Consumer Finance Monitor Podcast (Season 9, Episode 2): Breaking Developments in National Bank Preemption

Speakers: Alan Kaplinsky, Arthur Wilmarth, John Culhane, Jr., Ronald Vaske and Joseph Schuster

Alan Kaplinsky:

Welcome to the award-winning Consumer Finance Monitor Podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly show brought to you by the Consumer Financial Services Group at the Ballard Spahr Law Firm. And I'm your host, Alan Kaplinsky, the former practice group leader for 25 years, and now senior counsel of the Consumer Financial Services Group at Ballard Spahr. And I'm very pleased to be moderating today's program. For those of you who want even more information, either about the topic that we're going to be talking about today or anything else in the world of consumer financial services, please don't forget about our blog, consumerfinancemonitor.com. We've hosted our blog since 2011 when the CFPP became operational. There's a lot of relevant industry content there. We also regularly host webinars on subjects of interest to those in the industry. So to subscribe to our blog or to get on the list for our webinars, please visit us at ballardspar.com. And if you like our podcast, please let us know about it. You can leave us a review on Apple Podcasts, YouTube, Spotify, or wherever you access your podcasts. And also, please let us know if you have ideas for any other topic that we should consider covering on a future podcast show or speakers that we should consider as guests on our show.

Okay. So let's turn to our webinar today, and I have some introductory remarks that I hope will set the stage for what I expect is going to be a very interesting discussion and in part a debate about the significance of a trilogy of cases. Three cases have come down recently pertaining to national bank preemption outside of Section 85 of the National Bank Act, which pertains to federal usury law preemption for national banks. We are not dealing with that subject today. None of the cases deal with that subject that we're going to be talking about.

So in my view, we've reached a real turning point. Over the last year, three major court decisions Cantero in the Supreme Court, Conti in the First Circuit, and the Kivett opinion in the Ninth Circuit have together reshaped the way courts are interpreting the National Bank Act and the scope of federal preemption of state laws.

Let me start with the big picture. For decades, national banks have relied on federal preemption as a central benefit of having a national bank charter. The understanding was that national banks could operate under a uniform federal framework without being subject to a patchwork of state laws. The OCC's preemption regulations, in effect for decades, had essentially purported to specifically preempt multiple categories of state laws, including the category of state laws involved in the three cases that we're going to be talking about, requiring the payment of interest on mortgage escrow accounts. That has been the backbone of the national banking system since the National Bank Act was created by Congress in the 1860s.

But in Cantero v. Bank of America last year, the Supreme Court sent a clear message. Courts can't rely on sweeping assumptions of preemption. Instead, they must take a case by case approach asking whether a specific state law actually prevents or significantly interferes with a national bank's powers. In resolving the question of whether or not the National Bank Act preempt state laws that require the payment of interest on mortgage. Supreme Court instructed the lower courts to apply what it called a nuanced comparative analysis to a litany of US Supreme Court opinions going back many, many years, finding either National Bank Act preemption of state laws or not finding national bank preemption of state laws. The Supreme Court completely rejected the notion that so called field preemption of state laws applies to national banks, meaning, that all state laws just simply don't apply. Some actually do apply.

This, in my view, was a major signal from the court and it set the stage for what we're now seeing unfold in the lower courts. So then what we're really going to be focusing a lot on today is the Conti versus Citizens Bank opinion decided on September 22nd by the First Circuit Court of Appeals. The court ruled that Rhode Island's law requiring banks to pay interest on mortgage escrow accounts is not preempted by the National Bank Act. That's really a big deal. It's one of the first appellate applications of Cantero and the court's reasoning goes far beyond state laws requiring the payment of interest on mortgage escrow accounts. The First Circuit basically said that complying with this kind of state consumer protection law doesn't significantly interfere with the national bank's operations. And it did that after purporting to do the nuanced comparative analysis of the litany of US Supreme Court opinions, either finding for or finding against national bank preemption of state laws.

