. They sought to maintain private control of the banking system even as the public provided more support with a more expansive set of tools. After World War II, in an era of financial calm that seemed to validate the New Deal approach, various stakeholders wrestled with two core and competing questions: (1) how and whether to extend the scope for private risk-taking; and (2) how and whether to use institutionalized discretion to advance new policy goals, including antitrust and antidiscrimination. By the time financial instability forcefully re-emerged in the 1970s, the shape of the supervisory system had solidified, even as these debates grew more intense.⁷

The institutional layering that built up over the postwar period provides an essential window through which we view the supervisory successes and failures that followed. We track three in particular. First, the chartering prerogatives of the Comptroller of the Currency and the state banking authorities, each jealous of the other in an unsteady equilibrium known as the “dual banking system,” created a dynamic space of charter competition that defies usual conceptions of federalism in the provision of law. This was neither a race to the top nor a race to the bottom, although there was indeed some kind of competitive race

afoot. Second, the Federal Deposit Insurance Corporation (FDIC), the institution created during the height of the Depression in Franklin D. Roosevelt's first hundred days in office, initiated a new, encompassing focus on insurance underwriting and the preservation of the Deposit Insurance Fund. Although the FDIC relied on the Office of the Comptroller of the Currency and the Federal Reserve for supervisory insights in its first frantic years, it eventually became a juggernaut of its own, spanning the federal and state divide, and employing the largest corps of supervisors. And third, the Federal Reserve System, the nation's central bank evolved through the twentieth century to focus on supervision as subordinate to and in the service of broader conceptions of macroeconomic stability. These institutional prerogatives over risk management were almost constantly in conflict from the 1930s onward. Those conflicts—over chartering, insurance provision, and macroeconomic stability—defined risk, its management, and the political economy of bank supervision from the New Deal through the 1970s.

Institutional Evolution in *Private Finance, Public Power*

In telling the story of institutional layering in bank supervision, *Private Finance, Public Power* is an institutional history as much as it is a financial and political history. By institutional history, we mean the focus on the dynamic ways that institutions form and evolve. Here, we build on the work of new institutional economists like Douglass North and historical institutionalists from political science and sociology. These scholars focus more on the processes that proceed from the founding of institutions and more on the ways that later institutions build upon these earlier moments. Institutional layering is, of course, part of this institutional analysis, but so too is the recognition that institutions adapt to fit their contingent historical moments. Sometimes, those moments (as in those studied by the new institutional economists) are on the order of revolutions and constitutions. Other times, they are responsive to changes in political administrations or the structure of the economy. And in other instances, these moments of change occur because one person was appointed Comptroller of the Currency and another person wasn't. In *Private Finance, Public Power*, we look at critical junctures of all such moments (and many others).⁸

We can think, then, of bank supervision as the evolutionary outgrowth of a series of unrelated decisions made by politicians, bankers, legislators, policymakers, citizens, and many other stakeholders, eventually creating a system that creaks and groans as mismatched parts, crafted at different times for

different purposes, grind against one another, all while still serving useful and well-adapted purposes.

Evolutionary biologist Steven Jay Gould referred to such evolutionary adaptations in his 1980 book, *The Panda's Thumb*, to explain why the giant panda's elongated wrist bone survived despite its ungainly appearance and imperfect functionality. His insight is that complex systems like the panda's thumb—or, in our application, the financial risk management across the public-private divide—leave behind hints of a past that is much more complicated than our present uses of those systems seem to support. As we quote in the book's epigraph, “remnants of the past that don't make sense in present terms—the useless, the odd, the peculiar, the incongruous—are the signs of history. They supply proof that the world was not made in its present form. When history perfects, it covers its own tracks.” Bank supervision in its institutional forms is full of “the useless, the odd, the peculiar, the incongruous,” proof that the abiding challenges of risk management have been met again and again—and must continue to be met—in specific historical circumstances, meetings which have left ample evidence of history's failure to “cover its own tracks.” (For a long time, we called this book *The Banker's Thumb*, but many of our early readers had no idea what we were talking about or referring to, hence the title change at the strong encouragement of our editors!)⁹

