



Branching Out: A Retail Banking Podcast Series

Episode 2: Regulatory Environment Trends and Implications for Retail Banks

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Kristin Korzekwa: Well, hi everyone. Welcome to Branching Out, the podcast where we explore trends in retail banking through conversations with leaders from across the financial ecosystem. I'm your host, Kristen Korzekwa, and on today's episode we're going to zoom out and discuss how regulatory and related macro policy trends are impacting retail banks in the marketplace. I'm excited to be joined by Deloitte leader Tom Nicolosi, and Paul Sanford, an industry veteran of the CFPB, OCC, and FDIC. Paul, Tom, thanks for being here. Would you like to share a quick intro before we dive in?

Tom Nicolosi: Kristen, thank you. Tom Nicolosi, appreciate you having us. I'm a principal in our risk and financial advisory practice. I have been working specifically in this space for the last 20-plus years, and I lead our consumer and retail go-to-market segment from a risk and financial advisory perspective. Paul?

Paul Sanford: Thanks Tom, and as Kristen said, I've had experience with three federal agencies, both in safety and soundness and consumer protection, and also specialized in examiner training. And I did that for about 30 years before I became an independent consultant.

Kristin Korzekwa: Great. Well Paul, why don't we start off with a grounding question about the different roles and spheres of influence that major financial regulatory agencies have on retail banks, and of course ultimately on their customers. In short, what would you say, if anything, do each of the OCC, Federal Reserve, FDIC, and CFPB do differently? And which ones do you think retail banks should be the most focused on from an impact perspective and overall oversight perspective?

Paul Sanford: Well, thanks Kristen. Great question. I think it may be helpful if we level set it a little bit first with the universe of regulators. And so first let's break it down, we have the federal banking agencies, and they have responsibility for safety and soundness. Now, the federal banking agencies and CFPB have responsibility for consumer protection, and what's interesting about this is that the consumer protection responsibilities are divided and also shared for banks that are over 10 billion dollars. So there are specific regulations that are broken out between the CFPB and the federal banking agencies, but then they also have some shared aspects like compliance management systems, the consumer compliance rating system, and also they share a UDAAP, which creates some interesting, uh, scenarios, with the exception of the A component, which the CFPB has itself, which stands for abusive. Another thing that's interesting here is that CFPB has direct authority over non-bank providers, and that has some interesting implications for banks. And one other thing I'll think I'll mention is that the CFPB and the federal banking agencies have responsibility for third party service providers under the bank servicing company act. What the CFPB does that's a little bit different is, that universe is expanded by virtue of the fact that they have responsibility for these non-bank entities.

Tom Nicolosi: Paul, thank you. That's an extremely helpful primer. A level set on how those agencies interact with each other. If I think about what you just said. It's very much about what these agencies, what they do the same, and how that sort of plays through ultimately in the way that they show up from a regulatory and an enforcement perspective. We know each of those agencies, they work together on policy exam procedures, they train together through the FFIAC. And usually the differences that you see is, it comes through in, in how the leadership is viewing certain of those issues and the priorities that are set from a leadership perspective. I think a lot of the differences that, that the institutions will feel practically comes through what the examiner and charges are doing on the ground. How they view things, the experiences that they have, some of the personalities and, and what the regional offices from a regulatory perspective, how that pushes. I think, you know, at the end of the day, and Paul you've mentioned this, I've heard you say this many times, is you wanna really err on the side of inclusion, making sure that everyone comes along for the ride, everyone's included in what those things are, even though the CFPB may be primary or otherwise, and making sure that folks are all sort of aligned to the sorts of things that you wanna do from an institutional perspective.

Paul Sanford: I think that's a great point, the last one Tom, you're making about the inclusion. Because you can otherwise end up having to negotiate with a second regulator, even though you think you've settled the matter with one regulatory. So, better to have a global settlement when it's all said and done. So just err on the side of inclusion.

Kristin Korzekwa: And with that Paul, then what would you say are some of the key intersection points or interplays among the regulatory agencies? And, maybe touch on the evolution that you've noticed and the roles that each of them is playing.

