



“AI Regulation Shifts to States: What It Means for Your Community Bank”

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The “Big Beautiful Bill” landed in Washington this spring and was supposed to be a sweeping blueprint for tech governance—part economic stimulus, part digital consumer protection, and, for some, the long-awaited beginning of federal artificial intelligence regulation. But when the final text of the bill emerged in late June, one thing was conspicuously missing: AI.

Stripped out in the final stages of negotiation, the bill no longer includes any enforceable rules around artificial intelligence, despite months of hearings, bipartisan drafts, and broad agreement that the US is behind global peers. The decision to drop AI provisions may have salvaged the broader bill, but it has pushed one of the most pressing regulatory issues of our time back into the hands of the states—and left key industries, particularly community banks, in a precarious position.

How We Got Here: From Bold Blueprint to Last-Minute Cut

The original framework for the “Big Beautiful Bill” included an ambitious set of AI rules: mandatory transparency for foundational model providers, algorithmic audit requirements for high-risk systems, and the creation of a new federal AI oversight board modeled loosely on the FDA.

The effort was seen as a compromise between the sweeping European AI Act and the more laissez-faire US approach. Congressional staffers had worked with White House officials, major tech firms, and academics to craft a “middle path” for American AI regulation.

Then came the backlash. Tech industry groups warned that overregulation could chill innovation. Civil rights advocates pushed for stronger safeguards on discrimination and surveillance. And legislators from states like California, Texas, and Washington—home to most of America’s tech sector—grew increasingly uneasy. Facing the risk of losing centrist votes and watching the clock tick down ahead of the summer recess, Senate leaders made a strategic decision: strip the AI language to ensure passage of the rest of the bill.

The outcome was a major legislative win with one glaring omission—a gaping policy vacuum.

The New Front Line: State-Level AI Laws

Without federal guidance, states are now stepping into the regulatory breach. More than a dozen state legislatures are actively drafting or debating AI-specific legislation. Most follow one of two tracks: broad accountability laws with transparency and audit mandates, or narrower, sector-specific measures focused on employment, housing, insurance, or finance.

Key examples to look to include California’s AI Accountability Act, New York’s Algorithmic Transparency Act, and targeted laws in Colorado and Illinois. In fact, according to the Center for Law and Emerging Technology by the end of 2025, at least eight states are expected to adopt or introduce new AI regulations.

State	Legislation Name	Expected Action Date
California	AI Accountability Act	October 2025
New York	Algorithmic Transparency Act	November 2025
Colorado	Automated Decision-Making Regulation	Q4 2025
Illinois	AI Use in Financial Services Act	Q4 2025
Texas	Pending Bill on AI in Employment Decisions	TBD 2025
Washington	Automated Systems Fairness Act	In Committee Review
Massachusetts	Responsible AI Use Framework	December 2025
Florida	AI Oversight and Risk Act	Under Legislative Review

(Expected Legislation Across the US in 2025)

The Community Bank Dilemma: High Exposure, Low Capacity

So why does this cause concern for community banks?

While global banks and fintech platforms have dedicated compliance teams and in-house data science groups, small and midsize financial institutions—many with under 500 employees—are increasingly reliant on third-party AI vendors to deliver everything from credit scoring to fraud detection to customer service. And they’re doing it under growing regulatory uncertainty.

Already facing tight margins and digital competition from fintech and megabanks, community banks are turning to AI to stay relevant. Yet without a clear national framework, these institutions face a troubling choice:

- 1) Adopt AI and risk running afoul of evolving, inconsistent state laws, potentially exposing themselves to legal liability
- or
- 2) Delay AI adoption until legal clarity emerges, risking competitive stagnation and customer attrition

Many banks also worry about being caught in a compliance squeeze. State-level requirements for algorithmic transparency and explainability—now being considered in California and New York—could force community banks to demand new disclosures from their vendors but most smaller institutions lack the leverage to negotiate those changes. The result could be a two-tiered banking system: larger firms with the resources to navigate regulatory complexity, and smaller institutions boxed in by uncertainty.

The Foot Forward for New Jersey:

Concerned about the implications of a lack of regulation, New Jersey has already begun asking important questions about AI. A little bit of research reveals the answers: New Jersey is among the most proactive US states in regulating artificial intelligence. Its approach blends ethical governance, civil rights protections, innovation incentives, and early enforcement action—with



direct implications for financial services and community banks. Community banks must anticipate oversight and adopt best practices around AI governance, transparency, and vendor risk management.

New Jersey Regulatory Status:

- 1) Executive Order 346 – AI Task Force (Oct 2023): Established to recommend frameworks for equitable, innovative, and responsible AI use across sectors. Final report delivered Nov 2024
- 2) Next New Jersey Program (July 2024): Allocated \$500M in AI investment support, including \$250M in tax credits for AI firms and data infrastructure.
- 3) AI Task Force Report (Nov 2024): Outlined ethical deployment, workforce development, and innovation strategies.
- 4) Criminal Deepfake Law (April 2025): Outlaws deceptive AI-generated media, including stiff penalties and civil remedies.
- 5) Algorithmic Discrimination Guidance (Jan 2025): NJ Attorney General clarified that existing anti-discrimination laws (LAD) apply to biased algorithms in credit, housing, and employment.
- 6) Insurance Bulletin from DOBI (Feb 2025): AI used in insurance decisioning must comply with anti-discrimination and consumer protection laws.
- 7) AI Funding Task Force (A5168, Jan 2025): To explore sustainable public-private AI investment strategies.

What Community Banks Can Do Right Now:

- 1) Implement AI Governance & Ethics Policies using the Task Force framework.
- 2) Conduct Bias Audits on AI credit, lending, and HR tools.
- 3) Ensure Transparency in all AI-generated marketing or communications.
- 4) Explore Tech Partnerships through NJ AI Hubs—while enforcing vendor risk protocols.
- 5) Prepare for Regulatory Oversight by building audit trails and fairness documentation.
- 6) Engage in NJ's Fintech Ecosystem to innovate responsibly within state-supported programs.

AI is no longer an emerging technology, but a pervasive one. Waiting until it's entrenched in daily life puts community banks behind. However, acting without intention can leave them vulnerable. Now is the time to prioritize both innovation and regulation - so that community banks can continue to be more than just places to bank, but places where relationships, trust, and community truly thrive.

Joe McMann is a seasoned entrepreneur and corporate strategist who currently serves as Co-Founder & Chief Revenue Officer at Artificial Intelligence Risk (AIR). In his role at AIR, Joe leads go-to-market and revenue operations for a platform recognized as the #1 AI compliance & cybersecurity solution in 2024. A multi-time founder with deep expertise in corporate & business development, Joe specializes in bridging the gap between cutting-edge technology and practical implementation. At AIR, he drives initiatives to integrate safe, private, compliant, and customized AI platforms—deployed via a streamlined 14-minute ARM script—for agnostic AI governance, risk, compliance, and cybersecurity (AI GRCC) integration with any large language model (LLM), data repository, or AI agent within a bank's private-cloud infrastructure. Under his leadership, community banks gain a tangible pathway to leverage enterprise-grade AI securely and effectively ensuring they accelerate innovation while preserving the relationships and trust that make community banking so valuable.