In my view, the Conti opinion represents a sea change in National Bank Act preemption jurisprudence. It calls into questions decades of OCC regulations and interpretations and undermines one of the core advantages of having a national bank charter. If this trend continues, we could be looking at a future where national banks are required to comply with practically all the state laws that apply to state chartered banks. That means that uniform national standards that have historically guided national banks are eroding rapidly and we're moving toward a far more fragmented regulatory landscape. That calls into serious questions whether there is any continuing value to having a national bank charter.

So what should national banks be doing right now? Well, we're going to deal with that during the course in a lot of detail during the course of our webinar today. Prudent institutions are not waiting for further court rulings or regulatory guidance. They're already reviewing in detail their products and services, especially loan and deposit products, to determine where they may now need to comply with a wide range of state laws. They're looking for federal preemption where that clearly still applies, and usually that's in the case with a direct conflict. And also where preemption may not apply as a result of the Conti opinion, and they're updating their compliance programs and their documents accordingly. We're actively involved in counseling many national banks on this subject, and Joseph Schuster, toward the end of our webinar, is going to really get into detail on that.

Our goal today is to help you understand what these decisions really mean, what's likely to come next, and what concrete steps your institution can take in order to stay ahead of the curve. We're very fortunate to have an outstanding panel with us today. Professor Emeritus Art Wilmarth from George Washington University Law School, who has long written about the limits of National Bank Act preemption and the role of state laws in consumer protection. And my colleagues, John Culhane, Ron Vaske and Joseph Schuster, who have been closely following these developments for years and advising clients in real time on what they mean for compliance strategy.

So with that as background, and I know that was a long introduction, but I thought I really wanted to paint or set a foundation for this discussion and debate. Let me now turn the program over to Art. And Art, can you start by walking us through Cantero, Conti and Kivett and why this represents a watershed moment?

Artur Wilmarth:

Well, thank you very much, Alan. And thank you for including me in the program. It's a pleasure to be here with everyone. So as Alan said, the Cantero decision, the Supreme Court really is a watershed decision in terms of rejecting what really was a de facto field preemption argument that the Second Circuit had adopted in Cantero and that national banks have pursued for many years with a great deal of support from the OCC in its preemption regulations.

So again, just very briefly, Cantero arising out of the Second Circuit presented the issue of whether or not the New York interest on escrow law was invalid, preempted the payment of at least 2% interest on amounts held in mortgage escrows. The Cantero Second Circuit decision essentially said, yes, New York's law was preempted because it attempted to control the exercise of a national bank power. Now, there were two national bank powers at issue.

Under 12 U.S.C 371, national banks may make real estate mortgages under regulations prescribed by the OCC. That statute doesn't specifically refer to escrow accounts or any payment of escrow, interest on those escrow accounts. There's a second statute, however, 12 U.S.C 247 that you're all familiar with defining the incidental powers of banking. And the OCC many years ago opined that in fact, the establishment of escrow accounts is an incidental power of banks. And that itself was not a controversial opinion. It's well recognized that escrow accounts, a very convenient and useful feature of mortgage arrangements.

So essentially, escrow accounts in a way are forced budgeting borrowers that when they're required, borrowers have to put aside monthly installments in the amount that will allow them, allow the bank to pay interest... I'm sorry, to pay other associated charges, also insurance charges, when those come due. And so it's a way of forced budgeting to make sure that borrowers are not caught short. It also, of course, provides very important protections for the bank because if the bank is able to pay the taxes and the insurance, there's not going to be a problem with a tax lien or the possibility that a casualty could occur to the property that wouldn't be covered by insurance.

Of course, in general, banks pay no interest on escrow accounts, and so it's both forced budgeting, but I've also called it a mandatory savings account without interest. So what New York and about 11 or 12 other states did in different ways was to say it's not reasonable for the bank to require these escrow accounts, which are very much for its protection, and to pay no interest and to keep all of the float income that is produced by those accounts, because of course the bank does not simply put them in a vault. It invests those funds in various types of investments, and it reaps the profits from making those investments. And again, without these state laws, the borrowers would get nothing. And when New York passed its interest on escrow law back in the 1960s, the legislature specifically said, "We think it's completely unfair for the banks to require these accounts, to benefit from these accounts, to earn float income on these accounts, and to pay nothing to the borrowers." And that's where the 2% interest requirement came from. States have done different things. Interestingly, Conti took a different approach, which is to say, "We view these accounts as essentially mandatory savings accounts, and so we will require banks to pay the same interest on those accounts that they would pay on essentially their default statement savings account, which of course could be quite a bit lower than 2%."

