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2024 Financial Services Outlook: ESG, Automation, Tax Update and More

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Artificial intelligence (AI), environmental, social, and governance (ESG) issues, and other prominent financial trends from 2023 are expected to remain at the forefront in 2024.

Below are topics and related strategies that organizations can prepare for in 2024 and beyond.

Overview

- By mid-2023, AI was dominating headlines and will continue to generate news in 2024, particularly around risk of use, regulation, and continued innovation.
- California enacted climate reporting rules in 2023, and the SEC has been expected to issue similar rules for the past year. Those are likely to surface in 2024, along with a renewed ESG conversation.
- Look for new regulations in 2024, especially regarding climate disclosure, and areas such as AI, digital assets, and regulatory compliance related to fintech companies.
- The Public Company Accounting Oversight Board (PCAOB) proposed a rule related to noncompliance with laws and regulations that could be as big a disruption to the auditing and accounting industry as Section 404 of the Sarbanes-Oxley Act and should be monitored closely.
- 2023's inflationary pressure and rising interest rates decimated the mortgage industry's origination volumes. Even as the Federal Reserve signals an intention to reduce rates in 2024 and mortgage rates decline, early home buying activity hasn't improved. Nonetheless, there's building sentiment that a soft landing might be possible, and deal activity could increase as fears of a recession wane.

ESG

ESG reporting (/articles/2023/03/get-started-with-esg-reporting) is becoming a top priority as organizations understand the benefits related to ESG strategies and the emerging ESG regulatory compliance requirements at a state, federal, and international level.

All entities must manage ESG risks related to climate change impacts and the transition to renewable energy to reduce greenhouse gas emissions. In addition to avoiding risks of greenwashing litigation, organizations can capitalize on ESG business strategies.

ESG 2024 Trends

The financial services industry is likely to see continued growth in sustainable finance offerings. ESG-themed investment products, such as green bonds, green loans, and sustainable investment funds, are anticipated to expand as investors increasingly seek to align their portfolios with ESG principles.

Financial institutions (/insights/webcasts/2023/11/navigating-esg-landscape-financial-institutions) will likely continue to develop innovative ESG-focused products and services to meet this demand, providing opportunities for both profit and positive societal impact.

Regulatory pressures related to ESG are expected to intensify. Governments and regulators around the world are likely to introduce stricter disclosure requirements and reporting standards, pushing financial companies to enhance transparency and ESG risk management.

In response, financial firms will need to invest in robust ESG data and analytics (/articles/2022/12/data-analytics-for-sec-climate-disclosures) capabilities and obtain independent assurance (/services/accounting/assurance/esg-audits) over their ESG data to meet compliance obligations and reduce potential legal and reputational risks.

ESG practices will factor more in decisions in the financial services sector. In addition to regulatory requirements, firms are acknowledging advantages of ESG initiatives and programs. This shift could precipitate the integration of ESG considerations into investment strategies, risk assessments, and corporate governance structures (/articles/2023/09/esg-reporting-and-controls-faq), reflecting a growing awareness of the importance of sustainability and responsible governance in the financial world.

Accounting & Auditing Standard Update

Two updates are worth noting in 2024.

Purchased Financial Assets

Stakeholders have highlighted the challenges related to accounting for acquired financial assets in connection with the post-implementation review of Accounting Standards Update (ASU) 2022-02, Financial Instruments—Credit Losses (Topic 326) *Troubled Debt Restructurings and Vintage Disclosures*. The accounting for non-purchase credit deteriorated (non-PCD) assets, speci[illegible]s been described by stakeholders as unintuitive because a loss is recorded upon the acquisition of financial assets witho[illegible]han-insignificant deterioration in credit quality since origination (non-PCD), whereas no loss is recorded upon the acquisition of financial assets with more-than-insignificant deterioration in credit quality since origination—PCD— which results in accounting that is not economically neutral.

The proposed ASU addressed comparability and complexity concerns by eliminating the credit deterioration criteria that previously limited the use of the gross-up approach in ASC 326 solely to purchased financial assets with credit deterioration. The FASB is currently redeliberating the amendments based on stakeholder feedback, and the most recently published technical agenda overview has a final standard targeted issuance timeline of first quarter 2024.

