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BROKERED DEPOSITS IN THE FINTECH AGE

FEATURING KEYNOTE REMARKS BY
FDIC CHAIRMAN JELENA McWILLIAMS

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P R O C E E D I N G S

MR. KLEIN: Good morning. If I could ask folks to grab their coffee and take a seat. I want to welcome everybody here for a conversation at Brookings at the Center on Regulation and Markets. I'm Aaron Klein; I'm a fellow in Economic Studies and the policy director here at the center.

You know, I'm sure that everybody in this audience, and frankly everybody in America, has been talking nonstop about brokered deposits (laughter) for all of 2019, starting when the FDIC put out their advance notice for public rule making and started soliciting comments. And in point of fact, I make this joke because this is not on the front page of the papers, this is not on the bubbling lips of the chattering class, but this is very much the type of issue that changes in regulatory policy can make that can have deep and profound consequences. And it's why Brookings established a Center on Regulations and Markets and why I believe its work is so critically important, because particularly in today's political and complicated regulatory and legislative environment, it is precisely changes to regulations like this that have significant consequences for the future of the financial system and for consequently, deep impacts on everyday people.

I think most people don't appreciate, and frankly, to be slightly honest I didn't either until I started reading all of the wonderful comments that came in through this process, how many brokered deposits I have. I didn't realize that my health savings account little debit card was a brokered deposit, I didn't realize that the prepaid card gifts that I get and receive this time of year are often brokered deposits. I didn't realize when I talked to folks who said they had bank accounts, when you really broke it down had fintechs or broker dealers that swept their money that they were considering and falling under this rule brokered deposits.

In point of fact, you know, often my view of brokered deposits was what I had learned 30 years ago, or well, 20 years ago when I started in this space, which is based on the financial crisis, or the banking crisis that wasn't quite the last one. We all focus on the last crisis and then we forget all the other ones before. History has shown one thing, it's rarely the same crisis twice in a row. But a couple of ones ago, the savings and loan crisis, which those of us of a certain age are old enough to remember in varying degrees, and was a really big -- it was the greatest banking calamity anybody was ever going to see in their lifetime, featured a large role of brokered deposits, and there was a series of regulations after that. And in the intervening time, the world has changed a bit. And the FDIC has chosen to look at this issue, solicited comments, and I think we're going to hear from Chair McWilliams kind of some of the thoughts and ruminations and where the ball has moved on this in a way that is going to touch everybody in this room, it's going to touch everybody in America, and probably honestly isn't going to end up ever on the front pages of the newspapers.

That's precisely the type of regulation that it's important to have an open and honest and public conversation about, feature diverse views, and hash through and make improvements.

With that, it is my great honor and privilege to introduce Chair McWilliams. For those of you who have not had her speak, I wonder where in the banking world you've been because she's been everywhere. She is an amazing personal story, but couples with it -- what I want to give -- is just amazing whip smart analytical insight and ability in my experiences with her to cut to the heart of an issue immediately to see arguments that make sense and to probe to see arguments that are self-serving and fallacious and swat you down pretty quickly. Whenever you go into talk to the Chair you better be on your A+ game, and even then you will be on your toes.

Beyond that, I just want to thank her for taking the time ad opportunity to engage with us and all of this on a rule that I think is incredibly important and is indicative of her leadership at the agency.

So, with that, I'd like to welcome Chair McWilliams to the stage. The floor is yours. (Applause)

MS. McWILLIAMS: So when Aaron talks about remembering crises from 30 years ago, I feel like saying, okay, boomer. (Laughter) But then I remember that we're very close in age and I decide not to.

Thank you for having me here today and it's always a pleasure to be with you, Aaron, and it's an honor to be at Brookings as well. As a kid growing up elsewhere, I could have only dreamt of standing here, but I do remember when I first came to DC, just being enamored by coming to listen to different sessions at Brookings and thinking what a venerable institution. So it's a privilege to be here today.

I will talk briefly about -- briefly -- it's not that brief (laughter) -- about brokered deposits today. And I have generally abstained from giving major policy speeches in general. Why, because I think it was warranted for me to spend some time at the FDIC digging deep to understand why do we do things the way we do them. And this is actually one of my first major policy speeches where I'm actually laying out some of the ground work for what we are looking to accomplish and hopefully with your help.

On April 29, 1982 the superintendent of banks for the State of California closed down a bank in San Diego by the name of Pacific Coast Bank. Do you remember that one too, Aaron? All right, good, not a boomer. In the four months prior to failure, Pacific Coast Bank, despite a capital position of less than $200,000 acquired more than $5 million in brokered deposits and booked more than $5 million in loans. The majority of the new loans were fraudulent and resulted in jail sentences for the individuals who controlled the bank. The bank failure ended up costing the FDIC approximately $5 million.

More famously, or infamously, and far more costly to the FDIC, was the story of Penn Square Bank, a one office bank based out of a shopping mall in Oklahoma City that was closed a few months later. From 1977 to 1982, Penn Square Bank grew dramatically from around $30 million in assets to more than $400 million. The bank focused on oil and gas loans, many of them notoriously poorly underwritten, and many of which it sold to upstream banks. When oil prices began to fall, the bank suffered large losses.

Prior to January 1982 Penn Square maintained only a moderate level of brokered deposits, around $20 million. However, between January and July the brokered deposits at Penn Square increased to $282 million. Even as the condition of the bank deteriorated and local depositors pulled their money, Penn Square continued to churn out loans. On July 5, the office of comptroller of the currency -- notice not an FDIC bank -- closed the bank and losses to the Deposit Insurance Fund ultimately amounted to $65 million.

The failure of Penn Square Bank shined a spotlight on the use of brokered deposits, prompting congressional hearings and regulatory scrutiny. It was one of many bank regulatory issues Congress and regulators debated as hundreds of banks and thrifts failed across the country over the next few years. Many of these institutions exhibited a similar pattern, rapid growth in risky, poorly administered, low quality assets fueled by brokered deposits, followed by attempts to "grow out of their problems" by adding more of both.

This was an era before minimum capital rules, when banks could operate with very low or even negative levels of capital but continue to stay afloat. I'm fortunate I wasn't the chairman during that time, Bill Seidman was, and he had a whole building now named after him.

When these so called zombie banks failed, it was very costly to the insurance fund. In 1989 Congress acted by, among other things, amending the Federal Deposit Insurance Act by adding section 29, which generally prohibits the acceptance of brokered deposits by banks that fail to maintain a minimum level of capital. Congress addressed the specific problem present at both bank failures, such as described, the use of brokered deposits by troubled institutions to fund rapid growth in low quality assets.

The statute mandates that the FDIC use a blunt tool to address an important policy problem. The law permits the unlimited use of broker deposit funding for banks that are well capitalized, but completely cuts off bank from all brokered deposit funding once capital falls below a certain level. Yet this is when banks are most in need of a stable source of liquidity to try to right the ship. While some 500 banks failed during the recent financial crises, many others that experienced trouble were able to stabilize and survive at no cost to the Deposit Insurance Fund, or the taxpayers frankly.

Meanwhile, the language used in the statute has led to many questions regarding what is and what is not a brokered deposit. The statute defined a deposit broker in a manner that some have interpreted very broadly and others more narrowly, and provided non-exceptions from this definition, including one, the primary purpose exception, that some have interpreted very broadly and others, again, more narrowly. The FDIC historically has interpreted the term deposit broker broadly, with notable exceptions and has interpreted the primary purpose exception narrowly, again, with exceptions.

Since section 29 became law in 1989, the industry has change dramatically and it continues to evolve today. In the 1980s business communicated through phones and fax machines and bank customers typically deposited money and accessed banking services by walking into a local bank branch. The term brokered deposit was commonly understood to refer to a specific market in which third-party brokers gathered and pooled funds and placed them in brokered CDs issued by banks. Since then, the emergence of the internet and other technological innovation has fundamentally changed how banks interact with their customers. While some depositors still walk into a local branch, many customers now access banking services solely through the use of internet or smart phones. And today customers are increasingly utilizing channels such as prepaid cards and third-party fintech apps. Bank accounts are increasingly available to customers through partners or affiliates of banks.

A prime example is so called sweep accounts, which emerged around the early to mid-2000s, in which broker dealers sweep cash balances that are not invested in stocks and bonds into FDIC insured bank accounts or money market funds. Additionally, regulatory changes, such as the repeal of interstate banking restrictions, have increased competition for deposits in markets throughout the country.

As the banking landscape has changed and the permutations of how deposits are structured and offered have expanded, the FDIC's brokered deposits regime has struggled to keep up. First, the FDIC faced difficult questions regarding whether different types of deposit arrangements should be reported as brokered. The FDIC responded to each of these questions on a one off basis, typically through confidential letters or public or nonpublic staff advisory opinions. The result was development of a fragmented, opaque legal regime that exists outside of the FDIC's public facing regulations understood by only a select few.

It reminds me how my good friend, Randy Quarles, described the Federal Reserve's treatment of control under the Bank Holding Company Act, which he said was understood only by those with -- and I quote, because I could not come up with this on my own -- a long apprenticeship in the subtle hermeneutics of Federal Reserve lore, receiving the wisdom of their elders through oral tradition, like the tribes of Orinoco. (Laughter) If English were my first language maybe I would have a greater appreciation for subtle hermeneutics, but I suspect many of you will need to look up where the Orinoco is too, and some of you will have to look up the word hermeneutics as well. Nonetheless, it seems like a suitable description of the FDIC's brokered deposit regime, and I wish I could have come up with it on my own. You should know better than to play Trivial Pursuit with Randy Quarles. (Laughter)

In 2015 and 2016 the FDIC issued a set of FAQs in an effort to more clearly explain the agency's interpretation of section 29 and how its interpretation applied to different types of deposits. While this was a commendable effort to provide more transparency, it did not address many of the underlying interpretative issues and inconsistencies that had arisen over the years. And many firms continue to operate under individual nonpublic advisory opinions.

In December 2018, 6 months after I became chairman, the FDIC issued an advance notice of proposed rulemaking seeking comment on how to update and modernize the brokered deposits regime. I promised to undertake a comprehensive review of changes to the industry and the FDIC's regulatory policy. After receiving more than 100 comments, which apparently Aaron read individually, in a year of closely studying changes to the industry, the FDIC board will vote tomorrow on a proposal that establishes a new framework for regulating broker deposits.

That new framework was designated with four specific goals in mind. The first goal is to develop a framework that encourages innovation within the industry and allows banks to serve customers the way customers want to be served. The approach is intended to reflect how consumers want to access banking services in 2020 and beyond. The proposal will clarify that various types of existing partnerships in which a consumer maintains a direct relationship with a bank generally would not result in a brokered deposit.

Since becoming chairman, I have prioritized establishing a regulatory approach that encourages rather that stifles innovation. Striking the right balance in how we interpret the brokered deposits statute is key to this goal. As we seek to remove regulatory hurdles to innovative partnerships between banks and nonbanks and avoid discouraging banks from offering products and services through online and mobile channels.

The second goal is to take a balanced approach to interpreting section 29 that tracks the letter and spirit of the law. For example, the statute provides that an entity is not a deposit broker and thus deposits it places are not brokered deposits if the entity's primary purpose is not the placement of deposits at depository institution. Under our proposal, the FDIC would analyze whether the primary purpose exception was met by looking at the business relationship between the third-party and the customer for whom it is placing or facilitating the placement of deposits consistent with the plain meaning of the statute.

The third goal is to minimize risk to the Deposit Insurance Fund and to ensure we address the core problems Congress sought to address in passing section 29. In furtherance of this goal, under the proposal brokered CDs would continue to be treated as brokered deposits under the proposal. These were the specific products members of Congress explicitly referred to when debating the legislation and they continue to compromise -- I think I put contacts in the wrong eyes this morning -- to comprise a large portion of the brokered deposit markets today. Brokered CDs are used by some investors to place money in a number of FDIC insured accounts, thus receiving FDIC insurance on large sums of money by spreading out deposits to stay within the $250,000 statutory limit at each institution.

Separately, the FDIC is also considering changes to its deposit insurance assessment pricing to address concentrations in funding that are correlated with higher losses to the DIF. This could include unaffiliated sweeps that qualify for the primary purpose exception under the proposal and certain listing service deposits, which in many cases are not considered brokered today.