In the Ninth Circuit, back in 2018, the Lusnak opinion upheld California's interest and escrow law, which was essentially equivalent to New York's 2% minimum interest. And in doing so, the Ninth Circuit said, "We don't see how this prevents or significantly interferes with the exercise of any national bank power." And we noticed that under the Truth in Lending Act, as amended by Dodd-Frank, Congress required that certain essentially high interest mortgage accounts, escrow accounts to avoid the risk of default, and if required by federal or state law, the national banks or other banks must pay interest on those accounts. Now, that particular section of the Truth in Lending Act was not at issue in any of these three cases, but the Ninth Circuit looked at that and said, "Well, Congress felt that in certain cases there should be mandatory escrow accounts, and they didn't see any problem with the state law requiring payment of interest on those accounts." So that was a signal that Congress did not see the payment of interest as a terrible thing. Of course, the national banks pointed to the Real Estate Settlement Procedures Act, which provides for disclosures and other requirements regarding escrow accounts, but does not either require the payment of interest or prohibit the payment of interest.

So the Second Circuit, again, said any attempt to control national bank powers is essentially void almost categorically. They sort of admitted that maybe general state laws that were not banking specific might be okay, but that runs into its own problems because, for example, national banks have the right to make contracts. That's an express power. So any state law that affects any contract is interfering with the national bank power. And Justice Scalia pointed that out in his opinion in the Cuomo versus Clearinghouse case, which was the last big national bank preemption case in the Supreme Court. And so this attempt to distinguish general state laws from banking specific state laws is, to me, questionable given the broad powers of national banks to make contracts.

So the Second Circuit obviously took a very restrictive approach, which conflicted with Lusnak. Kivett came along in the meantime, in which Kivett, we are bound by our Ninth Circuit precedent, Lusnak, and we are following it, not particularly expressing great enthusiasm, but saying, "We're bound by our Ninth Circuit precedent. We're going to continue to uphold California's interest on escrow law." So now you have a circuit conflict, the Supreme Court takes it up. For those who followed the oral argument, it certainly indicated that there was a division of view on the Supreme Court as to whether state interests and escrow laws were preempted or not preempted. It was difficult to see exactly what the division might be, but there was pretty clear evidence that the justices were divided on their view. And when the opinion came out, I think many people were surprised it was a nine zero unanimous opinion, but essentially what the Supreme Court did was to adopt a methodology for addressing these cases, not to reach the final result and to punt the cases back to the lower courts.

So what did the Supreme Court say? Well, looked at the Second Circuit Cantero opinion and said, "The Second Circuit is wrong. There is not a categorical rule on preemption." And Dodd-Frank changed the landscape because before Dodd-Frank, there wasn't any federal statute specifically dealing with state consumer financial laws or state consumer protection laws, but Dodd-Frank put in this provision, 12 U.S.C 25b, which says state consumer financial laws, and it was no doubt that this interest on escrow law was exactly that, a state law that specifically and directly regulated the terms and conditions of a financial transaction between a national bank and a consumer, says state consumer financial laws are preempted only if, I mean, those words are pretty strong, only if either the state law discriminates against national banks in favor of state chartered institutions, or, the state law prevents or significantly interferes with the exercise of a national bank power.

And in addition, Dodd-Frank said, "There is no field preemption." Field preemption does not exist under the National Bank Act, so it's conflict preemption. It also said that if the OCC wants to address an issue of preemption, it has to do so on a case by case basis. It has to find substantial evidence supporting its preemption determinations. And if it wants to preempt the law of more than one state, it has to consult with the Consumer Financial Protection Bureau and get the CFPB's advice or view before it's similar laws in more than one state.

