Module 3
The US Banking System

Learning Objectives:

After the completion of this Module you will be able to:

1. Describe the role of banking in the nation's economy

2. Describe the roles and duties of the Federal Reserve system

1. Identify bank regulators and major bank regulations

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The Economy and the Banking System:

Introduction:

- Banks are a critical component of the national economy.
- The Banks’ role is to safeguard money for individuals, businesses and the government
- Banks are also financial intermediaries transferring money from one party to the other.
- Through the lending process they fund the economy as loan proceeds are usually deposited into depository accounts and increase the money in circulation.

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The Economy and the Banking System:

- Demand deposit balances less reserve requirements become the major funding source for loans granted to individuals, business and the government.
- Banks also serve as conduit for economic and social policy
- Through the banks, the Federal Reserve decrease or increase the money supply.
- Banks have major impact in the nations economy as they:
- 1. Offer financial services to consumers, business and government
- 2. Provide access to the payment system
- 3. Create money
- 4. Expand and contract the money supply

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Milestones in the evolution of US Banking:

1791: First Bank of the United States : First attempt to form a central bank failed due to opposition from bank competitor

1861: Second bank of the United States: Second attempt to form a central bank that also failed due to opposition from other banks.

1863: National Bank Act: Created national banks, Office of the Comptroller of the Currency, introduced the national bank note and the system for reserve requirements.

1913: Federal Reserve Act: This regulation created the first central bank and the Federal Reserve system

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Banking Law through the Great Depression

Banking Act 1933: Glass Steagall Act:

- Prohibited banks from charging interest on demand deposits
- Raised minimum capital requirements
- Prohibited members banks of the Federal Reserve to be engaged in the sale/underwriting of securities
- Created the Federal Deposit Insurance Corporation (FDIC)

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Banking Law through the Great Depression

Securities Exchange Act 1934:

- Gave the Federal Reserve the power to set margin securities.
- All loans made by banks that are secured by securities were subject to margin requirements.

The Federal Insurance Deposit Act 1935:

- This regulation is the amendment to Banking Act 1933
- Set standards for operation of FDIC member banks
- Gave FDIC authority to examine member banks
- Empowered the FDIC to establish action plans to protect member banks from failing
- Authorized the FDIC to pay depositors in banks that have failed

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Banking in the 20th and 21th Centuries

1946: Exchange National Bank of Chicago established the first drive in

1947: First Chicago Bank installed the first lockbox

1952: Franklin National Bank New York issued the first credit card

1960: Magnetic ink character recognition for automated check handling was created

1961: Citibank (formerly under the name First National Citi Bank) created a certificate of deposit for selected clients

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1966: Hempstead Bank established the first point of sale system (POS) in thirty two (32) retail banking establishments

1969: ATM machines were created

1972:

- Automated Clearing House (ACH) payment mechanisms was created.

- Citi National Bank of Columbus. Ohio offers the first

1974: Phone bill payment services was initiated

1980: Creation of first banking infrastructure

1994: Bank start their presence in the Worldwide Web (internet)

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1999: Mobile banking and electronic payment services was initiated

2000: Introduction of electronic signatures in consumer transactions.

2001: Introduction on the internet of the electronic payment systems

2003: Creation of electronic substitute check to support digital imaging of checks

2007: Large banks set – up websites to reach customers

2010: The initiation of cell phone point of sale purchases

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The Economy and the Banking System:

- Additional Readings:
- Banking in the United States: Timeline
- http://www.infoplease.com/timelines/banking.html

- http://www.factmonster.com/ipka/A0801059.html

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The Banking System and Regulation:

Gramm-Leach-Biley Act (GLBA)

- Enacted in 1999 provided a complete evolution to the financial service industry since the Great Depression.
- It is called the Financial Services Modernization Act of 1999
- The law repeal key provisions of the Banking Act (Glass Steagall Act) of 1933.
- The regulation provided banks the resources to compete with security firms and insurance companies. With the enactment of the law banks can now provide full complement of financial services, including loans, deposits, insurance and mutual funds.

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The Banking System and Regulation:

Gramm-Leach-Bliley Act (GLBA)

- Through the elimination of constraints, banks became leaders in the application of technological advances including mobile devices, growth of internet to improve communication and provide financial services.
- With the GLBA the following activities were allowed:
- 1. Lending, exchanging, transferring and investing for others;
- 2. Safeguarding money and securities for others;
- 3. Underwriting and selling insurance
- 4. Investment or economic advisory services
- 5. Securitization
- 6. Securities underwriting and dealer activities

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The Banking System and Regulation:

Gramm-Leach-Bliley Act (GLBA)

- With the GLBA the following activities were allowed:
- 7. Merchant banking and equity investment activities
- 8. Products offered overseas including travel related services
- In order to facilitate these new activities the law allowed for the creation of holding companies and financial subsidiaries
- The law specifies the powers that may be exercised in each type of banking organization

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The Banking System and Regulation:

Gramm-Leach-Bliley Act (GLBA)

- Aside from business opportunities, the law imposes requirements and obligations to protect customer financial information
- The law protects financial privacy and provide assurance that the customers' personal information will not be shared with third parties without authorization.