This evolutionary basis of supervision's historical trajectory means that bank supervision is not some sleek, efficient machine ordained by farsighted legislators. Rather, many of the most important innovations to bank supervision resulted from supervisory officials' creative repurposing of statutory constructs. In the 1860s, Congress authorized ad hoc bank examination in the National Banking Acts, which supervisors made into routine, periodic, and surprise inspections. Congress set strict eligibility rules for Federal Reserve discounting in 1913, onto which the Reserve Board layered discretionary acceptability criteria. What makes supervision as it evolved so functional is that it provides a negotiated and negotiable space through which risk can be managed across the public-private divide. Through this space, occupied by partisans and technicians alike, both sides discover profoundly important information not otherwise available through other mechanisms of risk management. This negotiated, liminal space means that the financial system of the United States cannot and need not ever be completely “future-proofed” through legislative design. Bankers and bank supervisors, on the ground and behind closed doors, can manage risks on an open vector, assessing changes as they come with better speed and better protection of competing interests than the legislative process could ever possibly deliver.

To make an implicit point explicit: Just because supervision can work this way does not mean it has or will. Often, over supervision's long history, officials managed risks poorly or failed to confront risks they could neither see nor understand. Officials in different agencies and at different levels of government pursued conflicting and counterproductive risk management strategies, while bankers, caught amid opposing forces, played for advantage. Legislative reforms, incremental and wholesale, could change the field quite dramatically but did not on their own determine the subsequent movement of the players.

In this sense, recognizing that the development of banking supervision is not simply a teleological march toward greater and greater perfection informs how we approach history in another important respect. Just as bank supervision took a somewhat circuitous path toward reaching functionality, its history can't be told in a crisp series of genesis moments when certain institutions were called into being by an enlightened Congress. This is the province of the heavily leaned-on genre of constitutional history, which tends to replay the moves of the "founding generation" and defines, through their thoughts and intentions, institutions from free speech to affirmative action, gay marriage to gun control. In the case of banking history, scholars might focus on the legislative acts that created new supervisors, such as the National Banking Acts or the Federal Reserve Act, as if those acts cast the institutions in stone—supervision as it was and always should be.¹⁰

We don't neglect those key moments in *Private Finance, Public Power*. All the legislative stars of banking are here. The history of bank supervision, though, is not merely legislative history. We want to tell the history of the organizations and practices of bank supervision not just as they were designed but also as they evolved. What the Lincoln administration thought they were doing in creating the national banking system, or the ways that the creation of the Federal Reserve System altered supervisory institutions, or the curious advent of federal deposit insurance supervision in 1933—all of them elucidate much of what bank supervision would become. Not completely, however, so our history is not focused exclusively here either.

The Faces of Institutionalized Discretion

Since our theoretical conceit is that history is contingent and unpredictable, the history of *Private Finance, Public Power* focuses both on structural changes—war and peace, economic growth, and changes demanded by citizens through political processes—and on the individual words and actions of bankers, politicians, supervisors, and other historical players as they engaged in the tug-of-war

that defines bank supervision. In these historical spaces, we start to see the many contests to define how residual risk should be managed and where in the space between public and private that management should occur. Our historical actors agree on very little. These disagreements themselves generate the content that defines what bank supervision evolves to become over the course of our account.

The disagreements also define the core logic of bank supervision and what separates it from rival epistemologies of government action: Supervision is about the public's institutionalized discretion in the management of and, subsequently, ultimate responsibility for the risks taken by private actors. Discretion is, by its nature, inexact and hard to predict, as supervisors have long recognized. In 1884, the Comptroller of the Currency acknowledged the uncertainty: "The exact line at which the Government shall interfere and the point at which Government discipline shall commence is a matter of some delicacy to determine." In 2020, Randal Quarles, the former Vice Chair for Supervision at the Federal Reserve, put the same sentiment somewhat more colorfully: Identifying the line between regulation (which generally follows the crisp rules and procedures spelled out in law) and supervision (which is harder to track) only becomes clear after "fasting and much prayer."¹¹

The discretion in supervision has become, in the 2020s, something of a controversial flashpoint in legal circles, with some arguing that "the confidential and tailored nature of supervision sits uncomfortably with the responsibilities of government in a democracy," while others defend bank supervision's basic compatibility with those responsibilities. This book does not assess the legal arguments that these disputants make, but we do trace in this history the irreducible centrality that such discretion has had in federal financial oversight. The use of discretion in assessing the risks taken by private actors is one of the few throughlines that we discuss in *Private Finance, Public Power*. The way that the institutions of bank supervision evolved to place such discretion, exercised to manage a large and growing number of various kinds of risks, is in an important sense the entire argument of the book.¹²