Okay. So the Supreme Court said in light of Dodd-Frank and in light of the language prevents or significantly interferes, the Second Circuit's view cannot be upheld. It was a categorical view that preempted essentially all banking specific laws, and in my view, would have thrown into question almost all state laws, because as I said, almost all state laws affect in some way the national bank's right to make contracts. So it was very hard to see what state laws would have survived if the Second Circuit opinion had been upheld. So the Supreme Court says, "That's wrong." And they said in addressing the prevents or significantly interference standard, which goes back to Barnett Bank, a court must, as they said, make a practical assessment of the nature and degree of interference created by the state law with the exercise of a national bank power. That certainly indicates a practical economic, financial, and competitive impact of the state law. And then as Alan said, in making that practical assessment of the nature and degree of interference, a reviewing court should look seven cases, which the court identified and make a nuanced comparative analysis of the law they're looking at with the laws that were either upheld or not upheld, struck down in those seven cases, and which were those seven cases?

Well, obviously the first one was Barnett Bank because that's the foundational case where the preventer significantly interference standard was adopted. And then there were three cases cited in Barnett that found preemption. Those cases were Franklin National Bank versus New York, First National Bank of San Jose versus California, and Fidelity Federal Savings & Loan versus De la Cuesta. And then there were three other cases that held no preemption, National Bank versus Commonwealth, which goes back to 1870, six years after the National Bank Act was enacted, McClellan versus Chipman, a case from the 1890s, and then the most recent federal preemption case in a way before Waters and Cuomo, which was Anderson National Bank again versus Kentucky. So the Supreme Court said, "You have to look at those seven cases and make this nuanced comparative analysis of how your law that you're looking at in a sense either is comparable or not comparable to the laws that were either upheld or struck down in those seven cases." And at that point, the

Supreme Court having vacated the Cantero case, remanded that case back shortly thereafter, they vacated the original Kivett decision and remanded that one back.

And then there was this third case, Conti versus Citizens Bank that was pending in the First Circuit. Now in Conti, the district court very much influenced by the Second Circuit's opinion in Cantero had struck down Rhode Island's interest in escrow law and Conti appealed the case to the First Circuit. The First Circuit had not rendered its decision, and the First Circuit said, "We are going to wait. We are going to wait until the Supreme Court issues its decision in Cantero, and then we will issue our decision based on what the Supreme Court tells us." And so that's where things stood after the Cantero case came out in 2024, remand to Cantero, remand to Kivett, and now the Conti case is waiting out there.

Alan, would you like me to stop there and allow others to comment on the Supreme Court's decision before I proceed to the Conti case?

Alan Kaplinsky:

Yeah, I think that's a good stopping point or a good place to pause Art. So Ron, John, Joseph, do you have anything that you want to comment on so far?

John Culhane, Jr.:

The only comment that I would have is just an observation as much as anything is that the direction to look at these six or seven cases, it doesn't really provide a lot of clear guidance to the First, Second, and Ninth Circuit. And I think we're going to see as we go further in this, those courts struggling with exactly what that direction means and exactly what it means for a law to significantly interfere as opposed to merely interfere if there is such a thing with the operations of a national bank. So in some respects, the Supreme Court sort of punted this issue back to the circuit courts for further consideration.

Alan Kaplinsky:

My only thing that I would add, I agree with John that when I first read that opinion, my reaction was, why did they waste their time? I mean, I understood they didn't agree with the Second Circuit opinion, but to just say you've got to look at all of our precedent or all the cases that we've decided going back to the beginning of the National Bank Act, it provided zero guidance. It didn't give any guidance or direction to the lower courts as to how to do this comparative nuance, comparative analysis. And it left open a whole bunch of issues like, will federal preemption vary from national bank to national bank and will it require that there be a proffer of evidence dealing to show significant impairment? I mean, it did nothing. And I'll stop there. Joseph or Ron, do you want to add anything?

Joseph Schuster:

The only other thing that I would add is the references to Dodd-Frank I think were particularly important. A lot of us, I think, thought that preemption changed when Dodd-Frank was enacted. And you saw the court saying that in Cantero, that there is a standard that was adopted in Dodd-Frank that needs to be followed. I think the OCC's regulations, they basically readopted the regulations as they existed prior to Dot-Frank, but there was an indication that something has changed. I think that the piece that we need to think about then too is how do you consider this going backwards of what's been done since Dodd-Frank was enacted as well?