The changes the FDIC is considering to its brokered deposit regulation should not be interpreted to mean the FDIC is ignoring the potential risks associated with different forms of funding. For large banks, a modification to address these types of funding concentrations is one of several changes the FDIC is considering to make its pricing more risk sensitive.

The fourth goal of the new framework is to establish an administrative process that emphasizes consistency and efficiency. First, our proposal would establish an easy to understand bright line standard for determining whether an entity satisfies the statutory definition of a deposit broker or not. Second, it would establish an application process for implementing the primary purpose exception. Today, when a new product is developed and an institution wants to know whether to report it as brokered, there is no established process for making such a determination. At time, requests to the FDIC for clarity have lingered for years. Meanwhile, there are certain types of deposits that some institutions report as brokered and others do not report as brokered. We intend to establish a more rigorous process to give institutions clear timely feedback on whether deposits should be reported as brokered or not.

Those are our four goals. Optimizing for all of these goals is challenging and we look forward to feedback on the proposals if approved by our board tomorrow. The new framework is still somewhat complicated, but this is the inevitable result of an ambiguous statute that was written in a very different era.

It is of course up to Congress to decide whether and when a holistic review of the brokered deposit statute is warranted. But if Congress were to undertake such a review -- and I was asked about it at a hearing last week, so I feel compelled to offer a suggestion -- they should know better than to ask questions -- there might be better ways to accomplish the worthwhile public policy goal

Congress intended to address. One option to consider is replacing section 29 of the FDI Act altogether with a simple restriction on asset growth for banks that are in trouble. This would be a far easier regime for the FDIC to administer, would at the very least limit the size of the FDIC's potential exposure, and would more directly address the key goal of preventing troubled banks from using insured deposits to try to grow out of their problems.

A simple limitation on asset growth would also be more durable and should retain its effectiveness as the industry evolves and as banks change the way they attract deposits over time.

If Congress were to choose not to replace section 29 altogether -- they shouldn't ask me -- and instead if they choose to maintain a statutory restriction on brokered deposits, Congress could consider repealing the primary purpose exception, which puts the FDIC in the challenging position of trying to decipher the purpose of every potential deposit broker in the country and replacing it with a more flexible exception based on actual risk to the DIF. Congress could also consider allowing more flexibility regarding when and under what circumstances broker deposits are prohibited or restricted.

If Congress chooses to tackle these issues, the FDIC stands ready to provide assistance, although they might not want us after today. In the meantime, we will implement the law as it exists today. The proposal the FDIC board will vote on tomorrow is the next step in that process.

According to the FDIC's most recent national survey of unbanked and underbanked households, more than 20 million Americans live in households in which no resident has a checking or savings account at a bank. Yet approximately half of these individuals own or have regular access to a smart phone. Meanwhile, many banks located in low income areas, including a number of minority depository institutions, depend on deposits sourced from outside their local areas for funding. The changes we are considering to the brokered deposits regulation are intended to help such individuals and such firms and they are intended to provide more certainty and less opaqueness to the regulatory framework.

Thank you for your time today and I look forward to the questions you may have later.

Thank you. (Applause)

MR. KLEIN: Thank you. Great. Thank you very much. you put a lot of ideas out there.

MS. McWILLIAMS: I know.

MR. KLEIN: Let's kind of start in the beginning. You were talking about the 1980s and the history of brokered deposits in the savings and loan crisis, back in the good old days when bankers went to jail who broke the rules. When I read through the FDIC's --

MS. MCWILLIAMS: Still go to jail for fraud.

MR. KLEIN: Well -- anyway (laughter).

MS. MCWILLIAMS: Talk to our IG. They actually send people -- they arrest people and take them to jail.

MR. KLEIN: I remembered watching that after Enron, which was a different kind of fraud.

But you guys, when you were going through the last financial crisis and did a big history on that, the FDIC kind of wrote "the history shows that failures in downgrades were highly correlated with reliance on brokered deposits and other wholesale funding sources". So I kind of want to ask like a threshold question, right. You have this topic, it was certainly mega toxic in the S&L crisis, according to the FDIC's work it had an interaction and a high correlation with the last crisis, why choose to engage? You don't have a legislative mandate. What was the rationale and choice behind going down this road?

MS. MCWILLIAMS: Because apparently I didn't get the main lesson of being in Washington, DC, which is that status quo is always better than rocking the boat when rocking the boat is when the boat has holes in it.

All joking aside, it's because frankly we looked at both the history of how we have interpreted broker deposits, we have looked at the technological changes in the industry, we actually have looked ad nauseam through the legislative history of the changes made to the FDI Act in response to the crises and the brokered deposits, and we tried to understand exactly what was congressional intent. And as former congressional staffer I always like to be closer to congressional intent rather than further away because that can get us to all kinds of trouble. Frankly, industry has changed. Everything has changed about how deposits are taken. You know, how many of you would have imagined 15 years ago taking a picture of a check and depositing it -- 15 years ago. And we're talking about a statute that was put in place 30 years ago. And I actually had to teach my daughter the other day what it looks like to sign the back of the check and it says deposit only. (laughter) And apparently that's a lost art on kids these days.

So the industry has changed, the way banks and nonbanks frankly are dealing with the deposits has changed, and the statute has not kept to date. So I figured it's better to open it up for comment and allow all of you an opportunity to comment -- the affected stakeholders will I'm sure comment -- and give us feedback on what should be changed and how it should be changed.

MR. KLEIN: Well, I mean you make a very fair point, a lot has changed in the financial world. In point of fact, as somebody who was involved in writing the law that allowed you to take that picture -- you know, that would have been illegal to do without Congress changing the law. And it was only changed not because of a desire to increase with technology, it was changed because of 9/11 and the planes that used to fly the paper around were grounded for a week and people got freaked out that that could regularly occur. So this kind of -- back then the Federal Reserve was very forward looking on the payment system and put out an idea and Congress acted, but it was more of a security instability perspective.

I commend you for thinking about --

MS. MCWILLIAMS: I actually don't want to play Trivial Pursuit with Aaron Klein either.

MR. KLEIN: Well, I would love to play Star Trek Trivia with Governor Quarles.

(Laughter)

But, look, new financial technology is radically changing, right. I mean we can -- you know, I've been in presentations with fintechs and we'll hear from in the room in the panel, where in the end I thought I've opened a bank account. And only then later found out that I actually opened a broker dealer account that's going to sweep my money into a bank account and I'm going to have all the appearance of running a bank account, but I think I'm actually having a brokered deposit.

MS. MCWILLIAMS: And so we did anecdotally the same thing. You know, a couple of my advisors and I, as we were looking through this, we started looking at our accounts, literally started looking through our different accounts, realizing that some were brokered and we didn't know. Literally reading the fine print to understand this is a brokered account.

MR. KLEIN: And is your point then that the risk that poses to the DIF are the way consumers behave on those type of accounts have nothing in common with the six month CDs that are chasing the highest interest rate in the newspaper?

MS. MCWILLIAMS: Yes. The bottom line here is that we're not trying to, you know, shake up the system for the sake of shaking up the system. I would have probably picked a less difficult topic to do that on. The bottom line here is that we have a system that's not clear as to what's brokered, what's not. It's based on our interpretive opinions, which are also not clear to everybody. So not everybody is playing by the same rules in terms of what's brokered and not. And it's more so driven by the entity by the type of a deposit right now, as we look to determine what's brokered and what's not?

MR. KLEIN: What do you mean "by the entity"?

MS. MCWILLIAMS: We will give advisory opinions that something is brokered and for entity A that may be reported as brokered, for entity B that same activity may not be reported as brokered.

MR. KLEIN: So there's a deep inconsistency across America's 5,700 depository institutions? I won't even talk about credit unions.

MS. MCWILLIAMS: Let's not. Yes. (Laughter)

MR. KLEIN: Okay. So let's assume that your idea is adopted by the FDIC board tomorrow and the first lesson of working on the Hill is count the votes.

MS. MCWILLIAMS: Yeah. And if you grow up on the wrong side of the Iron Curtain you don't take anything for granted, so I'm hoping we have enough votes, but we'll see tomorrow.

MR. KLEIN: We'll see.

So then let's play this little game that kind of 10 years from now, right, we all get to come back and take a victory lap on this change. What do you think or hope the best impacts will be from this change that we'll have seen in society in 10 years? And bonus points if that can impact a real person and not this kind of back room consistency of the back office of banking, which itself is a valuable perspective.

MS. MCWILLIAMS: So what we're hoping to accomplish is basically to encourage innovation in this space, and while we're doing that to provide clarity on how you can do the business of deposit taking and what is truly brokered, what is not without you actually having to go to the Orinoco tribes and figure out what exactly, you know, they are saying.

The bottom line here is that we are stifling innovation. If you have to send me a request to explain if something is going to be brokered or not as you're entertaining different business models that have not been entertained before and we take say six months to a year to respond to you, you know where the product is going -- to Hong Kong and London. And there was just an article about two-three weeks ago that London is surpassing Silicon Valley as the startup and innovation hub. And so the question is how do you want our system to function? Do you want it to function based on a 30 year old law that has been surpassed by the technological changes, that are frankly -- the law is stifling innovation in this case. And waiting for us to give you that interpretation is truly -- could kill your business model. And if that business model works to the benefit of the consumers, then we need to be more responsive. In the end, you know, America is a place where people come because -- I came here because it was, you know, one of the best places in the world for innovation and for the opportunity to do things that nobody else is doing. And if our regulatory framework is not adjusted to that and actually fosters innovation and promotes innovation, it's not going to be a place where things develop. It's going to be someplace else.

MR. KLEIN: The difference between permission and forgiveness is somewhat important, right, if you think about ride servicing, right. If Uber and Lyft had gone to every single county and asked the taxi cab board for permission, I can at least tell you in my county of Montgomery County, Maryland where the taxi cabs are controlled 90 percent by a guy named Barwood who also sits on the citizens advisory board as chair of the taxi cab commission, I can tell you where that would have ended up, which was incredibly expensive and poor service that was deeply disrupted.

On the other hand, we have a financial services sector that has a very different role than local transportation, that has a lot more government regulation. So let's play the time traveler game in a different way. We are going to come back from the future and something went wrong and we'll say that it was your successor's watch and error, who did -- something bad happened in this rule under their watch.

MS. MCWILLIAMS: Of course.

MR. KLEIN: Of course. What do you think it would have been?

MS. MCWILLIAMS: Well, if we come back from a time travel, I would insist that you write me a comment letter when you're in that point further in time and then make sure to deliver it within our comment period now (laughter) telling me what really I need to focus on.

MR. KLEIN: I wish I could have been Dr. Manhattan, for those of you watching the latest show.

QUESTIONER: That's our comment letter.

MS. MCWILLIAMS: That's your comment letter? Thank you, Ben.

Here's the bottom line, we have -- as we developed this comprehensive overhaul -- this is not -- you know, we had a choice of do we just want to tinker on the edges and, you know, not shake the boat, you know, why would you, or do we want to actually create a system that's going to be feasible -- a regulatory system and the framework for deposits and brokered deposits that's going to be feasible and open to innovation as we look forward. Basically we could have done, you know, look back 5 to 10 years and address those issues or you could look forward 10-20 years and try to address and create a framework that's going to be open and a platform for those developments to be sustainable in that platform.

We tried to analyze, you know, where are some of the other shortcomings of the proposal and frankly where, you know, we could be -- as the agency could foresee trouble. And as you look at that, frankly -- I will rely on you to be even more creative than we were in the set up of this framework -- but the bottom line is that we have looked at the same issues that we looked always, you know, a bank that is close to being undercapitalized, just trying to beef up, you know, their balance sheet with deposits of all kinds and loans, et cetera, et cetera. So it's kind of a same formula that we need to be cognizant about, which is why we frankly do have some recommendations for Congress if they are willing to take this on and create legislation that will address some of these issues.

In the end we have to work -- and this had been paramount for me as the chairman of the FDIC -- we have to work within the constraints that Congress gave us. And Congress, as you know as you've drafted legislation in the past, you give regulators some discretion in the statute, right, and it's up to the regulators exercise the discretion judiciously. So as we look at this rule, you know, we figured out what are the four walls where Congress wanted us to be. We spent a lot of time analyzing that congressional intent and debate on the floor of Congress as to why this is necessary. We looked at the historical data and tried to come up with a framework that's innovative on its own, but frankly that lacks some congressional guidance to make it perfect. And to the extent that Congress is willing to give us additional changes, you know, even if it's going to make our job at the FDIC more difficult, but better for the system overall, we are more than willing to work with them to do so.

