

The Discretion Dilemma

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BANKING OVERSIGHT IN THE UNITED STATES developed through a process of institutionalized discretion and layering. Rather than rigid rules or improvised interventions, each crisis, reform, and political compromise added new layers of authority and responsibility. The result? A system in which public power negotiates continuously with private finance—a dynamic that ultimately defines financial governance.

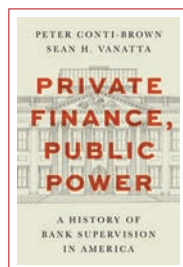
So say Peter Conti-Brown and Sean H. Vanatta in *Private Finance, Public Power*, a fascinating historical account of how bank supervision has evolved over the past two centuries. This historical lens is valuable for policymakers grappling with today's complex and fast-evolving financial ecosystem.

The authors trace how the architecture of US supervision—from the Office of the Comptroller of the Currency to the Federal Reserve, Federal Deposit Insurance Corporation, and state regulators—emerged not from deliberate design but incremental adaptation. Although often messy, this begot institutions capable of exercising discretion while remaining accountable to democratic authority. Institutionalized discretion—supervisory judgment embedded in an institutional structure—gives oversight its resilience and flexibility.

This adaptability has proved its strength, say Conti-Brown, an associate professor of financial regulation at the University of Pennsylvania's Wharton School, and Vanatta, a lecturer in financial history at the University of Glasgow. Institutionalized discretion enabled supervisors to respond to emerging risks, tailor interventions to institution-specific conditions, and interpret evolving norms and practices. It enhanced legitimacy of policy: Discretion is not arbitrary, but grounded in transparency and politically supported institutions. It can support both financial stability and market dynamism.

Yet there are limits to this model—limits that have become apparent in the contemporary financial landscape, where market structure, technology, and financial innovation evolve rapidly. A growing share of financial intermediation has shifted in recent decades beyond the regulated banking system to non-bank financial institutions (NBFIs)—asset managers, pension funds, insurance companies, private equity and credit funds, fintech lenders, and others. Banks, however, continue to provide liquidity, credit, and other crucial fee-based financial services to NBFIs. The fragmentation of regulatory and supervisory agencies compounds the challenge.

Risk taking has also been shaped (directly and indirectly)



**PRIVATE
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PUBLIC POWER**
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by the Federal Reserve's expanded crisis-management role, which has drawn the central bank deeper into financial markets over the past two decades, from backstopping markets during the 2008 global financial crisis to emergency interventions during COVID-19 and the 2023 regional banking stress.

Fundamental changes in market structure and rapid technological innovation point to emerging vulnerabilities: Fast-moving global financial flows, the rise of digital finance, and data gaps in the NBFI world make it difficult to monitor the migration of risks beyond the traditional supervisory and regulatory perimeter. Without better data, discretion could become guesswork. The rapid growth of private credit illustrates the tension between innovation, evolution of market structure, and the current approach to supervision.

This raises a question policymakers can't ignore: Is institutionalized discretion enough? In today's era of bank disintermediation, digital finance, and global capital mobility, maintaining the delicate balance between public power and private finance may require rethinking the supervisory and regulatory perimeter, expanding the supervisory tool kit, and clarifying policy objectives.

The book's historical insights remind readers that effective oversight depends not only on the wisdom of discretion but also on the strength of the institutions that wield it. **F&D**

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