Remarks by

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I would like to thank the Office of Financial Research and the Michigan Center for Finance, Law, and Policy for the opportunity to speak with you today.

This conference is an excellent opportunity to discuss trends affecting financial services and how regulators should respond to those trends.

The Role of Banks in the Financial System

There is longstanding interest among policymakers and academics in how best to organize the regulation of financial services. The traditional U.S. regulatory model for financial services focuses on the legal entity, whether it is a bank, a broker-dealer, or an insurance company. Another school of thought is that since different legal entities sometimes provide similar financial products, the focus of regulation ought to be the products or activities themselves.

The FDIC – in its deposit insurance, supervision, and resolution functions – is an example of the legal entity model of financial regulation at work. As FDIC Chairman, my focus is to work within the regulatory structure we have, and try to make it work as effectively and transparently as possible.

A vibrant banking sector that operates in a safe and sound manner and is fair to consumers is a strong support to a nation's economy. Banks play a number of important functions in our economy. In addition to providing a safe place for consumers to deposit cash and an avenue to access credit, banks also play a unique role with respect to their central role in the payments system. Bank depositors have the power to place and demand money, write checks, and access the payment system, including through wire transfers, all of which provide benefits to the financial system both in normal times and in times of stress. Deposit insurance preserves public confidence in banks' capacity and ability to meet deposit obligations, which in turn contributes to overall financial stability.

Over time, the traditional role of banks has evolved, and continues to evolve today. The financial services sector is always shifting in response to legal and regulatory changes, economic cycles, competition, and technological innovation. Many of these changes have brought great benefits to consumers – the democratization of finance; cheaper, more accessible services; and more efficient markets. At the same time, banking inherently comes with risk, and it's important to monitor what types of risk accompany changes in the industry.

Today, as in the past, developments in financial services force us to consider questions about how the traditional role of banks may evolve. For example, will the rise of non-bank companies providing new and technologically innovative financial products and services drive banking activities out of banks? If so, in what ways? How will the risks in the financial system change if there is a significant migration of activities to the nonbank sector?

The migration of traditional bank activities outside the banking system is not new. In fact, nonbank competition and innovation have always been a part of the financial landscape. This competition has helped spur evolution in bank product offerings and delivery channels, as well as changes in policy, regulation, and supervision to address new and sometimes unforeseen risks. For example, money market mutual funds, introduced in the 1970s, proliferated in the high interest rate environment in the 1980s and resulted in a migration of cash away from insured savings accounts at banks into money market funds.

In response, legislative and regulatory reforms allowed banks to offer new products – bank money market deposit accounts and negotiable orders of withdrawal – and removed restrictions on interest rates. These changes leveled the competitive playing field for insured deposits, but led to other risks – namely, providing incentives for banks and thrifts to engage in higher-yielding, but risky, lending and investment activities. Today, money market mutual funds – with balances of $2.8 trillion and estimated insured bank deposits at $7.4 trillion – co-exist as important and convenient options for investors and savers.

While new competition always bring evolving opportunities and risks to the financial services landscape, regulators and industry participants need to ask whether this time is really different, given the rapid pace of innovation and the changing tastes and demands of consumers.

In other words, over time, what will it mean that I can get a mortgage while sitting at home in my pajamas? (And that may or may not have happened.) Financing a home purchase with a mortgage has traditionally been a significant life event and a major relationship "touchpoint" for banks with consumers, so how will that change? Similarly, how will the proliferation of alternative payment platforms affect banks' role in the payment system? How will consumers value

the relationship with the bank or the payment app? Also, if transactions are out of regulators' purview, how can we ensure that consumers are treated fairly and that sensitive data is secure?

Migration in Mortgage Activity

For some financial activities, migration outside the banking system is happening now. The most prominent example during the post-crisis period has been a substantial migration in mortgage origination and servicing from banks to nonbanks.

As with many banking activities and business lines, banks have long competed with nonbanks for mortgages. Going back to the earliest days of the American mortgage market, privately owned mortgage companies dominated local markets, often funding their loans through life insurance companies or, especially in more urban markets, through mutual savings banks. Indeed, for a time, nationally chartered commercial banks were actually prohibited from providing mortgage loans.[1]

[1] The National Bank Act of 1864 prohibited national banks from making loans on real estate. These prohibitions remained in place until 1913. See, e.g, Robertson, Ross M., The Comptroller and Bank Supervision, 1995, page 65.

Of course, that has changed, and both the availability of mortgage credit and the composition of the mortgage market have ebbed and flowed over time in response to crises and business cycles, legislative changes, and technology and innovation, among other factors. In the last decade, banks have lost significant mortgage market share to nonbanks. For example, in 2009, nonbanks accounted for only 9 percent of the volume of mortgages originated by the top 25 originators, versus 44 percent in 2018. Five of the top 10 mortgage originators are now nonbank institutions, compared to just two in 2009. Additionally, one nonbank originator is now the largest retail originator, after being outside the top 10 in 2009.[2]

While mortgage origination activity has migrated to nonbanks, a portion of that risk remains with banks or could be transmitted back to the banking system through other channels. Bank lending to nonbank financial companies has increased from $56 billion in 2010 (when the data were first collected in the Call Report) to $376 billion in June 2018, a 571 percent increase. While it is uncertain the exact makeup of the obligors for this Call Report line item, supervisory experience has revealed that nonbank mortgage originators do receive funding from bank loans.

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[2] Based on Second Quarter 2009 and Second Quarter 2018 data from Inside Mortgage Finance Publications, Inc., www.insidemortgagefinance.com.

A similar migration pattern is evident in mortgage servicing. Nonbanks accounted for 41 percent of mortgage servicing rights held by the top 25 servicers in 2018 versus just 5 percent in 2009. Six of the top 10 mortgage servicers are now nonbanks, compared to just two a decade ago. This trend has been most notable among mortgages guaranteed by Ginnie Mae, where 60 percent of outstanding loans are now serviced by nonbanks.

Implications of Migration for Banks and Regulators

As we look at the migration of activity away from banks, regulators and policymakers should consider the risks and benefits. Part of that process is asking questions. What happens to the systemic risk in the financial system when banking activities migrate to nonbanks? Are prudential banking and market regulators adequately positioned to deal with such shifts? How much exposure do banks have to nonbanks engaged in traditional banking activities?

There also are positive aspects of migration – namely, increased consumer choice, positive consumer experiences, and potential for increased access to new innovations. On the subject of innovation, it's safe to assume that banks will want to keep pace with the new technology and services offered by nonbanks. And, as regulators, we should encourage banks to innovate, especially in ways that can improve the customer experience, lower transaction costs, increase credit availability, and expand access to the banking system.

This last point is particularly important to the FDIC: our latest survey shows that more than 8 million households do not have any relationship with the banking system. Another 24.2 million households are underbanked, meaning they have a bank account but also meet some of their financial services needs outside of the banking system. Innovation and technology may provide inroads to bring these households more into the banking system.

The FDIC is working to establish our own Office of Innovation. We are in the very early stages of scoping out this office and its mission, and we are looking at ways that the FDIC as a regulator can avoid getting in the way of beneficial innovations and technologies that will help our regulated entities stay competitive.

Innovation can introduce safe and reliable products and services that will provide Americans with more options to meet their financial needs. It is my goal that the FDIC lay the foundation for this next chapter of banking, encouraging innovation that meets consumer demand, promotes healthy and successful banks, and reduces compliance burdens.

Thank you.