In the meantime, we will also take a look at pricing deposits accordingly, depending on what category they fall in. And that's something that we have not undertaken in a while. So pricing risk to the DIF in accordance to the risk that these deposits present will be something that's on the table as well.

MR. KLEIN: So I'm going to turn to the audience in one second, but I have one final question before that, which I commend you for putting out a proposal to Congress, and I know that's not something you've undertaken lightly.

MS. MCWILLIAMS: Let's not go that far. No hashtags proposals to Congress, okay. (Laughter) This is subtle recommendations on improvements to a 30 year old law.

MR. KLEIN: In regulatory speak, it is bold and it is meaningful. And the one I want to kind of dig in a little bit is you said the goal is to prevent troubled banks from trying to grow out of trouble. This is kind of the ultimate position of equity as you approach zero value versus the insurer's role, right. They can flip a coin. If I grow my way out of trouble, I still have something of value, if I fail, I failed anyway, so what does it matter if I run up your tab, essentially.

Part of the problem in that is knowing when an institution is in trouble. And as the FDIC you're in this unique situation where you're the insurer but often not the primary regulator. And as I've looked through the history of lots of troubled and failing institutions, the primary regulator has more information than you do and they often get to determine when the institution is or isn't in trouble, and they have their own mixed incentives as to whether or not to allow the institution to fail or not.

The question I want to ask is if they were to kind of go down more this goal route that you're suggesting, within the regulatory framework what is the role and responsibility and how would the relationship between the FDIC and the primary regulator need to change? And more broadly, what would be the cultural ramifications of an institution? Because if you're not going to allow them to grow out of trouble, then they need to fail.

MS. MCWILLIAMS: Yes. And in a premarket economy, you know, some institutions fail, some succeed. Hopefully if you're failed, then those that succeed and the failures are not as common as success. But that's how the market works, right, and that's normal.

So the idea here would be to if Congress were willing to put a cap on how much they can grow so that at least we're minimizing the risk to the Deposit Insurance Fund.

Your real question is really not about that, your real question is how are you going to work with the other regulators on making sure that you have enough information to step in when you need to step in. So we do keep data on how things are doing, we do have back up supervision. We actually have two separate back up supervisions, one through Dodd-Frank, and one prior to that that Congress gave us. And we're just going to have to be willing to flex our muscle and say, no, we need to step in there sooner rather than later. And, again, if you think this proposal is bold, I'm willing to make that call as well.

Luckily for me, I have a very good working relationship with the comptroller of the currency and both with the chairman of the Federal Reserve and the vice chairman for supervision. I don't think that would be a problem to go in and say, listen, we actually have serious concerns about this and we need to put a cap and we need to exercise the statutory cap. We can't put a cap right now. It will take a whole lot more than just small regulatory discretion to put that cap. But we could basically do that and in my view we should absolutely exercise that authority as both the receivership and the resolution authority, but also as the deposit protection authority.

MR. KLEIN: I couldn't agree with you more about the need for -- if you have 5,700 institutions and they survive year after year, that to me is not the mark of a healthy free economy.

I was thrilled to see four financial institutions fail in the last six weeks. I know that's been a lot of work for you guys.

MS. MCWILLIAMS: No, it's actually -- I'm glad you mentioned that. I wasn't thrilled to see them fail, but I wasn't concerned. And I looked at every one of those institutions and I said is this idiosyncratic failure or this something that's indicative of a broader issue. I don't want to be the chairman who was asleep at the switch, there were four banks and they all failed for the same reason and what were you doing on such and such date. And then there's a documentary with my face kind of staring at the camera going, well, I was having a cappuccino. (Laughter)

So the bottom line is we looked at them and after I analyzed each of those failures and talked to our staff, they were idiosyncratic, they were not indicative of anything else. But I did have a -- frankly, I had a sense of -- a little bit of a sense of relief, we did not have a bank failure for 17 months and that's not normal. And in a good year -- in a good year, when the economy is good and everything is going well, we have about five. Our problem bank list is at the lowest level at 51 banks. And so to not have a failure was not normal, not normal.

MR. KLEIN: That's -- yeah.

MS. MCWILLIAMS: People need to understand, not normal.

MR. KLEIN: Three years in American history there wasn't a bank failure, calendar year, three years -- 2005, '06, and '17, right. The first two of those years was not a mark of a good thing. And so hopefully we're on a good track.

MS. MCWILLIAMS: And that's exactly why I had heightened scrutiny of those banks, to make sure are we missing something, are we missing something. In the end, they all failed for individual reasons that are specific to each bank.

MR. KLEIN: So, on that note, who in the audience -- Burt? I see you in the back and I know that you have a comment letter, so I can't say I'm shocked.

QUESTIONER: Thank you very much, Madam Chair, for being here today --

MS. MCWILLIAMS: Hi, Burt.

QUESTIONER: -- and sharing your thoughts with us.

I want to come back to your comment about growth, which I have long considered to be the real high risk situation with banks. When they grow very rapidly they increase the likelihood of at least getting into trouble.

My question for you is this, to what extent had you in looking at this proposal and at risk based pricing decided that it's more appropriate to focus on the rate of growth in a bank as versus how that growth is funded? Because there are various ways to fund growth other than with brokered deposits.

MS. MCWILLIAMS: So if you're going to provide clarity to industry in general, right, if you're going to have a uniform approach of what is brokered and what is not that's not driven by an individual institution, but the type of a deposit, you have to focus on what would enable us to minimize the risk to the DIF. And that's when the idea of well, restricting growth would be better than saying you can't do brokered deposits, because you could still do risky stuff, even if you're not getting brokered deposits.

QUESTIONER: Are you thinking then of incorporating into the risk sensitive deposit insurance premium some growth related factors, such as a faster growing bank would pay a higher premium than a slower growing bank?

MS. MCWILLIAMS: You know, Burt, if I told you now you would never come and listen to my board meeting presentation, and you would not.

QUESTIONER: I'll be there.

MS. MCWILLIAMS: So you have to stay tuned for part two and season two of this, yes. (Laughter)

MR. KLEIN: All right, we've got a cliffhanger.

MR. MUELLER: Hey, Chairman McWilliams, this is Jackson Mueller from the Milkin Institute.

MS. MCWILLIAMS: Hi.

MR. MUELLER: So great to have you here. Aaron, thank you very much and for Brookings for putting this on.

Quick question for you. Just based on my list, you talked about it earlier about, you know, when Congress will get engaged on this. I've got at least four bills here that I'm tracking covering deposit brokers --

MS. MCWILLIAMS: Well, there may be a fifth one too if they follow up on my subtle recommendations.

MR. MUELLER: Yeah, exactly.

So I'm wondering, as you are developing this proposal, how influential some of this legislation was to what you put in your proposal and if any of these legislative bills that have been introduced in the House will actually counteract what you're looking to do?

Thank you.

MS. MCWILLIAMS: So I have learned, painfully, not to comment on bills that are pending. As a former congressional staffer, I also learned that you don't want regulators commenting on your bills. So I won't comment about the pending bills.

I wouldn't say they were influential. You know, we knew that Congress is looking at different things and frankly we have the information that Congress doesn't have on the supervisory side.

And so we looked at droves of data and we looked at, you know -- and I basically was very -- you know, speaking of blunt, was this why the bank failed, was that why the bank failed. So we went very specifically looking at what cause some of the failures and were the brokered deposits the cause of it and, if so, what can be done, cannot be done.

So the plan we devised here was based on our institutional knowledge, frankly, analysis of the failures, and then legally looking at different interpretations we have had over the years. And I have to tell you, when I joined the FDIC I knew there were a lot of questions about brokered deposits, I just didn't truly understand the tributaries of Amazon that our framework looks like. And as I asked more questions it became clear to me that there's no clarity to the outsiders as to what is and what is not brokered. And if you have to come to us and expect us to give you an opinion and nobody else can abide by that opinion but just you, the playing field is frankly not level.

And so what we are trying to do is both level that field, give clarity and certainty and transparency. You know, nothing -- at least under my watch nothing should be so opaque in how we regulate. The rules of regulation should be very clear. And so if Congress, you know, takes a look at this and, again, notice I didn't talk about any language as to how they would do any of this, these are just ideas and concepts that frankly as we came to the bottom of the barrel here on what works and what doesn't and where we are restricted, we realize there is an opportunity for Congress to act if they could.

MR. KLEIN: Okay. Sir?

QUESTIONER: Hi. I'm one of these hopeless people who got an MA in statistics back in 1973 and I interpret artificial intelligence as meaning the computers now might be a trillion times more powerful than the individual brain to analyze things.

So my question to you is are there any technologies that are actually helping you with all of this data that you're analyzing, or how do we get technologies to help? And, you know, is block chain an enemy or a friend potentially in the kind of work you might be doing?

MS. MCWILLIAMS: I think there is a great opportunity for regulators to do more with innovation and technology. And so we have set up at the FDIC office of innovation with a specific goal of looking at these channels, the new channels of delivery and how technology is facilitating those channels of delivery.

And I'm actually -- I have been very reluctant to say that block chain is a force for good or block chain is a force for bad, distributed (inaudible) technologies, et cetera, et cetera. I think there is an opportunity for us to take a look at what's going on and utilize the knowledge from the outside and develop knowledge on the inside as to how we're looking at, you know, the future supervisors and the future examiners. They're going to be more data scientists than folks who are looking at a five foot stack of loan documents, right. I think we'll be able to employ machine learning and artificial intelligence into analyzing the loan documents and looking for idiosyncrasies and the patterns and repetitions and kind of systemic and systematic issues as well.

And so there is an opportunity for us to do a whole lot more. And I want to make sure that whatever we do now at the FDIC does not shortchange the opportunity to grow and be there with the technologies that are developing, or worse yet, to stifle technology.

So we are working with folks on the outset, looking at how are they utilizing technology. I, frankly, whenever somebody brings me a novel business and say they're a fintech and they come and said oh, we decided to do this. I say, why. What market issue are you trying to solve, what is it that you are developing that folks with billions of dollars in ability to invest did not invest. And then I go back to those folks -- you know, usually they are banks and they are some of the larger banks, and I was like why didn't you develop that, you know, why did this happen outside of you.

And so you want to understand the nexus as to why some of these things are developing outside of banks. And frankly not just because I'm curious, you know, I am curious, right, but it's because frankly more things are developing outside of the banks that look like banking products and services than in the past. And a part of that is understanding why. And in my personal opinion, I think, as I talk to both regulated entities that we regulate and also the nonbanks and fintechs, there was a need and the banks didn't satisfy that need. And the question is why. And if it's because of regulatory concerns, then we should take a look at those regulations and see if it makes sense to change those regulations. And this is how we came with the brokered deposits in addition to just general uncertainty and ad hoc approach we have had in the past.

And the second thing I ask is are we better off having these types of products and services inside of banks where we regulate them, or outside of banks with tech companies, which are more agile, but regulated differently than banks. And you want to create a system that works. And I wish there was a formula, I wish there was a formula. You know, I wish I could just plug in things and tell you, well, if we do this, this happens. But quite often it's a see saw. If we do this, you know, it kind of moves a little bit here and you want to make sure that you don't do more damage than good.

And in the end it's for the consumer. You want to make sure that there are adequate consumer protections in place and on everything you're doing. You want to make sure the consumers have an opportunity to avail themselves of financial products. And then if those financial products are being offered outside of banks versus inside of banks, you want to make sure that banks have an opportunity to do the same because I actually believe that the system and the consumers benefit from competition.

MR. KLEIN: But it's incredibly important, the point that you make. You reference the survey that talked about the unbanked. Well, the other part of that survey that strikes me is 20-25 percent of Americans are underbanked. That is, you now, we're looking at 1 in 4 to 1 in 5 Americans, or 3 times as many people are underbanked as unbanked. And your definition of underbanked, which is now our definition, because when you set the survey you set the rules.

MS. MCWILLIAMS: Yeah. Because it's good. Yes.

MR. KLEIN: It is a good definition. And it basically says you have a bank account, but you also used a payday loan, a check casher, or a wire transmitter, which are three services that you would think a person with a bank account would never use.