Noncompliance with Laws and Regulations (NOCLAR)

The PCAOB has proposed amendments to existing standards that would expand the scope of the auditor's requirements for considering a company's possible noncompliance with laws and regulations, including fraud. The proposal revising Auditing Standard 2405, *Illegal Acts by Clients*, to integrate a scalable, risk-based approach that considers recent developments in corporate governance and internal control practices.

The proposal expands the auditor's requirements related to identifying a registrant's possible noncompliance with laws and regulations. As part of the financial statement audit, the auditor would be required to consider all laws and regulation in every jurisdiction that are applicable to the company, even down to a county or city level. It also extends to every aspect of a company's operations, including the expansive population of regulations applicable to financial institutions that have historically been considered to have limited financial statement impact.

AI and Automation

Organizations are currently facing a perfect storm of challenges. There were multiple interest rate increases in 2023, challenges with sourcing qualified personnel, and a continued increase in customer demand for faster and more efficient responses.

These challenges are pushing institutions to adopt automation and AI strategies.

Automating tasks isn't a new concept, but current and developing technology solutions can make it more feasible. Management teams will be facing significant automation-related questions in 2024, such as:

- Which technologies meet automation needs?
- Can these technologies perform in the regulatory environment?
- What is the most effective and efficient implementation plan?

Customer service is paramount to the reputation, growth, and success of an institution. The demand for faster, more efficient response to customer demands is fueling growth in the number of companies partnering with fintech organizations to add functions such as automated credit decisioning, account openings, and enhanced online banking and regulatory monitoring. This growth raises many questions for leadership, such as:

- Which fintech service is right for our customers?
- How does the fintech service integrate into or enhance existing technology environment?
- [illegible]e fintech provider address more than one need?
- [illegible]ntech partner active in our industry?
- What is the entry and ongoing cost to use this fintech partner?

While it may not be seen as big a need, automating operational business elements is increasing drastically. Lack of available talent, the hiring costs, and the complexity of the current business environment are facilitating a change in approach to back-office processes.

Many fintech organizations offer automated solutions that can be implemented to support client-facing or operational needs. The rising cost of labor means automation and AI solutions could be less expensive to implement than hiring highly trained staff.

Decreasing effort is the key consideration when automating operations. Reducing the time needed to perform repetitive tasks such as reconciliations or ESG reporting returns time to workers giving them the bandwidth to support more complex, high-level business activities.

Tackling these issues requires budgeting and strategic planning by executive teams.

Mortgage Outlook

Elevated interest rates coupled with housing supply shortages continued to challenge the mortgage banking industry in 2023. The Fed began raising the federal funds rate in June 2022 to combat inflation, increasing it 525 basis points from 2022 through July 2023.

Higher federal funds rates put upward pressure on longer term Treasury rates and thus mortgage rates, which helped slow origination volume. Total mortgage origination volume for 2023 is estimated at $1.6 trillion, a decrease from the $2.25 trillion origination volume of 2022.

The Fed has left rates unchanged since July 2023 and signaled further pause in rate hikes at their December 2023 meeting. The yield on 10-year Treasury notes, a proxy for mortgage rates, moved below 4% in mid-December 2023, following the Fed's rate news.

In its December 2023 forecast, the Mortgage Bankers Association projected the 10-year yield to remain near or below 4% through 2024, and the mortgage and Treasury rate spread could narrow; the 30-year mortgage rate is projected to be 6% by the end of 2024. The decrease in rates supports an uptick in origination volume, which is projected to be $2 trillion in 2024, and $2.3 trillion in 2025.

Here are mortgage market trends to know about in 2024.

Housing Prices

The US housing market inventory remains historically low. A slowdown in the acceleration of year-over-year pricing gains can be attributed to Fed rate increases slowing demand for housing, though new housing units are necessary to stabilize home prices and affordability in the long term. The projected decrease in mortgage rates should trigger additional listings of existing units, however the mortgage lock-in effect will continue to keep inventory low creating an opportunity for builders to bring new units online.

Com[illegible]: M&A

Elev[illegible]st rates pressured the gain on sale margins during 2023. Independent mortgage brokers (IMBs) cut expenses and scaled back operations to weather the downturn in originations. Industry competition among market players remains strong. Expect M&A activity as buyers seek out opportunities to increase market share and sellers look to exit.

Demographics

Based on recent census data, millennials are the largest group of people in the US and are entering their peak home buying years. Many are still sitting on the sidelines in the current market, but with rates expected to drop in 2024, expect this large, resilient group to fuel the purchase market moving forward.