Paul Sanford: Well, in the consumer protection space, the place where there's a, a strong intersection has to do with the compliance management systems. Because if you're supervised by both the CFPB and one of the federal banking agencies, technically either one could make an evaluation of your CMS. The same goes for a rating. You could end up with two different ratings from the different regulators. And they also have shared UDAAP authority. Now, CFPB has the abusive portion of that. They have the second A, and that's a whole other conversation about abusive, which is being contested. But with UDAAP for instance, you have a scenario where both agencies might have jurisdiction over the same issue. And so that's why it's really important to make sure that you have both parties at the table whenever you're talking about, you know? Another thing about UDAAP is that you might see the federal banking agency use UDAAP as a means for being able to enforce one of the technical regs that CFPB has oversight

responsibility for. If you think about it, there are these elements within a technical regulation, and those are requirements, well, what's to say you couldn't apply unfairness or deception and achieve the same end result as what the provisions are but a different regulator is drawing that conclusion. So that's why I think it's really important that we're talking about how these regulators, the connections between them, and the importance of how you engage with them.

Kristin Korzekwa: So what would you say are some of the major evolutions over the last handful of years in the roles and the focus areas for each of these agencies?

Paul Sanford: So, I think collectively there's continued or increasing emphasis actually on fair lending manners. So when you, you look back, it's, it's been, uh, a-, about a year or so now, but there was a bread-lining case that was settled with a relatively large bank, and it involved the CFPB, the OCC, and the Department of Justice. And this is actually a good approach to, to, uh, public policy when the agencies collaborate on these things. Of course it, it makes it challenging for an entity when you're having to engage with multiple regulators on an, on an issue, because it's challenging enough to deal with the, the federal government, not to necessarily have to deal with, with three, uh, all on the same issue. So one of the things that I think is, is interesting though, that there are some situations also worth noting, and, around fair lending. One is having to do with UDAAP, and the usage of UDAAP as a tool for being able to cite discrimination in cases where ECOA would not be applicable. And this was ruled out by the CFPB through examination procedures. And I think actually there's a, a policy case to be made for this, and yet it was really strongly contested, and it has actually been litigated by the banks because of concerns about overreach. Now, the important point here is, when you're a regulator the how matters as much as the what. So if this had been approached differently with an opportunity for notice and comment, and a dialog with the industry, there may have been a different outcome here. Another recent case involves an entity called Townstone, and this is very recent. And in this case the CFPB has pushed for an interpretation of ECOA where a prospective applicant can be considered to be discriminated against instead of just an applicant. And h-, here is an entity that's not that large that stood up against the CFPB and actually said, "We really disagree and we're going to contest this," and actually won in a court of law. It's challenging for, for a lot of entities to make these kinds of decisions because it, it comes at some cost to be able to fight in court against an agency that has a huge amount of resources to be able to make these kind of, bring these kind of cases.

Tom Nicolosi: Paul, do you, do you think that when you sort of see that stuff come through, that Townstone that you mentioned, that, that set from a legal perspective, the precedent that that sets, does that change how sort of the agency is looking at things and the way that they may engage with others?

Paul Sanford: That's a great question, Tom. So, as a general matter, they're going to be somewhat constrained on a going-forward basis, there was a very clear ruling on this. They may still appeal it. In the case of the CFPB under its current leadership, Rohit has been very assertive on many fronts, and he's even come out and made statements right from the beginning that it's okay to lose cases. And it, it really is, as a matter of public policy. You know, you really should try matters even if there's a chance that you should lose. And there's merit to that. The real challenge becomes when there's overreach, and that you stretch, and try too hard, and then there could be unintended consequences down the line where you've then foreclosed yourself from being able to take similar positions on future matters. So, I don't think it'll change the behavior in terms of, let's say getting their wings clipped in this case and suddenly saying, "We're gonna have to dial it back." I think that he'll continue to try to bring cases where he really feels strongly that he wants to set a precedent. So, I've been talking about enforcement as a tool, and conducting investigations, and bringing lawsuits, and negotiating settlements. That's something that they're being very aggressive. They've, uh ... The CFPB has hired a lot of enforcement attorneys, have hugely increased the staff, and they're very focused on that. So that's why I've made this distinction between supervision and enforcement and wanting to make sure bankers understand the difference between the two and how they engage with the two. Because completely different cultures and approaches and you need to be careful because you can't approach this one agency with one lens like you would your, your federal banking agencies. So there are other tools in the toolbox that the CFPB has, and one that they've also been using pretty dramatically, is something they generally refer to as