MS. MCWILLIAMS: Yeah. And actually they are paying more than they would probably pay inside of the bank for the same type of services.

MR. KLEIN: Well, I've come to a different approach on check cashing when you compare that to overdraft and when you look at the very, very slow number of days it takes to actually process a payment. That's a subject for a different day. But --

MS. MCWILLIAMS: And a different agency.

MR. KLEIN: Correct.

MS. MCWILLIAMS: Thank you. Okay. (Laughter) So long as we're clear.

MR. KLEIN: I have my 19 page comment letter into them from January.

MS. MCWILLIAMS: So the comment letter on this to me cannot be more than 19 pages then, all right?

MR. KLEIN: All right. But the core point there is there's an inordinate number of people that I look at -- speaking of the other agency, the Fed did a good survey, because other people get good data as well, on mobile banking and they found that -- and this was mind blowing to me -- minorities use their smart phone to conduct banking more than whites. It's the only statistic I've ever seen in this financial services world that shows greater adoption and access for minorities than whites.

Now, if I were teaching econometrics, there's a hidden variable, there's an omitted variable bias in which this is not a story of race. I can tell you the story of race and show you a statistic, and I'm playing bad statistics, which no economist has ever done in the history of economics. And in point of fact, it's age. When you actually adjust for age, the racial differences go away, but the minority population is inherently younger and the actual variable that drives mobile adoption is age.

But the other factor of this statistic that was fascinating is if I know how you use your bank "mobiley" and how much money you have, if you move money between your accounts, if you use your smart phone to move money you're rich, if you use your smart phone to check your balance, you're not. That's it. Divide America into two groups, people who occasionally hit zero on their bank account, live paycheck to paycheck, and those who never do. And you can tell that with a high degree of precision just on how you use this technology.

So I want to commend you for incorporating the future of financial technology, for thinking about not just that 7 percent of unbanked, but that much larger group of underbanked people for whom the system can work better, and appreciating that as younger people come on line, this definition of what is a bank and what isn't a bank becomes very blurry. And this brokered deposit is kind of the hidden thing behind the thing behind the thing.

MS. MCWILLIAMS: Yes, yeah. No, it's -- I think you should write my preamble. (Laughter) This was really good. And you can cite the other agency's study, I don't care.

So here's the bottom line -- and thank you by the way for identifying it with such clarity -- you know, we talk about brokered deposits, we talk about Deposit Insurance Fund, and all of this in this kind of amorphous regulatory language and it's technical and all of that. In the end there is a consumer on the other end of that. And if our -- so peel four layers and you come to brokered deposits. In some cases it's three layers if you have an advisory opinion, if you don't have an advisory opinion there's more layers. But it may be brokered or not, maybe. There's is a consumer that either benefits or is shortchanged by our rules. And so you want to figure out how can we get more of the underbanked and also very much so unbanked people into the banking fold. And if as a country we make a policy decision that we want people to a have banking services, right, you want people to be banked in some form. You don't want them to go to some seedy place to like exchange money in an alley. Done that in foreign countries, it was awful. But the truth of the matter is you want to benefit the end user and the end user here is your ordinary consumer. This is your grandma in white tennis shoes who hopefully start using technology, and your immigrant kid, and a kid that grows up in inner city where there's not really an opportunity to walk to a branch that's really safe.

And so you want to focus on those consumers and understand really how can we bring them into the banking system and into the fold because, frankly -- and I'm afraid I'm going to become a one trick pony if I keep on talking about my secured credit card. When I first came to the United States I availed myself of the opportunity to get a secured credit card, not because I thought it was great, because I couldn't get anything else. I had no income and no assets basically. I came here with $500. And I opened up a checking account. I knew I should have a checking account. I came from former Yugoslavia and I knew I should have a checking account, I should safeguard my $500 and I'm going to put them in a bank. And there are immigrants who come from countries where you don't trust the banks, so you wouldn't put your $500 in a bank, you hide it someplace in the house.

So I did, I opened up a checking account and then I realized, everybody in the United States was using a credit card. Now, whatever you think about consumer debt, whether it's good or bad, this credit card was to me a symbol of kind of a fitting in. And so I applied for a credit card, got flat out rejected -- like big no. No income, no assets, no job. I was a NINJA before the term was even popular in the financial industry. And but they did make me an offer to open up a secured credit card. So I sent $300 of my $500. And I had to call my father back in the former Yugoslavia and tell him, you know, remember the $500 you loaned to send me to America with some cash? Yes? So I took $300 and I sent it to the bank and the bank is going to hold my $300 and I'm going to pay them interest on my $300 and they're going to hold it and I'm going to borrow against it, but it's a good thing, it's a great thing. And I think my -- I mean I think the phone calls back then, international phone calls were like $3.40 a minute. So I'm trying to say this very fast and I'm pretty sure that my father did not understand a word of what I was saying, not because he didn't understand the language, because the concept didn't make sense to him.

But that secured credit card, after 12 months, they released my deposit. Now I get an unsecured credit card and my credit limit was $500. So actually I benefitted because my spending power was more. And when I went to the grocery store I no longer had to county pennies, you know. To this day I remember when I went to the grocery store because I did have to count pennies, you know, eggs were $.79 a dozen, Wonder Bread was expensive, but there was like a cheaper version that was $.49, and you could buy 12 of those frozen pies for $.99. And, you know, all of the kids are now looking at me and saying, okay, boomer (laughter), things are a whole lot more expensive than then.

But, you know, when you don't have access to credit, you count pennies when you go to the grocery store because you don't know want to be at checkout and returning -- you know, putting products out.

MR. KLEIN: So here's a stat that blows my mind, right, and this one isn't quite your agency because your agency has come up with a little bit of a different number.

MS. MCWILLIAMS: The good things come from my agency. All the bad things come from other agencies. Let's get this right.

MR. KLEIN: So this stat said $34 billion are spend in bank overdrafts, which occur when you go to the checkout counter because probably in your experience, when they swipe the card, if you didn't have money they said no, return some food.

MS. MCWILLIAMS: That was back then, yes. It was -- they said no, yes.

MR. KLEIN: Right. Today they say, sure, and then depending on whether or not you had the money, you get a fee. And that's a fee only paid by people who run out of money in their bank account.

In addition, among people that use the overdraft -- so more than half of Americans never have one, among bank people it's more than half. The average family spends over $1,000 a year in overdraft fees. Now, think about how much money they have and think about how expensive that system is. So when you think we have free checking, right, it's really interesting what you pay for and what you don't. I was at a conference that you were at up in New York last month where somebody pointed out that 10 million people agreed to get Disney streaming at $7 a month. But the idea of$7 for a bank account, you know, that should be free. But then you think about who's paying for the bank account. Is it the people who are overdrafting, right, and the people who aren't? And this system has both permitted that expansion and the question in this broker deposit rule, because it's the thing behind the thing on a lot of these debit or prepaid cards, because a lot of people now instead of having that secured credit card -- 1 in 10 swipes at the register is a prepaid card. How many people have a prepaid card in their wallet? Starbucks gift cards count. One out of seven Americans will get one this month. It's one of the most popular holiday gifts in America.

MS. MCWILLIAMS: You need to pick your audience better. I think I only saw like six hands. (Laughter)

MR. KLEIN: No, that's exactly -- this is not a representative sample. And part of the problem among all policy makers and institutions is we have two classes of Americans that use the banking and payment system radically differently. And we have two classes of people that use brokered deposits radically -- the people who have sweep accounts at their broker dealers and have hundreds of thousands of dollars in cash or who use complex financial intermediation between multiple banks are using it one way. The people who are using debit and prepaid cards are using it a different -- all right, I'm getting the time hand.

MS. MCWILLIAMS: No, no, we're good.

MR. KLEIN: No, you get the last word.

MS. MCWILLIAMS: All right. No, there was one question. I just want to make sure we -- but if I don't like it I'll do the last word and not answer your question, so.

QUESTIONER: I guess I'll do this without the mic.

MR. KLEIN: Very quickly.

QUESTIONER: (Inaudible) a lawyer, I represented --

MS. MCWILLIAMS: All right, never mind, he's a lawyer. No, I'm going to have the last word. No, I'm kidding, go ahead. (Laughter)

QUESTIONER: We are both grads of UC Berkeley Law, so if that helps --

MR. KLEIN: Real quick.

QUESTIONER: Yeah, I've represented brokers and banks in this space since the late '80s. I am a boomer. I was in the room when they adopted the legislation. You are absolutely correct on that point. It was on brokered CDs. That was the only show in town. There was no debate over what's a brokered deposit because nobody cared. It was brokered CDs and that's what there was. So on that point, that's correct.

I want to make a couple of -- one minor historical point.

MR. KLEIN: One question, no points. A question.

QUESTIONER: Okay.

MS. MCWILLIAMS: You can send me a comment letter on the point.

QUESTIONER: I have sent -- comment -- I will make -- okay, Aaron, since you made this comment, I will throw you a question. You said brokered CD buyers are chasing rates. What's the current rate on a one year brokered CD?

MS. MCWILLIAMS: I have to look at a table.

MR. KLEIN: He made a comment, that's it.

MS. MCWILLIAMS: The tables are changing.

MR. KLEIN: I'm not chasing rate.

QUESTIONER: 1.65, brokered CDs are currently trading within 5-10 basis points of treasury securities. I can go to Goldman Sachs bank and get a savings deposit at 2.5 percent. So I think our paradigm -- I will make a comment -- the paradigm we're dealing with in terms of the average deposits through sweeps and CDs, much lower than you're representing here. These are sometimes smaller depositors.

Secondly, the rates are not the rates, these "high rate chasing rates" that you're talking about. We've commented on this multiple times, we'll continue to comment.

But thank you.

MS. MCWILLIAMS: Thank you.

MR. KLEIN: Great.

MS. MCWILLIAMS: Great things come of UC Berkeley.

So here's the bottom line. I never -- when we do proposals on rules, I never profess that we know everything. We have a lot of institutional knowledge, we have a lot of data, we talk to a lot of people. But if we knew everything and if we didn't have the requirements of the administrative procedure law that basically requires us to go out, give notice, and comment, I would still want to hear from folks who are affected by our regulations. You know, part of my thing has been to go state by state. I've been to 28 states in my 18 months talking to people, bank superintendents, customers, what are you getting, what are you not getting, what are you hearing from the banks. Fintechs -- I talk to fintechs, how are you teaming up with banks, why did you do what you did. And so I'm hoping that as we look to revise the framework and provide more certainty, and frankly make it forward looking instead of retrospective back to looking at CDs, and that's all we have to go by and now we're kind of meandering around that definition to fit everything else under that definition.

You will provide the feedback that we need to make our framework better. And I don't want you -- as you look at the proposal tomorrow, if it gets approved, I don't want you to take a look at it with any other view but is this going to work and can you help us think of the shortcomings and help us think of the good things that can come out of it and then provide your comment letters. Make sure it's under 19 pages.

And frankly there is an opportunity here for us to make the system better. And I joke when I said I think I switched my contact lenses this morning, but this is not a left or right issue. This issue is truly about is the system working at its maximum capacity, our regulatory system and our -- is that capacity of the regulatory system allowing companies to innovate where we can get to that next stage of innovation in American and not in other jurisdictions that we have to follow. Are we going to lead or are we going to fall behind.

Thank you.

MR. KLEIN: Thank you. Join me in thanking the Chair. (Applause)

Join the panelists in coming up as we switch mics. Come on up.

(Recess)

MR. KLEIN: Sit down, I will start the introductions so we can keep the spirit of this conversation. Alison Touhey is to my left, as Senior Vice president the American Bankers Association. Dennis Kelleher is the President and CEO of Better Markets. Shamir, I'm going to botch, let me --

MR. KARKAL: It's all right, Karkal.

MR. KLEIN: Karkal. I can't -- Sharmir is a serial entrepreneur, he founded his current founding company Scylla and also founded Simple, for those of you who know, it's one of the largest Fintech providers, who was subsequently purchased by BBVA.

And so, I asked you guys to come here and react to the chair's speech. So, what did you think?

MR. KARKAL: I loved it.

MR. KLEIN: Why?

MR. KARKAL: I have not heard anything clearly regulators in the U.S. in the last few years, but I do think this has to be one of the first times I have ever heard the head of a regulatory agency say that one of their priorities for a rule or a regulation was going to be promoting innovation. I think it doesn't get said enough.