We are, of course, not the first to emphasize the discretion inherent in bureaucratic authority. Most prominently in administrative law, Jerry Mashaw argued that the discretion exercised in the Social Security Administration threatened the very stability of our bureaucratic system. Similarly, in political science, a thriving literature on "street-level bureaucracy," that arose roughly at the same time as Mashaw's critique, focuses on the "challenges" of discretion to the rule of law, costs that other mechanisms must correct.¹³

These and other efforts to taxonomize and diagnose the strengths and weaknesses of discretion come down to the same basic arguments: It is ubiquitous in our system of government, and it can be used for good and ill. We do not dispute these basic premises. There is no question that bank supervisory discretion is both valuable and potentially ripe for mismanagement and abuse. But the institutionalization of supervisory discretion is about much more than the implementation of law enforcement in individual cases. Defining the boundaries and potential of supervisory discretion is a major part of our narrative, primarily because it was a major project through the two centuries of history that we narrate.¹⁴

Supervision as Residual Risk Management

The foregoing theoretical context of *Private Finance, Public Power* leads to four basic insights. Supervision is (1) about the relationship between individual actors in government and individual financial institutions, where public power meets private finance. It is further defined by (2) evolutionary processes and is resistant to efforts to impose a single defining ethos, instead leaving supervisors—and Congress—to use (3) supervisory discretion to choose among competing conceptions of what that individual relationship should be.

The most important payoff of this account is the fourth insight—that this system has (4) proven so functional, even if often inefficient, because institutionalized supervisory discretion works as a risk absorber for the entire financial system. Bank supervision is the promise that the government will participate with the private sector to manage and take responsibility for the residual risks that design choices about the American financial system will always produce. Contrary to other categories of risk—national security after September 11, 2001, for example—financial scandals, panics, crises, and other events have come to be viewed as more or less the cost of the American system. Supervision, then, isn't just about punishing wrongdoers or responding to panics; it is about managing a large and ever-growing system of risk that we, as a society, have decided we want to take, using a variety of tools and strategies that sometimes converge, sometimes conflict.

Supervision is, in that way, about managing the moral hazard that the financial system creates in so much abundance, and with so much controversy. The concept of “moral hazard” comes from nineteenth-century insurance, denoting concern that people or firms that take out insurance to protect themselves against specific kinds of risks will be less dutiful about avoiding those risks.

Eliminating moral hazard is often cited as the defining problem of institutional design in the financial system. The fact that banks and bankers are perceived to privatize the benefits of finance while they socialize the costs is a recurrent scandal in its own right. One of the reasons that the regional banking crisis of 2023 caused such alarm was not the risks to the overall health of the financial system but the seeming betrayal of the promise to end government bailouts of private actors in banking (especially large uninsured depositors who should be competent to manage their own risks).¹⁵

We argue, however, that moral hazard is irretrievably baked into the American financial system: Banking, by its very nature, will always involve risks that are prosocial in nature with no effective mechanism of rendering the costs and benefits of that system symmetrically socialized or privatized. Perhaps the political promises coming out of 2008 implicated an end to government bailouts, but the architecture of public-private risk management would never permit such a policy commitment. That fact means that bank supervision will always entail a contest and collaboration between public and private actors on how to manage that risk, including the provision of public insights and responsibilities for private action and inaction. Once understood in that light, moral hazard isn't a policy problem to solve for bank supervisors. Managing moral hazard is the job description.¹⁶

Audiences

Although we have aimed to capture the attention of readers with no prior knowledge of the sometimes arcane and technical details discussed in *Private Finance, Public Power*, we have no illusions about our target audience. This is a book primarily written for scholars of financial regulation in law, economics, political science, and history; as well as for bank supervision's stakeholders and participants across the public-private divide. We hope too that the book will be of interest to a variety of scholars from fields as diverse as administrative law, finance, sociology, and various subdisciplines of history beyond financial history (especially political and legal history). We recognize, of course, that some of this material will be substantively and methodologically different from those normally encountered by supervisory participants and practitioners in these other disciplines. We hope that it will generate debate as to the application of bank supervision in these contexts, even if by contrary comparison.