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The Banking System and Regulation:

USA Patriot Act:

- **Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act** (USA Patriot Act) was enacted to place responsibilities in financial institutions to track and prevent illegal transfers of funds.
- Some of the activities include:
- 1. Adopting and enforcing anti-money laundering programs
- 2. Implementing Customer Identification Programs
- 3. Reporting certain currency and other transactions to the government
- 4. The reporting of suspicious activities including potential terrorist financing activities

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The Banking System and Regulation:

Sarbanes Oxley Act 2002:

- Created to restore investor confidence in publicly held corporations.
- The law imposes new responsibilities in executives, directors, audit committees and accounting firms.
- Only applies to companies that are public and issue stock including public owned banks

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The Federal Reserve System:

Structure:

- The Federal Reserve comprises twelve (12) districts
- Each of the twelve (12) districts have a Federal reserve bank and a board of directors
- Member banks elect six of the members of the board of directors.
- The other three (3) directors are elected by the Board of Governors of the Federal Reserve System
- The Board of Governors of the Federal Reserve System are seven (7) members. Their tenure is for fourteen (14) years.
- The Board of Governors are elected by the President of the United States and confirmed by the Senate.

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The Federal Reserve System:

Structure:

- Through the President of the United States two (2) of the Governors received the appointment of Chairman and Vice-Chairman.
- The appointments are for four (4) year terms. The appointments do not coincide with the President’s term.
- Most federal reserve banks have branches.

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The Federal Reserve System:

Responsibilities:

- 1. Maintain the stability of the financial system
- 2. Conduct monetary and credit policy
- 3. Supervise and regulate banks
- 4. Provides financial services

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The Federal Reserve System:

Responsibilities:

- 1. **Maintain the stability of the financial system**: The Fed provides liquidity and controls risk in financial markets

- 2. **Conduct monetary and credit policy**: The Fed influences the cost and availability of money and credit. The Fed sets interest rates and as such motivates employment and economic growth.

- 3. **Supervise and regulate banks**: The Fed monitors the banks’ safety and soundness and monitors

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The Federal Reserve System:

Responsibilities:

- 4. **Provides financial services:** The Fed has a major role in the US payment system. It provides services to the US government, foreign banks and financial institutions.

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The Federal Reserve System:

Responsibilities:

- -The Fed controls the money supply and influences the flow of money and credit.
- These actions are performed through three (3) man tools:
- 1. Reserve requirements
- 2. The discount window
- 3. The open market operations
- - The Fed issues regulations and guidelines that are applicable to national and state member banks.

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The Federal Reserve System:

Services:

- -The Fed provides banking service to member and non-member banks.
- -These services are performed charging a fee.
- - These services include:
- 1. Packing and transportation of coin and currency to meet clients demands for withdrawals in depository accounts. It also removes damaged currency from circulation
- 2. Check processing by providing imaging capture, check clearing, and the service of collection and return items.
- 3.The Fed provides electronic transfer of funds and securities between financial institutions that maintain an account with the Fed.

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The Federal Reserve System:

Services:

- 4. Automated Clearing House (ACH): The Fed is the primary provider of electronic debit and credit transactions. It sorts the transactions and presents them to the paying or receiving banks.
- 5. Settlement services: The Fed provides settlement services when checks are processed by local clearing houses of Fedwire.
- 6. Service to the US government: The Fed is the fiscal agent for the US government and maintains the account for the US government.

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The Regulators and their role:

1. The Federal Reserve

2. The Office of Comptroller of the Currency (OCC)

3. Federal Deposit Insurance Corporation (FDIC)

4. Office of Thrift Supervision (OTS)

5. State Banking Departments

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The Regulators and their role:

1. **The Federal Reserve:**

- Considered the US Central bank
- Conducts monetary policy
- Supervises and regulates many of the nation's banks to protect consumers.
- Maintains the stability of the financial markets and constrains potential crises.

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The Regulators and their role:

2. The Office of Comptroller of the Currency (OCC):

- The OCC is part of the US Department of Treasury and in charge for chartering, examining and supervising national banks

- The OCC approves all applications for the opening of domestic and foreign branches, new services and mergers and acquisitions.

- It also supervises federal branches of foreign banks in the United States

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The Regulators and their role:

3. Federal Deposit Insurance Corporation (FDIC)

- The FDIC supervises and completes examinations on state-chartered banks that are not supervised by the Federal Reserve System.

- It examines other FDIC-insured institutions for deposit insurance.

- Any national and state-chartered banks that are members of the Fed must belong to the FDIC.

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The Regulators and their role:

3. Federal Deposit Insurance Corporation (FDIC)

- Promotes the safe and soundness of member depository institutions identifying, monitoring and addressing potential risks to the Depository Insurance Fund that insures deposits.

- Maximum deposit insurance I $250,000 per depository institution.

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The Regulators and their role:

4. Office of Thrift Supervision (OTS):

- The OTS regulates and supervises federally chartered and state-chartered thrift institutions.
- These financial institutions include savings banks and savings and loan associations,

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The Regulators and their role:

5. State Banking Departments:

- For state-charter banks each state has its own banking department to perform the chartering, supervising and examining the state chartered banks

- State chartered banks decide whether or not they will become members of the Federal Reserve and the FDIC.

- State banking departments also examine branches and agencies of foreign banks that operate in the State.