the bully pulpit. And what I mean by this is that the agency has a lot of vehicles that they can do to draw attention to an issue and cause change without necessarily writing a regulation. And we've seen this in a few cases, and, and to pretty good effect. So it's, it's a legitimate tool. I-, it does have its drawbacks, and it can be overused, just like I talked about with the use of enforcement as a tool. And what the agency can do with the bully pulpit is, uh, the director can go out and they can make speeches, they can hold public hearings, and they can publish reports, so it really draws attention to an issue and it becomes basically public pressure to cause an entity to want to, to change. And so that's what that's really all about. The challenge here that I, I think a lot of bankers are facing when they see the use of the bully pulpit is that, it's the rhetoric. And being able to distill out the, the policy issues from the noise that's created that tends to cause, uh, a backlash because folks can be upset about some of the terms that are used. So there are some judgemental adjectives being used to qualify certain views on the world that may or may not be true and supported by the facts. So for instance, labeling things like overdraft fees and certain credit card fees as junk fees. That's pre-judging what the outcome is and what the view is on these fees, even though there is, there are facts to support why there is a need for overdraft fees and need for credit card fees as part of the pricing structure, and it's just part of the, the, uh, financial product that's being offered. So that's the other thing I think that I've noticed that's a big change and, uh, becomes a complication for banks trying to understand how to navigate the regulatory environment. My advice is to try to look past the (laughs) narrative and look at the policy issue, look at the facts, and look at the legal position to be able to handle that.

Tom Nicolosi: Paul, you did mention junk fees, right? I, I know over the last 18 months overdraft fees has been a big thing from an industry perspective. And in fact, there's growing sort of sentiment in Washington, from a political perspective. New proposals, new bills, new other things around those broad umbrella of junk fees and what that actually means for the banking institutions.

Kristin Korzekwa: Yeah, Tom, uh, you know, you're, you're right. I think we've seen, we have seen a lot of big banks especially, take lead, right? In announcing elimination or reduction altogether, reduction of elimination altogether of overdraft and NSF fees, and, and I think a lot of that, to your point, is coming from that scrutiny, and the attention in, in Washington and, and is prompting some discussion around innovation, right? What other types of services can we offer customers? What types of tools can we offer customers, you know, which would support them in, in, in preventing OD occurrences? But, potentially also improve retention, stickiness of that customer, maybe generate a new revenue stream. So I guess the question, Paul, to you is, as banks are thinking about innovation in this sphere, right? And where do we go next? How do we either replace those revenue streams or introduce new tools or services? What would your advice be to banks in how to, how to think about that?

Paul Sanford: I think it's important that you do your due diligence and not rush into any arrangements. So the regulators are very concerned about these engagements with, with fintechs and what those arrangements are.

Kristin Korzekwa: And is this also where that, you talked about earlier the importance of inclusion, and transparency, and engagement, that kind of the relationship, if you will, uh, between the banks and, and the regulators? Is that where this comes into play as well?

Paul Sanford: It certainly does. I think it's always a good idea, if you're gonna get into something new, you oughta be right up front with the, with the regulators and make sure that you've laid it out for them and you can demonstrate that you clearly understand what it is that you're doing and that they have no reservations about it. It's, this is an ongoing iterative process when you're talking about supervision. So once you've established that relationship, you need to perpetuate it and make sure that it, it stays very positive. You know, the, the relationship between the supervisor and the bank is based on trust, and once that trust is broken it's pretty impossible to get it back. So if you're gonna get into a new area, this is a, a thing that can be fraught with, with problems, uh, the best thing to do is start that dialog with the regulator.