The U.S. is not just falling behind on innovation, it's actually already fairly behind. And arguably has the worst banking and payment system in the developed world. And unless the regulators really get behind supporting folks like me, I think it's just going to continue.

MR. KLEIN: I think we need to turn the volume up here --

MR. KELLEHER: Folks are indicating they can't hear.

MR. KLEIN: From a tech perspective if somebody can turn the volume and then Dennis if we need to turn the volume up, let me turn to you.

MR. KELLEHER: Look on high tech, you'd think the speaker system would work, wouldn't you?

MR. KLEIN: Oh I can project.

MR. KELLEHER: You know look, I don't want to be cast as a lead eye here, but a couple of observations. And I appreciate the work done by the FDIC, and I really appreciate the breath of fresh air that Chairman McWilliams is brought to the agency and the openness. And I really have enjoyed working with her and the staff at the FDIC.

But I think it's important to go back to first principles. And we're talking about the FDIC, the Federal Deposit Insurance Corporation. It's not the banking bureau for innovation modernization and competition. Right?

Its mandate responsibility and not maximizing the profits of the private sector, it's not. Innovation and modernization are too often just siring songs that end badly for investors, taxpayers and safety and soundness.

Everybody loves innovation. If you call it new we got to be for it. People sometimes think it's a synonym for less risky, when in fact new is often a synonym for more risky. And those new risks are often unknown, and particularly unknown at the beginning and they don't materialize until long after the profits are pocketed, and taxpayers are left with the bill.

Think about this, talking about innovation, brokered deposits were an innovation in the '80s. They were an innovation, they were new, they were exciting. They were high tech actually at the time. And look what happened to them.

You know, we could use other examples, CDS and Naked CDS, great innovations --

MR. KLEIN: Credit default swaps.

MR. KELLEHER: Credit default swaps, naked credit default swaps, CDOs, collateralized debt obligations, I know we don't want to use acronyms. And synthetic CDOs, great innovations.

I mean, you look at these things, innovation in and of itself, the claim of innovation, the technological change in new products is simply not a basis to discard carefully crafted and critically important financial protection rules.

Another first principle, when you talk about a bank you're talking about insured deposits. They're IDIs, Insured Depository Institutions. It's a privilege not a right to deal with a bank. And with those benefits come responsibilities and yes, rules.

Remember every single, I'm going to read this because I'll get it wrong if I don't. Every single FDIC insured bank has a sign that says what? "Your deposits are backed by the full faith and credit of the United States government." That's what makes it different. And that difference makes all the difference.

So, there are a lot of financial institutions out there. So, you can innovate, you can do whatever you want at the entire nonbank, financial sector, which is bigger now than the banking sector and ridiculously unregulated at the moment. I mean, FSOC has put up a going out of business side. So, FSOC's job is to regulate nonbanks, that's zero now. There isn't -- in fact, there is not one systemically significant nonbank in the entire United States today. And if anybody knows what the nonbanking sector looks like, that's absolutely laughable.

So, you could go to money market funds, you could, if you want to use all this type of innovation that you want to use with insured depository banks, you could go to money market funds, mutual funds, hedge funds, private equity funds, all the other financial institutions out there.

But that's not where this is focused. It's all focused on the insured deposits. And that's because people, customers, prospective customers, want the safety, soundness and security that comes with the insured deposit. But that's -- you don't -- it's not a one way street.

The one way street is you socialize the losses while you privatized the gains. You want the insurance and the uplift from the insurance, but you don't want the restrictions that protect the taxpayer and the system.

And so what you have, in opposition, we're not for or against broker deposits, were for prioritizing the protection of safety and soundness, the DIFF and taxpayers. That has to be the overriding objective. And I have to say in all candor, I was quite surprised that that was the third of the Chairman's four goals. Protecting the DIFF for the Federal Deposit Insurance Corporation to have the third goal protecting the DIFF is really, people should take note of that.

MR. KLEIN: All right, well let's get to the other --

MR. KELLEHER: So, to me the bottom line is the test has to be. So, whether or not any of these particular changes are good or bad, I don't have a position on. But what you have to do is you have to have an analysis that's unbiased, based on evidence, data and facts, that are publicly available and independently tested.

And if you look at what's being proposed now, I don't know what comes out tomorrow. On the ANPR, it's hard not to conclude that the changes are unjustified, unwise and untimely, given where we are in the business cycle. This is the wrong time to start increasing risk of the DIFF and the insured depository institution.

MR. KLEIN: Okay. So, I'm going to ask you two different things. First, getting back to the Chair's speech. And second, I'm going to ask you to kind of respond a little bit to Dennis' comment. But let me first by start, what did you think of the Chair's speech?

MS. TOUHEY: Well, we're very encouraged about her leadership and her proposal. Can you hear me now? Okay. I'm sorry. We are very encouraged by her --

MR. KLEIN: [Inaudible 0:07:35] like this all the time.

MR. KARKAL: You could have fooled me.

MS. TOUHEY: We're very encouraged by her leadership. We appreciate her leadership on this issue as well as on other issues. Dennis, I think we can both agree she is a great leader and a breath of fresh air. With respect to brokered deposits, I think in her speech and in her conversation with Aaron, it really highlighted that this isn't a simple issue.

And I think that there are some that make the mistake of oh, we are introducing risk to the deposit insurance fund, to the FDIC. If you look at the 1980's and the banking environment then, and the small slice of funding that Congress intended to isolate, what is encompassed in the definition of brokered deposit is way beyond that.

And it affects the 5,000 banks in this country. It hits every bank differently, it hits different banking business models differently, different consumers differently. And it's really opaque and doesn't achieve any clear policy goals.

So, we are very happy to see her leadership. I look forward to reading the proposal. Obviously, there are a lot of details in that proposal that we need to consider with our membership. But I think it goes a long way to really again isolating a specific type of deposit that was meant to be isolated, instead of this massive sort of hodgepodge of funding types that is nonsensical. There's no logical rationale for why these are classified as higher risk, when in reality it's just a different mechanism for raising deposits.

MR. KLEIN: So, hold on, let me pin you down on that, because there are two different questions. One is, is the definition of brokered deposits incorrectly sweeping up too many things and categorizing things as risky here? I think we're getting you a handheld.

MS. TOUHEY: Thank you.

MR. KLEIN: And so that's kind of point one. Sub point to on that is that the same things are being treated differently between different institutions. Right. And the Chair kind of made both points. From your experience in the nexus of all the institutions, right, have you guys seen that, that within institutions, within different banks, they're getting kind of slightly different rules on similar things, sometimes it's a brokered deposits, sometimes it isn't?

MR. KARKAL: I have. But you should answer the question. I don't want to mass (inaudible) here.

MS. TOUHEY: Well, I think, yes, there is a gray area. Is this not working either?

MR. KLEIN: No, it is you just got to put it right up.

MS. TOUHEY: Okay. So, I think there are a lot of gray areas. There's a lot of regulatory uncertainty. So, that yes, there's a huge amount of inconsistency. And to your first question, absolutely, the definition of, right now, as the FDIC has interpreted where it currently stands, is it sweeps in a broad amount of products, deposit products, and it's not a helpful isolation of calibration of risk.

It's just again, a nonsensical hodgepodge of deposit products, that there's no rhyme or reason as to why they are stigmatized, why banks pay more. It's about how the deposit is gathered, as opposed to the risk that they actually pose. I think another sort of misconception is that Section 29 is not, and was not meant for -- to be a proxy for liquidity risk or interest rate risk. And some people sort of view it as that. It's not what it was meant to be. Again, it was meant to isolate a very small, distinct product type, and it was meant to prevent troubled institutions from holding that very distinct funding type.

Now, it's impacting well capitalized institutions, it's impacting consumers. And it's sort of like has such a broad approach and again, it's a very arcane issue, so it's very behind the scenes. But it has a great impact and is prohibiting banks from serving their customers the way they want to be served.

MR. KLEIN: Shamir?

MR. KARKAL: Oh I don't even know where to begin. I think Paul Walker just passed away a couple of days ago, and I think at the end of the last crisis, he famously said that there's been no good innovation in finance since the ATM. Which came out in the '60s. So, he was he discounted everything in the '70s, '80s, '90s and 2000's, right, up until 2008.

And there's this approach that some people in the startup industry take, which is that all innovation is good innovation. And yet, I think Dennis here falls into almost the opposite trap, which is to look at all innovation as the same and just say it's all bad.

I'd like to actually -- I'd actually like to distinguish between two types of innovation here. And there's -- it's always hard, but if it -- but perhaps the best way to characterize it is if it's innovation by people in suits, for other people in suits, it's probably bad. And if it's renovation in people in hoodies, for people who struggle to buy clothes, it's probably good.

And I think the problem we have --

MR. KELLEHER: I'll let you off the question of what happens when suits come up with innovations for people struggling to buy clothes, but --

MR. KARKAL: That's called the payday loan industry. So, we've seen that too --

MR. KELLEHER: If the world were that simple.

MR. KLEIN: Or overdraft.

MR. KARKAL: Well, that's the problem we have, the world is not that simple, Dennis, the world is amazingly complex. And yet, we have a 30 year old rule which stars all of those types of innovation with the same brush. And then, as Chair McWilliams pointed out, also takes what looks like exactly the same thing and treats it different.

So, let me give you a concrete example. And I think one of the gentlemen back there commented that he represented banks and brokered dealers. I actually have started both of those. And the last bank that I started was a new bank. We couldn't -- in 2009, we couldn't get a banking charter because the FDIC had a closed for business sign outside. And so we had to go partner with an existing bank.

And by the way, the story I was told was that was the wrong time for innovation in the financial services industry, because we were deep in a recession and just coming out of the last crisis. We're at the opposite end of the cycle now, and I'm told it's still the wrong time for supporting innovation.

So, somehow this never seems to be a good time to support innovation. But we couldn't get a banking charter. So, we had to go partner with an existing bank. And then that didn't work very well. So, we ended up being acquired by an existing bank and became a wholly owned subsidiary of a chartered entity -- depository institution.

And then found that as a wholly owned subsidiary, which had no technical or legal way of putting its deposits anywhere except that its partner banks, those deposits would be treated as brokered. Because we were a subsidiary, one hundred percent owned.

The same situation now, and that's simple, by the way, I believe as far as I know, I haven't been involved with it for the last two years. I believe all of its deposits are still treated as brokered on BBV's balance sheet. Good news, BBV media has a massive balance sheet. That's a problem that because those are growing, but that's not yet a problem that's broken anything.

MR. KLEIN: So, Dennis --

MR. KARKAL: Oh well hold on, one second.

MR. KLEIN: You --

MR. KARKAL: That's an opposite point --

MR. KLEIN: -- let him respond for a second.

MR. KARKAL: -- too right. There's another company called Aspiration, which to every customer who uses it looks exactly like Simple, offers all of the same features, some better some worse, in an app. And is also a startup. But I believe, I don't know enough about it, but I believe that they are a brokered dealer, who now places deposits at multiple institutions using promoters, deposit spreading product. Which is completely controlled by Aspiration, could switch from one bank to another, depending on interest rates. And it's not treated as brokered deposits because of the reciprocal deposit definition. And I don't know anything that's more ass backwards than that under this rule.

MR. KELLEHER: So, there's a debate from the audience about whether or not it. All I know is I'm a customer of Aspiration.

MR. KARKAL: Okay.

MR. KELLEHER: And when they had to change their debit card issuing bank it was not a great -- I mean they handled it very well. But from their institution's point of view, you don't want to go through that with your customers.

MR. KARKAL: Been there, done that, I mean --

MR. KLEIN: Well, Dennis there are a lot out here --

MR. KELLEHER: Well, I won't respond pedantically mischaracterize what you say, or make assumptions about you based on your clothes.

MR. KARKAL: Touché.

MR. KELLEHER: I will, and although I'm quite delighted if you want to lump me in with Paul Volcker, I should be so lucky.

MR. KARKAL: We would all be so.

MR. KELLEHER: I'm about the most unworthy as I would be lucky. I'm not against innovation, and I think that that's kind of just a silly thing to say. The United States of America wouldn't exist without innovation, without entrepreneurship, without capitalism working, ideally democratic capitalism that works for a broad based prosperity, rather than its wealth extraction vehicle only.