Alan Kaplinsky:

Art, why don't you continue on?

Artur Wilmarth:

Yeah. I think exactly what Joseph said is important because the OCC essentially ignored Dodd-Frank and acted as if it never happened. In the 2011 so called readopted rules, they refused to recognize the preventer significantly interfered standard as the controlling standard. They said, which was staggering, I would use the word gobsmacking to me. They said, "Dodd-Frank does not establish a standalone prevent or significantly interfere standard." I said, they wrote it into the statute. How much clearer does it have to be? They just refused to accept the preventer significantly interfered standard. They refused to apply the case by case approach. They refused to follow the substantial evidence approach. They essentially readopted all of their 14 categorical across the field nationwide preemptions without consulting the CFPB, without doing any case by case work, any substantial evidence work. I mean, in my view, the OCC thumbed its nose at Congress. And the Supreme Court's opinion in Cantero, I think pretty clearly says you can't ignore Dodd-Frank. It's very clear.

Now, the validity of the OCC regulations was not raised I think quite deliberately because I think Bank of America knew that it really couldn't defend the validity of those regulations. Interestingly, the same thing has happened in Conti where Citizens Bank really didn't... They sort of hinted and cited the OCC regulations, but never really tried to argue that the OCC regulations were binding and determinative. And I think that's because everybody realized the OCC simply didn't follow Dodd-Frank. And so I think it is important that, to me, the OCC 2011 regulations, I believe, have been completely discredited by the Cantero opinion. And that's important because effectively the OCC, as I've argued many times since 2004 and even before, but since 2004, has really been trying to create a defacto field preemption regime And Dodd-Frank said as clearly as it could say, no, field preemption is out and you have to apply the preventer significantly interfere standard, which is a conflict preemption standard, which Barnett specifically explained that it was.

Now, I agree with you. I agree with all of you that the court really didn't give any clear direction on what prevent or significantly interfere means other than to say, look at our cases. And I think that's simply because the court was split and couldn't, and for some reason, didn't want to issue a divided opinion on that issue.

So let's proceed to Conti because Conti is now the first of the three cases to come out.

Alan Kaplinsky:

Art, before you do that, ask you a question.

Artur Wilmarth:

Yes.

Alan Kaplinsky:

Toward the end of the Cantero opinion in the Supreme Court, there is a puzzling footnote besides on the puzzling that said in so many words, and I don't have the opinion in front of me right now to quote verbatim, but it said upon remand, the Second Circuit should consider what weight to give to the OCC regulations.

Artur Wilmarth:

I agree with that. They hold that open.

Alan Kaplinsky:

Why would they have done that if they had, in the Cantero opinion earlier, implicitly rejected those regulations?

Artur Wilmarth:

I think that, again, I view that as sort of a compromise probably that Justice Kavanaugh who wrote the opinion, certainly if the oral argument struck me as the most supportive of the OCC opinion or the OCC view. And so I suspect that was a compromise that was made. And in a sense, neither the Second Circuit nor Bank of America really explicitly relied on the OCC's regulation. The Second Circuit said, "We're not relying on it. We see it and we kind of agree with it, but we're not relying on it." So I think, yes, the Supreme Court did not foreclose consideration of the OCC's rules, but it's interesting to me that as the appellate proceedings have continued, I haven't seen any of the national banks say, "All you need to do is look at the OCC rules and you're home free." Nobody is really relying on those to me in any significant extent.

Now, what's interesting is the new Comptroller of the Currency Jonathan Gould has said that he wants to go back to preemption and he wants to strengthen it and that they are thinking about issuing new rules. So that would tell me two things. One is that they may in some ways try to revive in some format what they did before, but that they implicitly realize that they have to... If they really want these preemption rules to have any real effect, they have to issue new ones. There's another provision in Dodd-Frank, which says that the OCC has to revisit every one of its preemptive rules every five years and decide whether to reaffirm them or to get rid of them. The OCC has never done the five-year review despite repeated requests from the Conference of State Bank supervisors among other people. So in a sense, the 2011 rules are also, to my view, of no force and effect because they're more than five years old and they've never been reviewed. But you're right. Technically, it will be interesting to see with the Second Circuit on remand makes any further reference to those rules.