Our intervention in debates about the historical foundations of bank supervision comes at a propitious time for the field of financial regulation, the

field to which we hope the book will be most relevant. As recently as the early 2000s, this field was relatively small and focused. The financial crisis of 2008 changed this. As the field has grown, conversations have become more specialized and more fragmented, a natural outcome of any expanding field. Financial regulation scholars have made contributions to monetary theory,¹⁷ market structure,¹⁸ sustainable finance,¹⁹ systemic risk regulation,²⁰ the political economy of crisis,²¹ congressional reactions to financial crisis,²² financial innovation,²³ digital finance,²⁴ financial inclusion,²⁵ payment systems,²⁶ financial regulation and bankruptcy,²⁷ bank antitrust,²⁸ and law and macroeconomics²⁹ (a nonrandom but still partial list). If anything, the COVID-19 pandemic—and the financial crisis that it sparked in the early spring of 2020—has solidified the intellectual energy around financial regulation as an important subfield of business law.³⁰

The problem, as with so many areas of scholarly specialization, is that these subfields have become evermore siloed such that those who focus on, for example, central bank governance are rarely engaged with those who are interested in market microstructure. This is lamentable, because there are genuine insights to be gained by keeping the subfields of financial regulation in conversation together, even on such disparate topics.

Private Finance, Public Power shows that bank supervision can be the connective tissue that brings these conversations together, thereby filling an essential role in unifying the field of financial regulation. In the chapters ahead, we address each of these literatures and many others as supervisors grapple with early changes to bank capital accounting, changes to institutional governance and market structure, antitrust overhaul, financial innovations, panics and crises, crime and scandal, and so much else. Bank supervision can provide the table around which these subfields can gather on a common set of insights and conversations.³¹

Indeed, our argument is bolder than that: Reliance on theory, legislation, and regulation alone—the primary tools of financial regulation scholars—is insufficient to understand any of these issues. Bank supervision is where these important ideas become tangible. To ignore bank supervision is to risk failure to grasp what really matters about each of these fields. Bank supervision is where the practice of government actually occurs in finance. Studying the development of legal rules and even institutions writ large cannot get close enough to offer much by way of description or interpretation of how public power is exercised in the financial system. The study of bank supervision thus facilitates that exploration much more authentically.³²

Supervision and History: State Capacity and Administration

Our other primary audience, beyond scholars focused on contemporary financial governance, are historians interested in the American administrative state. Our story about the development of bank supervision uncovers an important throughline in the nation's political and financial history, and especially contributes to debates about the evolution of state capacity and administration in the nineteenth century through the New Deal and on the process and consequences of the rapid growth of finance in the postwar period.

Private Finance, Public Power adds its voice to the chorus correcting the still-stubborn myth that American state capacity only came online during the Progressive Era. Others have expanded our view much more broadly, extending periods of experimentation deep into the nineteenth century. We join the revisionists but with a correction of our own: These scholars ignore bank supervision, one of the most creative and entrenched spheres of government action in the era. Federal bank supervision predated the Interstate Commerce Commission—the conventional starting point for bureaucratic development in the United States—by more than two decades at the federal level. It existed in the states for three more decades before that. In understanding the origins and rise of the bank supervision in the nineteenth century through the beginning of the New Deal, we learn about key aspects of state capacity that confirm some accounts and challenge others. These aspects include the array of institutional choices that confronted legislators and policymakers, judicial resolution of conflict versus bureaucratization, and, of course, the exercise of discretion in ordering private markets.³³

We also contribute importantly to the vast and still growing literature on the New Deal and the postwar period, focusing again on questions of state capacity. Here, the argument is not *whether* the government engaged forcefully in private markets—no one disputes these central facts of the New Deal and beyond. The question is more about the throughlines of such engagement, how much of a policy departure these moves represented, and what endured into the post–World War II era. The principal debates regard the intellectual content of the New Deal, including whether it was chaotically experimental or part of longstanding commitments, and the efficacy of the policy choices themselves. We engage in this literature directly to describe the key predecessors to New Deal bank supervision but also the extraordinary, seismic, and enduring moment that New Deal supervision represented, not least

that it was through supervision—in the form of the Bank Holiday of 1933—that Roosevelt created space without which the New Deal could not have materialized. The creation of deposit insurance and the reformulation of the Federal Reserve in the 1930s established conclusively the federal ownership of financial risk. Finally, we engage in debates about antitrust and financial concentration in the postwar era, as well as the role of state capacity used against said concentration and in favor of consumers and racial minorities as bank supervision arrived as a set of tools for managing residual risk beyond the safety and soundness of the banking system.³⁴

Overview of the Book

The book proceeds as follows.