But the issue here is you can innovate; anybody can innovate all they want. If you want to innovate, and where it connects up to insured deposits, when it puts at risk the full faith and credit of the United States. When it puts it risk taxpayers. Then you know what? We're not going to sit back and say, do whatever you want.

You know, take your hoodie, take our money, good luck, God bless you. It ain't working that way. You want to work that way, stay away from money that hardworking Americans support a financial system. A little over ten years ago, and it cost those hardworking Americans, I don't know a couple of trillion bucks to bail out a financial system.

And so that's why it's called the Federal Deposit Insurance Corporation. If you want unreserved cheerleading for innovation, which I'm for, go to the Department of Commerce. If you want to do it in foreign lands, go to the Department of State. There are a lot of places where unbridled support for innovation and entrepreneurship can be supported. I mean that's great.

And the only thing we're saying is that when you want to couple that innovation with insured deposits and insured depository institutions, then there ought to be a process, a rigorous process, a database process, an evidence-based process that actually prioritizes the statutory mandate for that institution, the FDIC, which is safety and soundness that protective the Deposit Insurance Fund and taxpayers.

Now, my view is that you can have both and we should have both. The financial system needs innovation, desperately needs innovation. The barriers to entry, the concentration, the allegories. We're for all of that. But it can't -- it's not one or the other. It's not one extreme or the other. And with brokered deposits, pretty interestingly, what we're trying to do is draw a line between, for lack of a better phrase, sticky deposits and super-hot money. That's what we're trying to figure out. Right.

MR. KARKAL: Okay --

MR. KELLEHER: We could call this core, we could call this brokered, however you want to do it. And the problem with the argument put forward by some, about the statute in Section 29, is it was not meant to be something in Amber, that looked back only and said, what we don't want is that last crash, and we don't want CDs in this amount being bundled and move this way.

That isn't what Section 29 of the statue was about. The FDIC and federal regulators were working with this issue since the early '90s as we know, and as the DC Circuit decided in '94, they couldn't -- I mean '84.

And so what we have is actually a statute that actually was addressed to this spectrum. And it addressed it in a way that gave fairly broad based authority, statutory authority to the FDIC, to draw that line. And people don't like how it's drawn, and it may be totally meritorious, right, if it's ad hoc and opaque, bad. If it takes too long, bad. But if in fact, it's rather a case by case analysis, because it's a product by product analysis, then that's probably good.

And so I think just saying the statute doesn't apply, it's opaque, we need innovation, and therefore, let's do x, y and z, is only half of the analysis. That's really the point.

MS. TOUHEY: Well, so I guess I would ask you then, the current interpretation includes the spectrum of sort of enhanced risk deposits, it includes what we can all agree are stable deposits, but that means different things for different institutions.

The implications of what happens if you fall below well capitalized in an environment where everything is a brokered deposit, to me, that puts the fund more at risk, because you'd be created a massive funding liquidity crisis in the event of widespread issues through the industry. And that isn't good policy in my book, right. It's better to isolate the risk and have specific goals that you're trying to achieve. As you noted, it's bad to be ad hoc and opaque. And that's exactly where we are.

There's no rationale for the funding types, mechanisms and products that are in the current bucket of brokered.

MR. KLEIN: So, let me let me drill down on that because there's a quote from MasterCard, who had a very interesting comment letter on this because they both deal with the prepaid space in the HSA. And I didn't fully appreciate, HSA's didn't exist when this rule came out. Whatever you think of their policy, you put money away, if you're wealthy enough you get a -- the richer you are, the bigger your tax benefit. And you know, you can use this money for healthcare.

And this was MasterCard. And then somehow these are considered brokered deposits. MasterCard wrote, both prepaid cards and HSA's are associated with a significant infrastructure forcing banks to make a considered judgment whether to enter the business in making it unlikely for a customer to move funds. Moreover, these products serve distinct purposes for consumers other than an investment purpose and for banks, other than deposit generation. Indeed prepaid cards and HSA's often do not pay interest.

I think that's pretty much the norm on HSA's. Is that on the right or wrong side of this sticky deposit?

MS. TOUHEY: Well, if I may, I think HSA is one area where it's gray. Right. Nobody knows and different banks and different firms have different interpretations as to whether that HSA's are brokered.

MR. KLEIN: So, how would you draw it? Where would you --

MS. TOUHEY: It depends --

MR. KLEIN: -- put HSA's on the line?

MS. TOUHEY: Well, it depends. I would put them under the Employee Benefits Exemption, there are several exemptions.

MR. KLEIN: So, you would exempt them from being brokered as an employee benefit?

MS. TOUHEY: Yes.

MR. KLEIN: Going down the line, where would you guys put them?

MR. KARKAL: I would put them probably more towards the sticky end of the spectrum. But it really does depend on the contractual kind of clauses and -- and by the way I agree with the characterization. That is, money and the sticky money, there's a spectrum in between. I wouldn't put

HSA's all the way on the left. I'd probably put them left of middle.

MR. KLEIN: Then what would you have if you were the chair of the FDIC, would they read contract by contract? If you put this in your contract, you're sticky, if you put this in your contract, you're not? Is that what you're saying?

MR. KARKAL: I think under existing regulation, I don't think there's any other way.

MR. KLEIN: Right. But under this new rule tomorrow, the FDIC is going to change it tomorrow.

MR. KARKAL: I think they would still have to do that. They'll just do it much more transparently than they have done in the past. What I really liked was Chair McWilliams' approach of saying, let's ask Congress to write a law which says, let's not get into that, let's -- the problems in a bank as far as I've ever seen, usually start on the asset side. And let's look at that.

And if you're undercapitalized, you don't get to do fast asset growth. And that really solves your problems much better than trying to differentiate between sticky and hard. But if we are going to do that, then we can do it much better than we currently do, which is draw a line and try and put things on the left or the right based on some 30 year old definition.

I mean 30 years ago, the entire U.S. banking industry had less computing power than this point.

MR. KLEIN: Dennis, where would you put it?

MR. KELLEHER: Well, I would like to start by saying, I hope people notice that they both actually agreed with the analytical framework I proposed.

MR. KARKAL: Yes.

MR. KELLEHER: And the truth is, there isn't -- and you know, this Aaron, and I appreciate the question. And I really do appreciate Brookings doing this. And it is a reason why they're here and the program is here.

But when you talk up here, you can tell -- but HSA's, well you know there isn't an answer. You can't say HSA, this or HSA that, it belongs here, here, here on the spectrum. You actually have to look at the particular program.

So, is it an HSA, where the sponsor of the HSA keeps all the money and it's I'll make it up? It's a billion dollars and it sloshes in and out of an IDI every night. I'm making that up, right.

MR. KARKAL: Yeah.

MR. KELLEHER: I don't know. Is that the circumstance or is it not? Is it like sticky money? Do they in fact, do the individualized accounts that build relationships with particular IDI's and therefore they sell them other products and they actually are broad based customers? I don't know.

MR. KLEIN: I think sometimes when you get this card you get locked in, right. Because I get this debit card, when I've had an HSA, I've not had a great experience with it. You get this locked in debit card and then you can use it some places and then you have to send some crazy amount of paperwork to justify that when I went to CVS I was using healthcare and not buying candy.

MS. TOUHEY: But from a liquidity perspective though, if I'm the HSA holder, I have a direct relationship with that bank. As I understand it under, we don't -- I don't have an HSA. But as I understand it, it's my decision to either bank with the bank that my employer originally recommends, or I can move that account to a different bank.

That's not a brokered deposit. And my choice in banks that offer that service is dependent on how brokered deposits are defined and stigmatized and what other institutions want to offer that product. So, my choice is ultimately limited, right, by regulations that don't reflect the actual marketplace.

MR. KLEIN: Would we all be open to an idea whereby there could be some definition of these contractual relationships where the HSA providers could know ad hoc -- a priority whether they'd be considered or not, and make a decision? I mean is that -- because we want to get away from this ad hoc nontransparent. That seems universal. Yes?

MS. TOUHEY: I think too, I mean, back to the point about Chairman McWilliams' recommendation on the asset side. Historically, the asset side is where the problems are. We have capital standards now; we have capital framework. I mean I would agree with the approach, it should be funding agnostic.

Funding is so different, and poses different risks, it's almost on a business model, institution specific basis. And many institutions that have what are perceived as risky funds manage those risks and mitigate the risk so that there's no problem, and that focusing on asset growth and limiting troubled institutions asset growth seems to be a much more simple way of looking at it instead of torturing ourselves into this like what funding product in what situation would be brokered. I mean, that's just a complex web that you --

MR. KARKAL: That's just --

MS. TOUHEY: -- don't want to get into that.

MR. KARKAL: And especially for an institution in trouble was funding its risky asset growth with some other type of short term lending, which was not brokered deposits. And we completely eliminated all brokered deposits in the system, those institutions would just go to some other funding source and try to grow out of their success that way.

So, the real problem here, I think I like Chair McWilliams' approach, which is the problems are on the asset side. Let's manage that. And if the institutions wants to go do brokered deposits, or it doesn't, as long as you manage the asset side well, your funding sources matter less --

MR. KELLEHER: Yeah but the belt and suspenders system, it's not one or the other, it's all. And we actually have, when I say we, the FDIC and the other banking regulators have an army of supervisors who are out there working on, supposedly working on -- working is the wrong word, supervising the activities of the bank or at large, including on the asset side.

And so it's a little bit -- we're talking about one tree, brokered deposits, in a big forest that has a lot of moving pieces and a lot of parts. And so I think it's -- so obviously we're focused on this because that's the rule, and that's what the Chair talked about. But I think we need to open the aperture to look at before we start acting as if this is the only thing there is.

And you're right, they will move to other, if you say you can't do this, then they will do what they can do --

MR. KLEIN: Something else.

MR. KELLEHER: Who knows, maybe they'll do that anyway. And you know, sometime in the future another banker will go to jail for breaking the law. Don't hold your breath. But so if you -- it has to be both. There has to be attention paid to the asset side, management, board, oversight, etc.

And there has to be actually application of the law. I mean, there is a law here, and hoping that Congress is going to actually pass a law on anything other than the Senate confirming a judge, is a fool's errand at the moment. So, I think we have to deal with the law as it is, and we have to deal with the regulatory structure as it operates in the real world, which is multifaceted.

MS. TOUHEY: But the law is based on a poorly worded statute that was geared towards a 1980's view of the world.

MR. KELLEHER: But --

MS. TOUHEY: Right and --

MR. KELLEHER: But there's a 1934 Act --

MS. TOUHEY: But in 19 --

MR. KELLEHER: -- and a 1933 Act.

MR. KLEIN: Hold on let Alison --

MS. TOUHEY: Well, but Section 29 was in the '80s. It was originally written by the FDIC as a rule and then Congress sort of copied and pasted that over. But I think about my father, at that point was close to my age. He went to his bank branch to deposit his paycheck. He wrote checks to pay and put it in the mail to pay for his electricity. He got his every morning he went out in his bathrobe to get his newspaper.

And then I think about my son, who's 14, who has never been in a bank branch, wouldn't know what to do with a check. And when he gets his first job, the banking system has to be able to accommodate my son, who is used to automatic transfers, refuses to take his allowance in cash. They can't -- the banks won't survive if they're --

MR. KELLEHER: Is he demoing his lunch?

MS. TOUHEY: Yeah.

MR. KELLEHER: Maybe by the way, maybe --

MR. KARKAL: And so --

MS. TOUHEY: If they're looking to my father's banking world, his grandfather, it's not the way to -- for a healthy banking system.

MR. KLEIN: Hold on one second. Maybe by the time your starts college or graduates college, the Fed will actually --

MS. TOUHEY: And gets a job yeah.

MR. KLEIN: The Fed will actually have processed that check any faster.

MR. KARKAL: Allison, your son, I mean, at 14 it's possible he may never walk into a bank branch.

MS. TOUHEY: Right.

MR. KARKAL: And I don't think -- I mean I think that's a great world. Like I'm personally not a fan of bank branches. If some people want to go to them, that's fine. I do agree that the statistics probably show an age correlation. But in the first six months of launching Simple, we had a 97 year old customer who signed up. And he actually broke our KYC system because he was born before the Social Security system was launched. And so it kind of caused some errors. And we figured out how to fix that.

So, the like older Americans actually hit branches even more because it's what they're used to, but actually getting to a branch can get hard when you're older.

