Banking and Finance Law Daily Wrap Up, BANKING OPERATIONS—Shadow banking, artificial intelligence on Senate Banking Committee's radar for 2024, (Jan. 2, 2024)

Banking and Finance Law Daily Wrap Up

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By Nora Macaluso

Following 2023 year-end recaps, committee members are focusing on legislation to regulate industrial loan companies, as well as addressing artificial intelligence threats, and state consumer law preemption.

A bipartisan group of Senate Banking Committee members introduced the Close the Shadow Banking Loophole Act, which would subject industrial loan companies (ILCs) to the same consumer protections and regulations as traditional banks. The bill, first introduced in 2007, would subject ILCs to the same Federal Reserve supervision as bank holding companies under the Bank Holding Company Act. There would be a carve-out for existing ILCS and allow the Federal Deposit Insurance Corporation time to consider pending ILC applications, though federal banking companies would be prohibited from approving a change in control of an existing ILC unless its acquirer is subject to Fed supervision, according to a one-pager accompanying the bill's introduction.

Senate Banking Committee Chairman Sherrod Brown (D-Ohio) and Sens. John Kennedy (R-La), Bob Casey (D-Pa), Chris Van Hollen (D-Md), Mike Braun (R-Ind), and Roger Wicker (R-Miss) said current rules that allow nonbank businesses access to the federal payment system and federal deposit insurance put traditional banks, which operate under regulatory supervision, at a disadvantage. "Letting Big Tech and commercial companies operate banks without proper oversight will only open doors for predatory lending, invasions of consumer privacy, and broader financial instability," said Brown. "To protect consumers' pocketbooks and ensure a strong banking system for Main Street, we need to ensure all banking institutions play by the same rules.

State consumer laws. Sen. Elizabeth Warren (D-Mass) led a group of senators urging Acting Comptroller of the Currency Michael Hsu to reconsider some rules and guidance regarding state-level consumer protections. The OCC is "overstepping its preemption authority" under the Dodd-Frank act, they said in a letter to Hsu. The OCC "improperly sidestepped" Section 1044 of Dodd-Frank in 2020 when it issued an interpretive letter saying an OCC action with "indirect" effect on state law is not a preemption, Warren and Sens. Jack Reed (D-RI), Tammy Duckworth (D-Ill), Peter Welch (D-Vt), Ed Markey (D-Mass), Sheldon Whitehouse (D-RI) and Bernie Sanders (I-Vt) said in a letter to Hsu.

Three "blanket preemption rules" issued in 2004 and republished in 2011 "superseded entire swaths of consumer protection law," and the OCC "disregarded the core requirements of Dodd-Frank" in republishing them, the senators said. They also said the OCC has failed to review its preemption determinations every five years, as required by Section 1044.

The review requirement "is an important mechanism for public examination and thoughtful consideration of the OCC's prior preemption determinations," according to the senators. "The OCC has unduly interfered with states' abilities to gather information about credible violations of non-preempted state consumers protection laws," the senators said, noting that 21 state attorneys general requested that the OCC issue guidance to banks advising them that it is "unsafe and unsound" to refuse to cooperate with state information requests.

"Under a 2002 agency advisory letter, state attorneys general are discouraged from contacting national banks about allegations of illegal behavior, and national banks are discouraged from responding to state requests for such information," the senators said. "The OCC's policy has meaningfully hamstrung states in their efforts to protect consumers from harmful national bank practices, despite a 150-year history of dual enforcement by both state governments and the federal government over national banks."

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AI threats. Sens. Mark Warner (D-Va) and John Kennedy (R-La) introduced legislation that would require financial regulators to identify and address uses of artificial intelligence-generated content that could disrupt financial markets. Warner and Kennedy, both members of the Senate Banking Committee, said AI is advancing quickly and the time to address its potential to disrupt financial markets is now.

Their bill, the Financial Artificial Intelligence Risk Reduction Act, would put the Financial Stability Oversight Council (FSOC) in charge of coordinating regulators' response to threats including the use of "deepfakes" and trading algorithms, and would require the FSOC to identify gaps in existing regulations, guidance, and exam standards that would hinder response to AI threats. It would also provide for penalties when AI is used in violations of Securities and Exchange Commission rules and requires anyone using an AI model to make sure that model complies with securities laws.

Year-end recaps, outlook for 2024. Senate Banking Committee Democrats said their priorities for 2024 include promoting affordable housing and cracking down on consumer protection, in addition to reining in shadow banking, crypto and AI. The committee will work to get the Recovering Executive Compensation from Unaccountable Practices (RECOUP) Act clawing back compensation for senior executives of failed banks, and the sanctions and anti money-laundering FEND Off Fentanyl Act "over the finish line and signed into law," said Chairman Sherrod Brown (D-Ohio).

The Democrats included a roundup of their 2023 accomplishments, which included holding hearings on oversight of credit reporting agencies, protecting consumers from cryptocurrency risk, and looking at tools to counter economic and national security threats; confirming three Federal Reserve nominees; and defending the Consumer Financial Protection Bureau.

Sen. Tim Scott (R-SC), the ranking Republican on the panel, said he and his Republican colleagues worked last year to advance legislation on fentanyl and national security, and housing and capital markets, as well as conducting "principled oversight of the Biden administration's burdensome regulatory agenda" and demanding "transparency and fact-based analyses" for proposed regulations. Scott, in a year-end review, noted his work on 11 pieces of legislation and legislative frameworks, 20 oversight letters to federal agencies, and two markups.

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