Conti looked at them and said, "We don't think Citizens Bank is relying on them other than by very indirect citation. They're not really holding those up as a pillar of their argument." And again, implicitly, I think Conti was saying these rules don't comply with the Dodd-Frank standards. So what Conti did, of course, I very much agree with the Conti decision, is to look seriously at what the preventer significantly interference standard requires, and to look at the seven cases. And then it goes on to specifically reject two arguments that the national banks have made over and over and over again. One is the efficiency flexibility argument, the other is the patchwork of state laws argument. So I think there's a lot that could be said about the seven Supreme Court decisions that are held up as sort of the signposts.

I mean, Barnett is a fairly easy decision. The state law there prohibited almost all national banks from exercising a power, which was selling insurance out of small town offices, that the National Bank Act specifically granted. So there was a clear and direct conflict between what the federal law allowed and what the state law did. The state law's really only fallback argument was that the McCarran-Ferguson Act allowed the state to do that. And the Supreme Court said no because it was a law specifically regulating insurance by Congress and the states can't override that under McCarran-Ferguson.

Franklin is a hotly contested case because the national banks generally look at it as being a trivial interference. It certainly was not. I mean, essentially at that time, there was a Federal Reserve Act provision that said specifically national banks and other Federal Reserve member banks may offer savings accounts, using those words, may offer savings accounts. For some reason, that statute no longer exists, but it did in the 1950s. And plus, of course, then national banks also had the general power to take deposits as an express power. New York came along and did two things. One is it discriminated against national banks by saying only state savings banks may use the word savings in advertising for savings account deposits. Nobody else, including state commercial banks and national banks can do that. So it was discriminatory.

And then again, it was in direct conflict because the federal statute says, "You may accept savings deposits." And the state law said, "You may not tell people that you're offering state savings deposits. You can't advertise the fact." And the Supreme Court said, "Look, advertising is one of the most powerful and usual methods of conducting commerce. And it would be extraordinary to say that you can offer savings and deposits and not tell people about it." And I believe that the Supreme Court made pretty clear that that was a very significant interference. It's even more clear if you look at the

New York Trial Court. The New York Trial Court said, "This is a violent obstruction," because they looked at testimony and polls showing that people didn't understand, if you didn't use the word savings, what you were offering, that savings accounts were understood very clearly. And if you used other terminology, they didn't know what that meant. So it definitely impacted and interfered with the national bank power. The Supreme Court didn't specifically refer to that finding by the New York Trial Court, but I think it's hard to ignore it that it was a very significant impact.

Fidelity is an interesting case because that arose out of the savings and loan crisis. The Federal Home Loan Bank Board issued a regulation saying Federal Savings Associations can include due on sale clauses in their mortgages and they can always enforce them because it's the only way for them to get mortgages that now reset to market sensitive rates. The interest rates have gone way up and the savings and loans were being killed by their fixed rate mortgages. So if they couldn't enforce due on sale clauses, they were toast. And again, that's a very powerful... When the Federal Home Bank Board says, "This regulation is necessary to ensure the survival of savings associations." It's hard to imagine a more powerful impediment than a state law that says, "No, you have to show that basically your security is impaired in order to enforce that thing." I mean, I think these are very powerful impediments.

In San Jose, they said that, and this is maybe the most important one because San Jose said California could not pass a law that said after 20 years or whatever, I think it was 20 years, deposits are presumed abandoned and will be escheated to the state without proof of abandonment. No hearing, no notice, no nothing. If you're dormant for 20 years, they're gone. And the Supreme Court said, "Well, that's unprecedented." State escheat laws have never said something like that, and that would deter many people from putting their money in a bank. That can't be good. And then of course, about 20 years later, along came Anderson National Bank, which is probably the most important of the non-preemption cases. And Anderson National Bank said, "No, this law is different. This is an escheat law that says after a certain period between 10 and 20 years, if the deposits are dormant, they will be transferred into the custody of the state." However, the state cannot take those deposits for itself under escheat unless it gives notice and an opportunity for hearing and due process and allows the depositor to say, "Wait a minute, those aren't abandoned. They can't be escheated." So the court said, "No due process problem, notice opportunity for hearing."