MS. TOUHEY: But there's no different risk between my son's approach with the app on my phone, which is how he gets his access --

MR. KARKAL: Its behavior.

MS. TOUEHY: -- and my father's approach in the '80s going into a branch. There's no added risk to the --

MR. KLEIN: So, let me ask one more question then turn to the audience to jump in here. But I mean, I do think it's all easy to say the problem is just on the asset side, don't worry about it, as long as we get the assets. Well, I have a bunch of assets, they're rated triple, they're in this complex security. But don't worry, I have insurance from AIG if the security goes under I'm currently covered --

MR. KARKAL: This also matters.

MR. KLEIN: Yeah. Right. And by the way, that was the story that was told, the last -- 2005, 2006 there were no bank failures. Everybody looked like they had these fantastic assets. Their balance sheet was spectacular. And they had these liabilities but don't worry, they're off balance sheet and they're not in the IDI and blah, blah, blah, blah, blah. And kaput.

MR. KARKAL: Right --

MR. KLEIN: And so, hold on. So, we do need a bit of a belts and suspenders in terms of activities. On the other hand, I think there is a fair point that HSA's didn't exist when they were thinking about this. That contrary to the point about the nominal interest rate, it doesn't matter if I'm chasing ten basis points of yield from 1.5 or 7.5. If I'm chasing ten basis points of yield and chasing ten basis points of yield. You know, corporate treasurers do that all the time, at very, very low nominal rates, and when they run into trouble, there's a cascading effect.

And so I kind of want to ask two different questions here. Shamir, you built a Fintech company.

MR. KARKAL: True.

MR. KLEIN: You built the company on the existing broker deposit rules?

MR. KARKAL: Yes.

MR. KLEIN: And whatever the costs and problems where it didn't deter you from building that company, launching that company and having that company be successfully acquired. Right?

MR. KARKAL: Yes.

MR. KLEIN: I mean it happened.

MR. KARKAL: Yes.

MR. KLEIN: So, this kind of begs the question, it drills in a little bit. It's not about not preventing innovation, maybe it made your innovation more costly, maybe -- Tell me about how the existing brokered deposit rules impacted the building of your company, because it happened, right. So, why do we need to fix this or not? Or what were the ramifications? This is a unique perspective.

MR. KARKAL: So, July 17, 2009, a classmate of mine from business school -- And by the way before I started Simple I was a consultant at McKinsey. My last two major projects before this July 17, 2009, were resolving a trillion dollar bankruptcy in Europe, and working on a country bailout plan in the Middle East. So, I am somewhat familiar --

MR. KLEIN: So, you almost disclosed your McKinsey client, so you can run for President now.

MR. KARKAL: I am not close to them anymore. I --

MR. KLEIN: That's what he says.

MR. KARKAL: I am -- well I don't think --

MR. KLEIN: Yeah, sorry, sorry --

MR. KARKAL: I'm banned from running for president in this country in many ways, most importantly by not being born here. So, like the -- I was much more familiar with the traditional financial system and kind of the massive mess that was 2008 and '09.

And then this classmate was a startup guy sent me an email, and he was a friend, and he is a friend, and said, let's start a bank. And I was like, my immediate reaction was like, what the hell has gotten into Josh, right.

And then I thought about it, and the vision he laid out, was so much better for end users and customers, right, like that's where he started from. He didn't think about the back end. That it was just so compelling that I started talking with him about it. And fast forward to like November of '09 and quit my job, moved back to New York and started up Simple.

And I pulled a McKinsey deck and I was like; how do you start a bank in the U.S. It was like you go to -- you take $10 million dollars, a few computers, go to Utah and get an IRC. And it was all laid out there. Guess what --

MR. KLEIN: The IRC is an Industrial Loan Corporation, which is essentially a loophole in the exemption between banking and commerce.

MR. KARKAL: Yes. And guess what? That was not an option in '09. It was not an option I believe between '9 and 2017.

MR. KLEIN: Even before '09.

MR. KARKAL: Yeah. In fact, every year between 2000 and 2008, there were between 100 and 300 new banks chartered in the U.S. Between 2009 and today I believe there have been seven. And there might be one more which the FDIC is approving. Of those seven or eight, I think only the last two I would characterize as anything new. The remaining would look like everything -- would have looked exactly the same in the previous two centuries.

MR. KLEIN: Tell me how brokered burger deposits impacted you?

MR. KARKAL: Sorry. So, the way brokered deposits indirectly and directly impacted it, is it took me three years from that email to launching Simple. Now, to people in the financial world, three years to build and launch a bank sounds really fast. To people in the venture capital world, it sounds like insanely slow.

And so it's not like I'm the only one who could do this, or me or Josh were the only ones. Like we were the only ones insanely determined enough to keep bashing our heads against the wall until the wall collapsed, right, or we got through it.

And that's the -- that's what's changed between 2009 and now is that by finding a way through that regulatory mess, other people are like, well we can do that. And we can do that better. If Josh and Shamir can do it, then I can do it.

And that's why there's now, I don't know how many, 20, 50, 100, Raj probably knows, like how many new banks and variations of new banks, the entire Fintech industry, it was back then it was like Lending Club, Betterman and Simple, Square and that's it. Maybe a few others.

And now, it's like there is, I think 8,000 fintech's. And all of that is kind of because somebody made their way through and blazed a trail, right. But if you could take that three years, and make it into six months, there wouldn't be 8,000 Fintech startups, there might be 80,000. The amount -- there are, I don't know two million apps in the app store. That's because it's so easy and quick to build an app. I don't think we'd want two million Fintech's. But I think we can do a lot better than what we have right now.

MR. KLEIN: Okay. In the -- we'll start in the back and then Burt, you'll go next.

MR. POLZER: Oh thanks. It's a terrific program. I'm Carl Polzer. My little project is the center on capital and social equity. And my -- and I'm a generalist, my concern is really protecting the little guy, including the little guy and having a stable system. So, when I took financial management, budgeting and control at the Kennedy School like 30 years ago, I think I remember that when you move liabilities around there can be effects or countervailing -- physics changes the assets -- can change the assets -- net assets.

Also, so my question is, who's watching and accounting for what's transacting here, either through the brokers or between banks, when they move liabilities or -- so and who's making sure it all adds up to 100 percent and not 200 percent of 300 percent or 400 percent? In other words, they're not levered when this stuff moves around, it's not being leveraged or hedged or sold three times like we had with the last -- And if -- how do you limit that? Does it make sense?

MS. TOUHEY: Sort of? So, let me start with your comment about the little guy, right.

And I think part of what we've all talked about here for the past two hours is that this isn't a simple question. There are many complexities here. One being the low and middle income contingent and the underbanked. And I know of community banks that are small that serve lower income areas that their demographics of their community, which they serve, is such that they need a lot of loans, but they aren't wealthy enough to fund those loans.

So, the community bank has to go outside of its local area to fund the loans that the community needs to grow and thrive. And the way that many banks do that is brokered deposits in the truest sense.

However, as has been noted, brokered deposits maybe don't pose the same risks that they did. They're less expensive and more stable in many cases than they were in the '80s. So, there are -- they're a tool that's being used to support underbanked and lower income communities.

With respect, I think you're asking about the deposit brokers themselves, and how they're regulated, which that's outside of my scope. Maybe others have thoughts on that. I would think maybe that's a FINRA issue, as sort of outside of the banking regulatory space. But banks also have capital and are highly regulated. So, from the bank safety and soundness side I think that they're protected. I can't answer to the deposit brokers and how they're regulated.

MR. KARKAL: I'm not sure I understood the question. But at least I think it was specifically asking about transaction monitoring, and sort of basic accounting in the nonbank space. Now, remember, Fintech's are actually a very small chunk of the nonbank space. Nonbanks is a very large cut and there's all those like, SPV's and all the other kind of acronym soup of the pre-crisis. Didn't actually go away, it's still pretty -- it's still there and still pretty big.

At least within the Fintech world, I think it's clear to, at least all the entrepreneurs and tech folks that I know, that everything from the Bank Secrecy Act, to the Patriot Act, and all the intermediate regulations actually does apply. And even the folks in the crypto world, who might have thought that it didn't apply to them, I think they have been disabused of that notion.

And so every startup I have invested in or been involved in had a compliance officer or compliance policy. Knew how to do it, say ML and monitoring. And in fact, in many cases, most of those startups did it better than many banks. And in fact, they did it better because they used technology natively.

And so a lot of transaction monitoring is quite amenable to technology first approaches, surprisingly. Accounting, for that matter, it's -- I mean, it's really a function of like ultimately, the only institutions that get access to the payment systems, whether it's Fedwire, ACH or the check clearing, are depository institutions. So, all of this has to go at some level through depository institutions.

MR. KLEIN: Or the real time payment network that's been built, external from the Fed --

MR. KARKAL: It's still --

MR. KLEIN: -- it's actually technologically more advanced.

MR. KARKAL: It is still clearing through Fedwire, though.

MR. KLEIN: Yeah no that's fair.

MR. KARKAL: Clearing through Fedwire I should say.

MR. KLEIN: Yeah.

MR. KELLEHER: The only thing --

MR. KLEIN: It slows it down.

MR. KELLEHER: -- the only thing I'd say is, thank you for what you're doing and starting with your initial comment, which is you're looking out for the little guy. Nothing happens in Washington, or I should -- put differently, everything that happens in Washington is claimed to be for the little guy. Almost none of it is, except when they're on the receiving end.

And so, the last statistics I saw, and somebody here can correct me, is roughly 48 percent of all brokered deposits in the country today are concentrated in the four largest banks. So, what, you know --

MR. KLEIN: It is brokered deposits; I believe are more concentrated among larger financial institutions.

MR. KELLEHER: Yes and --

MR. KARKAL: This is true.

MR. KELLEHER: -- and --

MS. TOUHEY: But how are --

MR. KELLEHER -- it gets to -- and the statement that community banks in unserved and underserved areas rely disproportionately on brokered -- or deposits from outside their area. I see that mentioned all the time. I see very little data put in the record on it, including on this ANPR, the statements are made but I haven't seen the data. Nobody put the data in that I'm aware of --

MS. TOUHEY: Have you read some of the comment letters, there are a lot of community comment -- community bank comment letters.

MR. KELLEHER: Well, I mean I've only read a few of the 130.

MS. TOUHEY: Okay, well I'm happy to point out --

MR. KELLEHER: But -- but the --

MS. TOUHEY: -- the ones --

MR. KELLEHER: -- but the four from the ABA I read.

MS. TOUHEY: Oh --

MR. KELLEHER: So, among others, and the MasterCard one and Burt's comment letter, I could go through the audience, actually. But I'm just saying, I would like to see a lot more concrete data associated with these changes to benefit the little guy that actually shows any nexus -- any nexus between the purported change and the benefits that are going to be showered on the little guy. I'd like to see a lot more data on that.

I'm not saying it isn't there. And I'm not saying they're all bad and it's all wrong. I'm just saying merely because it's said it's for the little guy, may or may not bear any relationship to that objective. And often it's not the case.

MS. TOUHEY: And I would note too that the CAR report data on brokered deposits, given all that we've discussed about how broadly it's interpreted, how inconsistently it's interpreted, that that one line item in the CAR report isn't always accurate or indicative of the real story.

And I'm happy, Dennis, to note in our response to the FDIC, and our comment letter, all the community banks and their funding and how they help their communities. And thank you for the reminder that that needs to be highlighted. And I will remind my community banks that are very actively involved in this issue to comment.

MR. KELLEHER: And I've read the ICBA --

MR. KLEIN: Hold on -- We got Bert and Raj because --

MR. ELIA: Thank you, Bert Elia, banking consultant. Dennis, a question for you. The Chairman, or Chairwoman, talked about the rate of -- the role of growth plays in rapid growth in failing bank institutions. My question for you is this. What are your thoughts, pro or con, with making the rate of growth a more explicit factor in how risk sensitive deposit insurance premiums are calculated? That is, should a fast growing bank pay a higher rate of premium then a slow growing bank?

MR. KELLEHER: You know, Bert, you're a bigger expert on this than I am. But we both know that merely looking at a rate of growth tells you very little. It's the composition, concentration and activities associated with the rate of growth. And it's both you've got to look at the asset side and the liability side.