Kristin Korzekwa: Thanks Paul. And often when we're talking about the regulatory environment, we're talking about the impact to individual consumers, right? Clearly a huge focus for our retail banking clients

and our retail banking institutions. But what are you seeing in terms of policy trends that would be impacting small business customers for example?

Paul Sanford: Well, the, the CFPB actually had a requirement to come out with a regulation that covered collection of data for small business lending, and it's referred to as section 1071. And I think the shorthand is 1071, if you hear that, that's what we're talking about. It's a requirement, so it's now over 10 years old, there's even litigation around this issue that forced the CFPB to, to finalize the rule. And we're expecting to come out any day now. The, the real important thing here is that work really needed to start yesterday on preparing for this, because it has a huge amount of implications for any entity that does small business lending. So the, the breadth of, of people, process, and technologies impacted is enormous. There's also a huge range of products as opposed to, like HMDA, for instance, which is a similar tool for gathering data. But that has to do with just mortgages. And we're also dealing now with individuals who are usually functioning in the commercial space, so they're not as exposed to the types of things that are required for doing the, the data collection. When you're developing or preparing for this tool, and all the things that need to be done, there's going to have to be monitoring that's put into place. And when you think about it, the end-game here is, is going to be able to analyze for a potential discrimination. So as you're developing everything, people, process, training, technology, you need to be considering what the implications might be for how you're gonna analyze this efficiently at the end of the day. Because that's the end-game, to determine whether there's any discrimination going on, or also determining if there is potentially a need for additional lending in certain areas.

Tom Nicolosi: Hey Paul, you, you hit it, right? Like the impact that this is gonna have, right? Net new for our small business banking clients. They have to think about process changes, they gotta think about control changes, they gotta think about data and technology impacts. This is truly end-to-end when you think about collection of, you know, new data points, being able to, to do that analyzation, to your point on discrimination, and then being able to report that in a timely manner to, to meet regulatory requirement. And so that is a big change, particularly for those small business folks. And I think it's just the tip of the, the, the iceberg, if you will, right? I mean, there's multiple new sets of requirements coming out from the CFPB that are going to, to have an impact on institutions from a data gathering analyzation perspective, right? You've got not only this set of requirements, the Fair Lending for Small Business focus, you've got changes to the Community Reinvestment Act that's right around the corner, and the intersections there and in collection of data and analysis. And then likely in, in the end of '23 we will see some, some items around open banking from the CFPB, which is again, another data play with finalization into '24. So it, it really will be a new sort of game for many of our retail and consumer clients.

Kristin Korzekwa: Tom, that's a great point too on the, the end-to-end impact, right? I mean, this, I liken this back to the significant onboarding changes that occurred, right? In the front office, and, you know, from a banker perspective and, and the, the impacts to, to their processes and how they're interacting with their customers as well. And, and again, to your earlier point, uh, banks historically aren't great data miners, right? And, and don't do a great job of, of analyzing the data that they've collected. So if, you know, 20 new fields at hand, there's a lot to think about. Okay, so last question. Paul, if you can, in, in 10 words or less, fill in the blank here. For retail banks to navigate the regulatory environment successfully, they need to ...

Paul Sanford: It may be a little more than 10 words. But I would say basically three things. Monitor guidance, consent orders, and supervisor highlights so you know what the issues are. Proactively assess your loan exposure. And then third, take appropriate action.

Kristin Korzekwa: Pretty close. I wasn't counting.

Paul Sanford: (laughs).

Kristin Korzekwa: Thanks Paul. Well, that's all the time we have for today. Thank you again to Paul and Tom for joining me in today's discussion. And special thanks to our Deloitte teammates who made this episode possible, including Batiste Kashanchi, Greg Healy, and Michelle, Dahl, along with our friends at Hangar Studios. For listeners out there, check out our podcast webpage online at [Deloitte.com/branchingout](https://deloitte.com/branchingout), where you'll find short show notes and relevant links from our conversation today including Deloitte's 2023 banking regulatory outlook. If you have ideas, suggestions, or other feedback about the show, drop us a note at branchingout@deloitte.com. We look forward to exploring the future of retail banking with you again soon.

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