In chapters 1 to 3, we discuss the longest historical period in the book, covering 1789 through 1907, including the period during which the institutions of supervision were most contingent and least resolved. In this part, we describe the state-based approach to bank supervision that existed in the nineteenth century, an ad hoc system that looked much more like “street-level bureaucracy” and much less like the system of institutionalized discretion that bank supervision would ultimately become. The origins are important, though, for the choices they reflect. In the nineteenth century, federal and state officials developed a variety of supervisory tools, including chartering, examination, publicity, private liability, liability insurance, forbearance, and receivership, all with the aim of limiting bank failure and failure’s consequences for bank counterparties. The balance of public and private power ebbed and flowed during this period, but repeated public failures—whether early liability insurance schemes before the Civil War or efforts at robust bank examination after it—led officials to fall back on private risk management within individual banks and collectively through private clearinghouses.³⁵

Chapter 4 then outlines the origins of the first competitive pressure among supervisory entities at the federal level with the advent of the Federal Reserve System in 1913, which sat uncomfortably alongside the Comptroller of the Currency (created in 1863) as a federal bank supervisor. Within the Federal Reserve System, the individual Federal Reserve Banks lacked the “chartering” authority of the Comptroller and the state banking authorities that usually brought supervision into existence. Instead, the Reserve Banks, built on the clearinghouse model, extended supervision through the practice of bank liquidity management by deciding which assets to discount or whether to

discount at all. Finally, chapter 4 outlines the continued limitations of “forbearance” as a method of supervision—that is, supervisory decisions to withhold action on non-performing loans in the face of crisis. This practice would become a familiar one, highlighting supervisory absorption of risk at the behest of politicians for purposes other than bank profitability.

Chapter 5 covers one of the biggest tests in the history of supervision: the Bank Holiday of 1933. We recast this landmark event as a triumph not of grand rhetoric and presidential charisma but as a successful invocation of bank supervision to legitimize uncertain political experiments that had already been attempted and had failed during the Hoover administration. This chapter also outlines the important relationship between supervision, legitimacy, and politics, a theme developed later on. Chapter 5 is the fulcrum of the book, placed between the origins of supervisory institutions and the solidification of risk management and discretion (backed by an unwavering public commitment) as the *raison d'être* of those institutions.

In chapter 6, we discuss the alternatives to the two models already tried and found wanting in the banking crises of the Great Depression—namely, the informational approach of the Comptroller and the states, and the liquidity approach of the Federal Reserve. Added to that mix are the Reconstruction Finance Corporation, one of the most important institutions of the New Deal, and the much more enduring Federal Deposit Insurance Corporation. The FDIC is, after Social Security, arguably the most important and successful innovation of the New Deal era. It also permanently and radically altered the orientation of bank supervision away from private conversations between bankers and the government for the purpose of protecting bank stakeholders writ large and toward a consumerist ethos that protected depositors (and, by extension, the deposit insurance fund). The other models did not disappear but remained as forceful sources of conflict between and among rival worldviews.

Chapter 7 narrates the problem of financial concentration and financial complexity by taking up the major postwar focus of bank supervision: mergers and acquisitions. Banking had been a special category within antitrust since the 1914 passage of the Clayton Act. In the 1950s, following a wave of bank consolidations, merger review became the explicit focus of bank supervisors as well. This change occurred alongside increasing challenges of supervising complexity. The model of the nineteenth-century unit bank that could be examined in a couple of hours by an aggressive and underpaid supervisor fell away. Financial department stores became increasingly the norm.

