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SECOND CIRCUIT REVIEW

Expert Analysis

Federal Preemption Of State Banking Laws

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In *Cantero v. Bank of America, N.A.*, 49 F.4th 121 (2d Cir. 2022), the U.S. Court of Appeals for the Second Circuit addressed the preemptive effect of National Bank Act (NBA) and the Dodd-Frank Wall Street Reform and Consumer Protection Act on state laws regulating banks. Plaintiffs in two putative class actions argued that Bank of America's failure to pay interest on mortgage escrow accounts ran afoul of a New York statute requiring payment of two percent interest on such accounts; Bank of America responded that the NBA preempted the state-law claims.

In an opinion written by Circuit Judge Michael Park and joined by Chief Judge Debra Livingston and Judge Myrna Pérez, the court held that the NBA preempts the New York interest-on-escrow law under "ordinary legal principles of pre-emption," and that the Dodd-Frank Act "merely codified those rules."

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Preemption and the NBA

States and the federal government have clashed over bank regulation since *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819), in which Chief Justice John Marshall famously struck down a state's attempt to tax a congressionally chartered bank. Since the NBA's enactment, however, both states and the federal government may charter and regulate banks as part of what courts refer to as a "dual banking system."

The NBA requires that national banks be authorized by the Office of the Comptroller of the Currency and subject to its regulations. In return, national banks enjoy enumerated powers—including the ability to issue mortgage loans—as well as "all such incidental powers as shall be necessary to carry on the business of banking." 12 U.S.C. §24 (Seventh).

The Supreme Court has explained that a congressional

grant of power to a national bank preempts state efforts to hinder the exercise of that power. See *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 12 (2007). Generally, the preemption doctrine means that federal law overrides state law where Congress expressly states its intent to do so, legislates so as to occupy an entire field of regulation, or enacts a statute that conflicts with state law.

Applying this doctrine to banking, the Supreme Court has reasoned that because Congress grants powers to national banks, state regulations that impair the exercise of those powers would conflict with federal law. It has stated this principle broadly, holding that state regulations of national banks are preempted if they "prevent or significantly interfere with the national bank's exercise of its powers." *Barnett Bank of Marion Cnty., N.A. v. Nelson*, 517 U.S. 25, 33 (1996).

The Dodd-Frank Act codified this preemption standard, instructing courts and regulators to determine whether a state law is preempted by employing the *Barnett Bank* test. See 12 U.S.C. §25b(b)(1)(B).

The Escrow-Interest Dispute in 'Cantero'

The Dodd-Frank Act also changed the legal framework governing mortgage escrow accounts—trust accounts to which borrowers make regular deposits, and which lenders use to guarantee timely payment on taxes and insurance premiums. Its amendments to the Truth in Lending Act, which took effect in 2013, make mortgage escrow accounts mandatory for certain types of loans, see 15 U.S.C. §1639d(a)-(b), and specify that, "[i]f prescribed by applicable State or Federal law, each creditor shall pay interest to the consumer on the amount held in any… escrow account that is subject to this section in the manner as prescribed by that applicable State or Federal law," id. §1639d(g)(3). At least 13 states have laws that require creditors to pay interest on funds held in borrowers' mortgage escrow accounts, including New York, where General Obligations Law §5-601 mandates a two percent annual interest rate.

In 2018, two sets of plaintiffs representing putative classes sued Bank of America in the Eastern District of New York for breach of contract and related claims, alleging that the bank failed to pay interest on their mortgage escrow accounts. The first plaintiff, Alex Cantero, purchased his home and entered into a mortgage agreement in 2010, before §1639d went into effect.

The second set of plaintiffs, Saul Hymes and Illana Harwayne-Gidansky, purchased their home in 2016—after §1639d's effective date—but the statute did not cover their type of mortgage loan. Bank of America moved to dismiss both complaints, arguing that, notwithstanding New York's requirement that it pay interest on mortgage escrow accounts, the NBA preempted that state law.

The district court denied the motion to dismiss and held that the NBA did not preempt GOL §5-601. *Hymes v. Bank of Am., N.A.*, 408 F. Supp. 3d 171 (E.D.N.Y. 2019). It first looked to Congress's enactment of consumer-protection laws concerning mortgage escrow accounts, including §1639d; although the district court acknowledged that this provision did not govern the loans in the case, it explained that §1639d(g)(3) was "nonetheless significant, for it evinces a clear congressional purpose to subject *all* mortgage lenders to state escrow interest laws." Id. at 189.

The district court then applied the *Barnett Bank* test and held that GOL §5-601 did not "significantly interfere" with national banks' mortgage-lending powers, because the state law's "degree of interference is minimal," and "the cost of compliance with the state law is not practical

abrogation of the banking power at issue." Id. at 195.

In reaching these conclusions, the court relied heavily on the Ninth Circuit's decision in *Lusnak*, which similarly held that the NBA did not preempt a California interest-on-escrow law, because the state law was at most a minor interference with a banking power.

The Second Circuit's Opinion

The Second Circuit reversed, holding that under the "ordinary legal principles of pre-emption" identified in *Barnett Bank* and codified in the Dodd-Frank Act, the NBA preempts GOL §5-601. 49 F.4th at 130 (quoting *Barnett Bank*, 517 U.S. at 37). In reaching this conclusion, it clarified its own approach to preemption and identified two key flaws in the district court's reasoning.

First, the Second Circuit elaborated on *Barnett Bank*'s "significant interference" standard. It explained that, when determining whether a state law significantly interferes with a bank's power protected under the NBA, a court should ask "whether enforcement of the [state] law at issue 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 (quoting *McCulloch*, 17 U.S. at 431). In other words, a state law that exercises *any* degree of control on a bank power granted by the NBA is preempted, even if the actual impact on the bank's bottom line is minimal.

Thus, the court parted ways with both the district court and the Ninth Circuit, which both looked to the degree of a state law's interference with a banking power in order to determine whether it was "significant."

Second, the court faulted the district court for considering §1639d to discern congressional intent for loans that were not governed by that statute. It explained that this approach mistakenly extrapolated a congressional desire to subject *all* mortgage escrow accounts to state interest-on-escrow laws from the fact that §1639d subjects *some* accounts to state laws. Moreover, that section took effect after Cantero obtained his loan, and congressional intent concerning that later-enacted statute was irrelevant to NBA preemption before that change in law.

In a concurring opinion, Judge Pérez wrote separately to indicate two paths for states to regulate national banks going forward. First, Judge Pérez indicated that states may regulate banks as long as state law does not "significantly interfere" with an enumerated or incidental bank power under the NBA. Second, the judge also stated that states may still require national banks to pay interest on covered mortgage escrow accounts for loans issued *after* the effective date of §1639d, because that statute states that a creditor must pay interest on a covered mortgage escrow account "[i]f prescribed by applicable State … law."

Conclusion

The Second Circuit's *Cantero* decision clarifies the preemptive scope of the National Bank Act: If a state law purports to control an enumerated or incidental power of a national bank, then it is preempted by the NBA regardless of its impact on a bank's revenues or management. This conclusion marks a departure from the Ninth Circuit's approach in *Lusnak*, and may raise an issue which will ultimately need to be resolved by the Supreme Court.