And so it's the full balance sheet you have to look at in the complexity of what the particular institution is doing and how it's doing. You know, if it's a single institution that's growing based on shopping mall funding in the Dallas area in 1989, that's very different than a financial institution growing at the same rate that's geographically diversified and product diversified.

So, and this as you know also, is supposed to actually be captured on, I don't know whether you want to call it the more nuanced or the more tailored supervisory side of our regulatory system. And so it already should be a material part of the regulatory architecture and the outcome of that.

Which is to say, and you know, you brought up a good point that I think everybody agrees with, part of the problem is you have this cliff effect. If you all of a sudden become less well capitalized, you can't get brokered deposits, boom there goes that funding source. And then where do you get it? What do you do?

You know, my answer to that is that really says nothing about -- but my view would be that says nothing about the brokered deposit rule. That said, I would say where are the supervisors six, 12, 18, 24 months before, they're at the point where they're paying less well capitalized in the brokered deposit option is not available.

So, I think it's a comp -- it's much more complex than saying like yes or no, look at assets, don't look at assets. They're looked at, they're looked at carefully, and they're calculated carefully in terms of the overall risk assessment.

MS. TOUHEY: And we agree that it should be a holistic balance sheet approach. I think we can come into agreement there, it's not just one source of funding, it's how a bank funds itself, what loans its making, and how it mitigates any risks on either side of the balance sheet. And of course, its capital position.

MR. KLEIN: Right. Ray or do you want to --

MR. KARKAL: Could I ask a question? Yeah?

MR. KLEIN: No let's let Raj go first.

MR. KARKAL: Okay.

MR. KLEIN: And then Shamir you're up next.

RAJ: Thanks Aaron for hosting this immensely boring topic but is actually quite important. I would have thought prior to this conversation based on whatever number of years now I've wasted in this one industry, that over the course of that time one of the things that has changed for the better in terms of prudential regulation is sort of the -- is a better focus, a more calibrated focus on the stability of the liability side of the balance sheet. It's not all about assets and the tyranny of double entry accounting. And as every crisis teaches, again like in a crisis, your assets are your liabilities, and your liabilities are your assets, it matters.

But given this focus on stability of liabilities, broadly, I would have thought that this sort of definition what's the brokered deposit what's not, would have become a dead letter by now. But rather, we should be more focused on potentially brokered deposits being a symptomatic of macro prudential concerns. In other words, as the curve steepens, and you're kind of at that sort of height of things like, should one be concerned that this allows like anyone with a Bloomberg terminal and charter to run a gigantic carrier trade that should be symptomatic prudential concerns. Any thoughts on that, especially Dennis, Aaron? Like how do you think about macro concerns as opposed to micro prudential concerns?

MR. KLEIN: So, I mean I guess I would start by saying, it's very interesting because when you read the history there's kind of two different themes that come through in brokered deposits. One is, troubled institutions aggressively seeking brokered deposits to foster the liability -- their lending, right. Because this is the magic of banking, I take your deposits that are redeemable either on demand or at specific intervals on the certificates of deposits. I make longer term loans that are far less liquid. I have this maturity transformation.

That's kind of the 1980's story that the Chair started out with. Then you see, in the current crisis there was a high correlation. That was kind of the quote I read to her on the crisis. It wasn't necessary -- because it also says and other wholesale funding, right. Because the world has evolved, right. The world has deeply evolved.

And I posit two major structural changes that didn't exist when this rule was come. One is interstate banking. And you just reminded me of that, Dennis, because I was thinking of your Dallas comment in 1980. And you said, one that's geographically diversified. And I realized that was only within one state.

MR. KELLEHER: Right.

MR. KLEIN: Right. People forget that up until the 1990's, you couldn't effectively bank in multiple states. And that's a huge imply -- that's a huge difference.

The second is the elimination, the combination of commercial investment banks. So, before you could have the sweep deposit relationships between investment bank and a commercial bank, but they weren't the same entity. And this kind of, I think, gets to Shamir's kind of core point, which is like, if you're a wholly owned subsidiary of an IDI you are not hot money that can run. You're on this sticky side.

If I'm Merrill Lynch and I'm sweeping into Bank of America, that looked very different pre-crisis than --

MR. KARKAL: Post-crisis.

MR. KLEIN: -- today, right. Where I'm on the same firm. And so I'm per your -- to answer your question, which is always a dangerous thing to do rather than give distractions and turn to the next person on the list. I think of this much more sales and micro prudential thing. I'm nervous in general about macro prudential as kind of a way to talk intelligently about things that we're not going to really regulate.

And so, and on the micro side, brokered deposits had been both causation and correlation with problematic. That being said, the -- what is captured in the rule as written in the '80s, what exists today now is different. And I kind of am drawn towards Dennis' sticky, not sticky framework.

And then I think reasonable people can differentiate where they fall between those things. That's what I'll say.

MS. TOUHEY: And what's sticky for me might not be sticky for you. Right. So, that is -- adds to the complexity. And I think, again, the macro issue is that we're mispricing risk, we're mis-calibrating risk with this rule. And we're discouraging banks from raising stable, sticky funding with an outdated concept.

And that's a statutory concept. Right. So, you were lumping every deposit with a third party, does not pose a hot money risk. And that's where we are right now.

MR. KELLEHER: Well, part of the --

MS. TOUEHY: So, not all deposits are brokered and not all brokered deposits are bad.

MR. KELLEHER: Part of the problem is we're all going to find out after the next crash. And that's something we should all think hard about when we're talking about the trees or the forest. Because look, there are a few industries that need more innovation in competition than the financial industry. I mean I don't think that's disputable.

If you look at the concentration and the poor incentives, the barriers to entry in the financial industry, it's hard to compete with them. But there's nothing worse for innovation than a crash, a crisis, or a scandal. And Shamir's comment about getting a bank charter in '09, and why was that?

Well, 2008 was the worst financial crash since 1929. It caused the worst economy since The Great Depression of the 1930's. Everything pulls back at that point, right, for good reasons, and maybe for some bad reasons or for -- but mostly for good reasons.

And so what we have to do when we're making policy or rules, and whether we're looking at the tree or the forest, is figure out how we really strike a balance in a way that achieves the statutory objectives, which the Chair and the FDIC has to do, irrespective of their personal views. And how that works in the overall architecture.

But for me, when I think about this, the worst thing to do is to start calling everything sticky money, when the label doesn't change the fact that it's hot money. And three, four or five years down -- and I'm not saying you're saying, anybody is suggesting that. I'm not in any way. I think people have good faith arguments for what they want to do.

But I think the problem is that they're associated with profit maximization which is perfectly legal, and we want that to happen, because good things come from it. But bad things come from it when profit maximization drives policy and rules.

And what you need is the balance, because in five or six years, when something blows up then you're going to end up with an overreaction. And you're going to set back innovation even more. And we're going to be constantly in the cycle where we seem to be in too often, and you know, you and I unfortunately have been around long enough, and not you obviously, but your father.

You know that we see the cycles of where you kind of have open regulation, something happens, boom it gets closed back down. And then it's going to come back and then boom. And what we need, and that's why I say we need balanced regulation where you're -- particularly when you get anywhere near OPM, other people's money.

When you get near other people's money, and those people are taxpayers, then the sensitivity to that should be higher. If you're in the noninsured depository arena, then you know, the concerns can be lower. If you want to lose your venture capitalist people money, I don't mean you want to. If that happens, you know I feel bad for those people, but they've got a portfolio and they're going to be fine.

When those risks and those costs have shifted to the taxpayers on Main Street, then the consideration for them ought to be commensurately higher. And so when you're looking for the balance on the spectrum, the analysis isn't always the same. Sometimes if you're out of the banking system, higher tolerance risk, higher tolerance for loss, because you and your funders are going to bear the loss, When you're over here in the insured depository, and where taxpayers are going to bear it, then higher goes the consideration for them.

And then somewhere along that spectrum, you end up with a balance. And that's what we should look for. And right now, the balance is out of whack in the overall regulatory architecture. It's all going towards industry asks industry gets. And we're all going to pay the price for that, no matter what your views are. I mean, if you believe, we all believe in innovation, we all believe in progress. And if we want to have that materialized then we need a set of rules that are going to work overtime.

MR. KARKAL: I'm just -- I'll answer Raj's question. But just before that I'm like this -- the answer to there is first for me, because I'm like this is probably the first time anybody's ever called me part of the industry, in my career. So, it's quite interesting.

MR. KLEIN: You made it.

MR. KARKAL: Oh no, I view this as a failure. But so I do agree with Aaron that this is the -- maybe the Chairperson, McWilliams' approach on this particular topic of let's put it all on the asset side, is maybe a better approach. That almost anything you could do would be better than what we have now. Because right now it's a mess, that only favors the large banks.

I should point out that the existing broker deposit, which are all, as you said, sitting with the large banks, none of the Fintech's I know keep any deposits at a large bank. In fact, they all keep it at small community banks, because those are the only ones who will work with them. The big banks view them as the enemy, not as a friend.

So, the only people who are actually getting screwed really, by all this mess of the existing brokered deposit, is not Chase or Bank of America, they still get all their brokered deposits, as you pointed out. The ones who are getting screwed are people like me, or the companies that Raj is now investing in, all right.

And so the system is it -- I don't think there's any way of kind of finding where people are on that spectrum of sticky to hot deposits, without going micro prudential. Right? I mean, either you don't do it and you just say we're going to trust the asset side, and we'll be fine, and we can ignore this problem. Or you say belt and suspenders, but then if you're going to do something about sticky versus hard, then you're going to have to do it micro prudentially. Because any kind of like, bright line you try to draw anywhere, some smart lawyer or consultant will find a way of getting around that.

And guess what? When it comes to hiring smart lawyers and consultants, the big banks do a much better job of it than us Fintech's. Right. We do a better job of writing technology. So, I think the only way to do it is to do it micro prudentially. Understand that, of course, if every examiner was perfect, then we would never have any problems. The reality is examiners are going to make mistakes. Let's do it transparently. Let's try to stick to one set of standards. Let's learn from it and let's evolve.

And I liked Chair McWilliams' approach for that too. But I do think there is a macro piece here. Which is also going back to your thing, Aaron, is that the world -- like you cannot stop an idea whose time has come. Right. Like nobody -- like no matter like the entire regulatory apparatus of all the governments in the world together will not be able to stop innovation. Maybe for a generation or two. Right. This is financially not regulation.

Money is way more important than ads or any other part of technology. Money has also been the, like the first buyers of like the early UNIVAX were all like financial institutions and the Department of Defense. Because guess what, back in the 1960's a computer was a job description for a person who added up numbers. Where did all these people work? At banks because they had to add up numbers. Thankfully, banks were mostly state or county level institutions. So, they didn't have to add that much up. But getting like a financial report of a bank's balance sheet at the end of a month took hundreds of people adding stuff up on paper general ledgers. As soon as there were computers bank started fixing that stuff, right.

So, this wave of technology has been brewing in the financial system, the whole tech industry, all these ad startups are the new ones. Banks adopted mainframes back in the '70s. So, that has been brewing, and that is going to change the world. It is -- it cannot be stopped.

And the only question is, how well can you get ahead of it, if -- and there are many different ways, right. Like, if you don't like Fintech's operating as brokered deposits in working with a community bank, maybe you should just give them charters and say you get to be a direct bank. But if you're going to block one route, understand that they will find another way, and the innovation will happen.

So, I think like, reflexively kind of trying to say the existing system is better, and screws sort of the screws over the small guy, when we started Simple, I had like 10,000 email conversations with potential customers, right. None of them knew anything about banking. So, I spent a lot of time trying to understand the small guys. And I -- and a lot of what Aaron says resonates with me. But the future is going to be people like me.

MR. KELLEHER: I just don't think it's either or I think it's both. I think you can have innovation, and you can protect the deposit insurance fund and taxpayers. And I think the constant characterization of one or the other is just a false choice. And I think it's difficult, and it's messy, and it's complex, but you can have both and we should have both, and we should expect both. And that's ultimately where we need to get.

MR. KARKAL: Totally agree.

MR. KLEIN: So, if you ever asked yourself, can I sit in a room and talk about brokered deposits for two hours, the answer is yes. Join me in thanking the panelists. And thank you guys for engaging in this conversation.

MR. KELLEHER: And thank you Brookings and Aaron.

MS. TOUHEY: Thank you Aaron.

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