Servicing

Mortgage servicing, a positive for many companies in 2023, continues to provide a natural hedge to production and a source of additional liquidity. Elevated interest rates fueled an increase in mortgage servicing right valuations. If rates decrease as projected, expect valuations to take a hit from reduced float income. Keep an eye on mortgage servicing right unpaid principal balance (UPB) runoff as portfolios continue to age.

As US banks position themselves to meet regulatory capital requirements, expect servicing to change hands. Interest-only (IO) servicing transactions have received much attention lately with trade volumes increasing as certain companies look to sell servicing. Agency approval is generally needed to create IO securities.

Technology

In today's competitive mortgage banking environment, a solid technology stack is a core strength and competitive advantage. Fintech companies have emerged with innovative ideas aimed at improving industry customer experience while driving down the cost to deliver.

Into 2024 and beyond, expect to see continued technology investment that leverages data and automation to innovate, connect with consumers, and improve efficiency, profitability, and visibility.

Tax Update

Legislative Updates

Under the Tax Cuts and Jobs Act (TCJA), eligible property acquired and placed in service after September 27, 2017, qualifies for 100% bonus depreciation. On January 1, 2023, the bonus depreciation percentage began to phase down by 20% per year until January 1, 2027.

For 2023, the allowable bonus depreciation percentage is 80%. The deduction provided in Section 179 of the Internal Revenue Code (IRC) remains an available alternative to bonus depreciation as a potential means for expensing 100% of qualifying property.

On January 31, 2024, the House of Representatives passed H.R. 7024 which would retroactively restore 100% bonus depreciation. If passed by the Senate, eligible property placed in service from January 1, 2023, through December 31, 2025, would qualify for 100% bonus depreciation. As of February 5, 2024, this bill has not been considered by the Senate.

With the passage of the Consolidated Appropriations Act (CAA), Congress allowed businesses the ability to deduct 100% of qualified meals expenses for 2021 and 2022. Beginning in 2023, the percentage of allowable meal deductions has largely retur %. Meals related to occasional office holiday parties or recreational events that are primarily for the benefit of empl tinue to be fully deductible.

Transferable Tax Credits

Under the Inflation Reduction Act, IRC Section 6418 was established to allow eligible taxpayers the ability to transfer certain energy-related federal tax credits in whole or in part to an unrelated third party. Section 6418 became effective for tax years beginning after December 31, 2022.

To be eligible, third-party buyers must pay cash in exchange for the tax credit. The cash payment made by the buyer isn't deductible as a tax payment or other business deduction. Any gain that arises from the purchase of a credit at a discount is not taxable income to the buyer.

The buyer may first use a credit in the taxable year a qualified project is placed in service based on the seller's tax year. Purchased tax credits have a three-year carryback and 22-year carryforward. Generally, tax credits can offset up to 75% of a C corporation's federal tax liability or can be passed through to the shareholders of an S corporation or partners of a partnership. Further, for pass-through entity purchasers, passive activity rules may impact the utilization of transferable tax credits at the shareholder or partner level.

Buyers may take into consideration a credit that has been purchased, or will be purchased, when calculating estimated tax payment obligations. However, the buyer remains liable for any additional estimated tax more than the allowable credit.

Fintech Outlook

Fintechs are increasingly looked to as a primary banking partner for many consumers.

With elevated interest rates, recent bank failures, and financial incentives related to the COVID-19 public health emergency ending, access to capital continues to be strained. Fintechs are prioritizing sustainability by controlling costs instead of focusing on growth.

Fintech companies are beginning to question the costs of partnerships with banking organizations, which are experiencing increased regulatory scrutiny in relation to those partnerships. Fintech organizations can see increased costs and need for internal controls and reporting systems when banks attempt to pass down that regulatory burden. A lack of systems, processes, and controls around customer information and reporting can hamper a fintech organization's ability to scale and meet customer needs.

Fintechs are likely to see more regulation regarding handling complaints, consumer disclosures, marketing representations, and fair treatment. The Consumer Financial Protection Bureau (CFPB) is likely to impose regulations like those in New York and California.

Fintechs are increasingly competing with each other rather than with traditional financial services companies and those with targeted markets and a solid plan to profitability will be more likely to succeed.

We're Here to Help

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