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# US regulators couldn't quite keep up with the evolving banking landscape in 2023

Article

**The trend:** While industry observers anticipated that **US regulations would address the economic volatility of early 2023**, their yet-to-be-seen results will redefine banking and banks' responsibility to the greater society.

- But even though the regulatory changes are noteworthy, some major gaps in guidance could prevent US financial institutions (FI) from fully engaging in some business activities.

**How we got here:** The changing rules reflect the reactive approach that US banking regulators have taken as they attempt to keep up with the rapid pace of change on several fronts.

- Regulators cited "supervisory lapses" for enabling the March banking crisis, promising stricter oversight in the future.
- Record-breaking temperatures and an increase in extreme weather events have caused major disruptions around the globe—prompting regulators to re-evaluate banks' roles in climate change.
- 2023 was what McKinsey dubs "generative AI's breakout year." With this technology at the center of major industry conversations, regulators tried to keep its use in check.

**What were the changes?** US FIs will now operate within a drastically different regulatory environment that reflects technological innovations as well as reactions to climate change and this year's banking crisis.

**1. Capital requirements:** When multiple banks collapsed earlier this year, regulators sought to discover what could have prevented the crisis.

- FIs won a minor victory when they were able to push forward the comment period on proposed regulations to January 26, 2024, giving agencies time to collect more data about the impact on banks.
- Since the Wall Street Journal reported on the toxic work environment at the Federal Deposit Insurance Corporation (FDIC), and claimed that Chairman Martin Gruenberg allegedly did little to abate it, he's faced calls to resign.
- His resignation could potentially stymie the agency's agenda with a two-two partisan split board, half of which opposes the stricter capital requirements.
- And banks aren't done fighting. This month, eight major FI CEOs met with Congress to convince them that increased capital requirements would take a heavy economic toll on US consumers.

**2. Climate change:** Banking regulators finalized multiple climate-related regulations and risk frameworks, marking a shift in thinking regarding banks' responsibility to address the escalating crisis of climate change.

- The Federal Reserve Board, the Office of the Comptroller of the Currency (OCC), and the FDIC published a joint framework on October 26 targeting climate-related financial risks at banks with more than $100 billion in assets. This framework mandates that management provide each bank's board with precise and timely climate risk information and show how it relates to their banking operations.
- Regulators also updated the rules of the Community Reinvestment Act (CRA) to include provisions for climate-related financial risk exposure, as well as expanding it to cover online lending.
- In addition, the Basel Committee has also proposed climate-related disclosures from FIs to facilitate analysis of an FI's climate-related exposures. This reporting will also inform whether the FIs hold enough capital to weather those risks.
- Global interest ESG is at an all-time high, although some banks have stepped away from optional efforts—indicating a potential shift in priorities.

**3. Banking fees:** A series of enforcement actions by the Consumer Financial Protection Bureau (CFPB) changed up many banks' major source of revenue.

- The CFPB levied millions in fees on two major banks after investigators deemed their fees unlawful.
- Starting in February 2024, FIs will no longer be allowed to charge excessive fees when customers request reasonable basic account information.
- This month, the CFPB plans to issue another rule to further crackdown on overdraft fees.

Many banks have moved away from these charges to win back the consumers whose complaints initially launched this trend. For example, since 2021, denial and nonsufficient fund (NSF) revenue has dropped by 86%.

- But it's unclear whether the new rule will also require smaller banks—including credit unions—to stop charging customers these fees, too.

**4. AI:** Technology evolved too fast for regulators to keep up with it as some FIs rushed to integrate AI into almost every aspect of their businesses.

- Acknowledging this gap, President Biden issued an executive order that regulates the use of AI in banking, consumer finance, and housing to prevent discrimination and privacy violations. The order instructs the CFPB and Federal Housing Finance Agency (FHFA) to vigilantly oversee AI use in lending decision-making processes.
- FIs want more clarity about how regulators will incorporate and enforce the President's guidance.


**5. Cryptocurrency:** The digital assets realm remains largely unregulated in the US, while other countries compete to attract cryptocurrency businesses by offering greater regulatory clarity.

- A review by the FDIC's Inspector General found that the agency lacked clear procedures and guidance for banks handling cryptocurrencies.
- The FDIC accepted the recommendations and agreed to be clearer about the process for offering supervisory feedback on FIs' crypto-related actions.

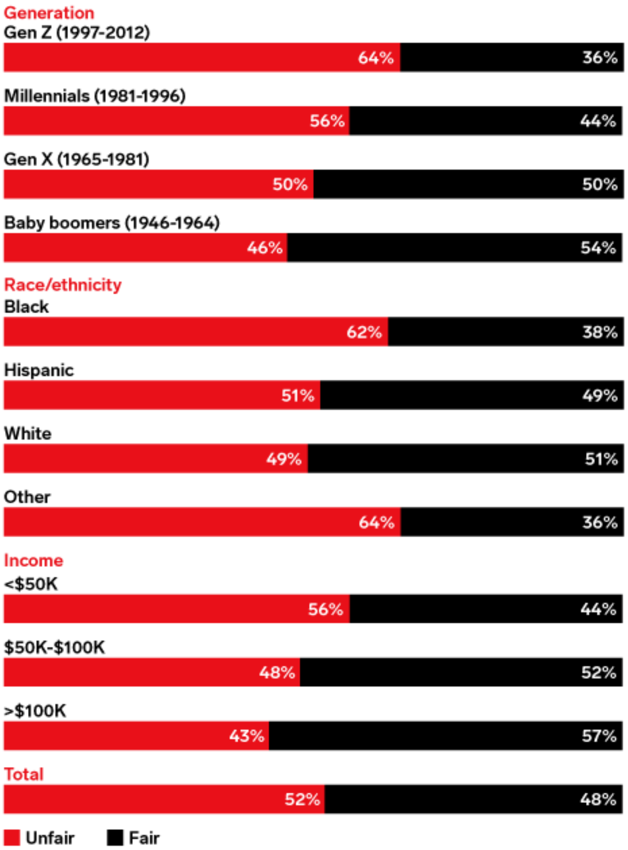
- Multiple bills aimed at regulating cryptocurrency are idling in Congress, but a recent meeting between big bank CEOs and US senators may increase their chances of passing.

**Key takeaways:** Most of these new regulations will go into effect in 2024, meaning we'll see the results over the next year. Here's what to expect.

- As regulations increase, and FIs adjust staffing, a growing number will lean on AI to help them stay on top of compliance requirements.
- Some regulations will have unintended consequences—for example, if the CFPB's new rule on overdraft fees is only enforced at larger banks, consumers will learn to associate smaller banks and credit unions with higher banking fees.
- FIs that lack the budget to keep up with these changes may merge with other FIs. That's especially likely for FIs that rely on the income from overdraft fees and haven't yet identified new revenue streams.
- Regulators themselves will come under more scrutiny in 2024 due to embarrassing scandals at the FDIC and OCC that called into question their credibility and cast doubt on their ability to spearhead future regulatory initiatives.

**Fairness of Overdraft Charges According to US Adults, June 2021**

*% of respondents*




*Note: n=2,200*
*Source: Morning Consult as cited in company blog, June 15, 2021*

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