In chapter 8, the first cracks in the New Deal order are revealed as personnel changes in the Kennedy administration led to a fundamental reevaluation of the intellectual purposes of supervision as the residual risk manager of the financial system. Chapter 8 functions as a kind of public biography of James J. Saxon, the Comptroller of the Currency and sparring partner of virtually all of official Washington. Saxon was a pugilist; he was also an institutional innovator who sought to alter the risk tolerance in finance through supervision, efforts that did not succeed in his day but that planted the seeds of a radical alteration of those risks in the future.

Finally, chapter 9 concludes with a discussion of how civil rights and consumer protection became key parts of the supervisory apparatus through 1980. Chapter 9 illustrates Congress's enthusiasm for multiplying the paradigms of supervisory discretion into areas far beyond micro- and macroprudential risk. Bank supervision absorbed, increasingly, political risks as well. In doing so, supervisors took a cue from Congress and gave consumer protection more weight than antidiscrimination—because Congress included stronger penalties that could endanger bank safety in its consumer legislation. Following a pattern of institutional layering found throughout the book, federal supervisors' failures to adequately manage civil rights in finance led Congress to give these supervisors yet more tools—through the Community Reinvestment Act—with which to do so.

In this book, we track major transformations in banking and government over two centuries, and yet our conceit is that supervision is in a sense profoundly interpersonal and discretionary, worked out in conversations and correspondence between specific people, in specific institutional and historical contexts. At the best of times, many of the conversations that animate the nature of bank supervision are protected by high walls of secrecy. We have encountered many varied barriers as historians trying to document the nature of bank supervision. In the sweep of two centuries and in the face of such restrictions, some of the most important details can sift out. To answer these problems—and perhaps to indulge our own interests in the people we study—we have included interludes between the chapters, which we hope will reveal some of the substance of private and public interaction.

Bank Supervision After 1980

This book is not a comprehensive history of supervision to the present. We stop in 1980 for important reasons. Around 1979, the world changed. Chaotic experiments with monetary policy shifted the economic landscape increasingly

toward the Federal Reserve through its monetary policy powers. What later became known as the neoliberal consensus exploded onto the scene on a transatlantic basis with the presidential campaign of Ronald Reagan and the installation of Margaret Thatcher in the United Kingdom. The financialization of the U.S. economy left the nation's agricultural and industrial sectors behind.³⁶

Bank supervision underwent important changes during this critical period too. The basic apparatus of bilateral, institutionalized discretion that functioned as a manager and absorber of risk stayed the same, but its uses evolved substantially. Part of these changes came through the rise of the Federal Reserve as the preeminent financial supervisor, with a preference for stability through monetary policy. Part of this change came through the advent of greater financial concentration. Part came through the dramatic expansion of other non-prudential categories of bank supervision, principally consumer privacy protection and, even more so, anti-money laundering. And part also came through the crystallization of capital regulation as the primary mechanism for prudential regulation. *Private Finance, Public Power* uncovers the origins of these changes but leaves for another book the exploration of just how the state capacity of supervision was deployed during this neoliberal era.

Even so, this book provides many important insights for the 2020s (the decade of its publication). In key respects, the supervisory conflicts and opportunities that the United States faces in the twenty-first century—from massive financial crises such as in 2008, questions about climate change, combating terrorist financing, federalist conflicts around marijuana banking, and what to do about cryptocurrency and cyber security—all flow through the same institutional apparatus that was forged in the fires of the nineteenth century, the New Deal, and the postwar era. While these debates in their particulars would be foreign to the bankers, supervisors, and politicians whose stories we tell in this book, in general there would be much that was familiar.

We began our collaboration on this project in 2014. At the time, we planned only to write an article on the history of the Examination Report, a document whose form—we then thought—stayed remarkably stable from the 1860s to the 1950s. We imagined the Examination Report as a cultural artifact and example of the state attempting to render financial markets more “legible” for state control. As we pulled that thread, though, we began to see bank supervi-

sion as something much larger than bank examination and its associated paperwork. It is the story not only of bank examiners and politicians, but of con artists and lobbyists, racism and federalism, financial crises and monetary theory, and those who view bank mergers as the protection against financial collapse versus those who saw such mergers as the cause of that collapse. In the pages ahead, we tell their stories—along with many others—through the lens of a unique set of institutions that, in important ways, defined the development of the American state far beyond the Examination Report.³⁷

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