LEGAL UPDATES

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Supreme Court to Hear National Bank Act Preemption Case

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The U.S. Supreme Court has agreed to address whether state laws that require national banks to pay 2% annual interest on residential mortgage escrow accounts are preempted by the National Bank Act (NBA) and thus inapplicable to such banks. *See Cantero et al. v. Bank of America NA*, Case No. 22-529. A circuit court split exists on this issue. A Supreme Court ruling clarifying how the NBA preemption standard applies could have implications outside of the mortgage context and affect multi-state compliance for federally chartered banks, their partners, service providers, and loan purchasers.

The circuit split on NBA preemption and state escrow interest statutes

In *Cantero*, the U.S. Court of Appeals for the Second Circuit held that the NBA preempted New York's escrow interest law. *See* 49 F.4th 121 (2d Cir. 2022). The Second Circuit analyzed whether the state law "would **exert control over a banking power**—and thus, if taken to its extreme, threaten to 'destroy' the grant made by the federal government." *Id.* at 132 (emphasis added). The Second Circuit did not assess "whether the degree of the state law's impact on national banks would be sufficient to undermine that [banking] power." *Id.* Ultimately, the Second Circuit found that the New York interest escrow requirement would control the exercise of the national bank's power to create and fund escrow accounts by requiring the bank to pay its customers interest. Thus, the NBA preempts the New York escrow interest law.

The *Cantero* case has an interesting element. Some of the petitioners obtained mortgage loans before the Dodd-Frank Act was effective and some obtained mortgage loans after the Dodd-Frank Act was effective. The Dodd-Frank Act narrowed NBA preemption of "state consumer financial laws" in various ways including by codifying the NBA preemption standard from the Supreme

Court's decision in *Barnett Bank of Marion Cnty., N.A. v. Nelson,* 517 U.S. 25 (1996). In *Barnett Bank*, the Supreme Court ruled that the NBA preempts a state law if the state law "**prevents or significantly interferes** with the exercise of a national bank's power." *Id.* (emphasis added).

The Second Circuit's ruling in *Cantero* was contrary to the 9th Circuit's rulings in *Flagstar Bank v. Kivett* and *Lusnak v. Bank of America*. In *Flagstar Bank*, the 9th Circuit concluded that its prior ruling in *Lusnak* (below) required a finding that the NBA does not preempt a California interest escrow requirement that is similar to the New York requirement in *Cantero*. No. 21-15666, 2022 WL 1553266 (9th Cir. 2022). The *Lusnak* court reasoned that because Congress required creditors to comply with state interest escrow laws for certain mortgage escrow accounts through a provision of the Dodd-Frank Act amending the Truth in Lending Act, Congress recognized that national banks may comply with such state escrow interest laws without significant interference with their banking powers. 883 F.3d 1185 (9th Cir. 2018). Based on this rationale, the 9th Circuit found that the NBA did not preempt California's interest escrow law.

Supreme Court's decision to hear *Cantero*

At the end of 2022, the *Cantero* plaintiffs and Flagstar Bank asked the Supreme Court to hear their respective cases. The Supreme Court agreed to hear *Cantero*, but has not ruled on Flagstar Bank's petition for writ of certiorari. The Supreme Court's decision to hear *Cantero* was counter to the U.S. Solicitor General's recommendation to the court.

Upon invitation by the Supreme Court, the U.S. Solicitor General filed an amicus curiae brief discussing both the *Cantero* and *Flagstar* petitions. The U.S. Solicitor General argued that both the Second Circuit and Ninth Circuit applied the wrong test for NBA preemption. According to the Solicitor General, the Circuit courts should have engaged in "a practical assessment of the degree to which the state law will impede the exercise of" a national bank's powers related to escrow accounts. Nonetheless, the Solicitor General recommended that the Supreme Court decline to review both *Cantero* and *Flagstar Bank* asserting that both cases are poor vehicles to resolve the current circuit split on NBA preemption and state escrow interest statutes.

Why this case matters

The importance of the *Cantero* case to national banks engaging in mortgage servicing in the 13 states with escrow interest laws is obvious – paying a minimum interest amount on escrow balances increases costs and the burden of ensuring compliance with a patchwork of state escrow laws.

What may be less obvious are the implications that the Supreme Court's ruling in *Cantero* could have on federally chartered banks outside of the mortgage context. While the NBA preemption standard is long-standing and is codified into federal law, there remains little court guidance on how the NBA

preemption standard should be applied to various types of state laws to ultimately determine whether the state law is preempted. As shown above, courts can interpret the NBA preemption standard differently and arrive at divergent conclusions on whether similar state law requirements are preempted. In addition to state escrow statutes, we have seen examples of divergent court conclusions on NBA preemption in a series of cases involving state notice and right to cure requirements.

Any guidance from the Supreme Court clarifying how the NBA preemption standard should be applied to state laws would be a welcome step in resolving this question, but could also significantly impact multi-state compliance for federally insured banks and their partners, service providers, and loan purchasers both inside and outside of the mortgage context.

Contact us

We routinely advise clients on the scope of NBA preemption and interest rate preemption, including whether federal banking laws preempt particular state law requirements. Contact Susan Seaman, Leslie Sowers, or your Husch Blackwell attorney if you have federal bank preemption questions or would like to learn more about this case.