And they said, "Look, escheat laws are well established. It's a law that's been around for a very long time, and these are laws that in many ways protect depositors as well as the state. We don't find this unreasonable." What's interesting is that the National Bank in that case, Anderson National Bank, made an impassioned argument saying, "Look, they're taking our deposits into state custody. They are depriving us of the ability to invest those deposits and earn money on them. We're losing a ton of money. We're losing all of the float earnings that we would otherwise have from these deposits. They're taking that away from us. That's terrible." And the Supreme Court said, "That is part of debtor creditor law. escheat laws are well recognized. We don't find that to be an undue burden was the test they use, which is in a sense a significant interference." Now look at state interest and escrow laws compared to that one.

So state interests and escrow laws are not taking the float earnings away from banks. They're simply saying, "You have to share some of those earnings." Now, I think Conti is an easier case because savings account deposits, savings account interest rates are much lower than 2% for the past 15, 20 years. But even the 2%... I did an analysis in my article where I showed that if you look at the average yield and earning assets for the past 15 years, it has been well above 2% for the past 15 years. And in most years, way above 2%. So there's no showing that paying this 2% would drive escrow business into a deficit. They would have a loss. In fact, the first New York case said, if they could show that this 2% interest would make them suffer a loss and make them pull their own money out, we would feel differently, but there's no showing that the national banks would suffer any loss.

And in fact, they would almost certainly still have a profit. And these escrow accounts are tremendously beneficial for national banks. They protect the banks. They ought to be able to pay something for them. So Conti looked at all these cases, they focused on Anderson. They didn't find any of the others persuasive. And they said, "We think that based on Anderson, this is a perfectly reasonable state enactment that doesn't significantly interfere." Now then they looked at the two... I think this is really important. They looked at the two big arguments that national banks have made over and over, which is we need maximum efficiency, maximum flexibility, and state laws take that away. And the last thing we can do is have to comply with the patchwork of state laws because they're different. And essentially Conti said, "Look, Dodd-Frank looked at that. " I mean, those arguments were made when Dodd-Frank was passed. And Dodd-Frank rejected those arguments because first of all, they said state consumer laws are preempted only if, which as they said, created a default rule of no preemption. They didn't say presumption against preemption, but I think it's fair to say it's a default rule of no preemption.

And then they said, either you show discrimination, which isn't applicable in Conti or any of these other cases, or you show a prevention or significant interference. And on top of that, we say no field preemption. And they said, the national bank arguments, which are, you've got to give us maximum flexibility and maximum efficiency, and you've got to give us no patchwork. Those are field preemption arguments. Those are the arguments that the OCC used to justify us defacto field preemption rules. That can't be right under Dodd-Frank. And I think Conti is completely correct. I mean, I think Conti is completely persuasive.

Now, again, what does it mean to say significant interference? To me, the National Bank has to show something like either complying with this state law would require us to absorb a loss in the applicable area of operation, in this case, operating escrow accounts, or would in some other way make it so burdens and so difficult that it would make it difficult for us to operate this business reasonably. And when we get to Kivett, there's some interesting evidence about the lack of impact in Kivett, but maybe we want to hold that for a moment. But I think that it's interesting that in a couple of Supreme Court cases that I've cited in my article and elsewhere, the word significant has been treated as the equivalent of the word material for both securities law and environmental laws. And I think that's really an important significance. So if the state law were so burdensome that it would require federal securities law disclosure, this state law has been passed and it has a material effect on our operations in this area of our business. And we must disclose this under the federal securities laws.

I think that would create a basis for a national bank argument, but simply arguing, oh, this is burdensome or we shouldn't have to figure out what state laws apply or this patchwork is unreasonable, I think those arguments simply can't fly after Dodd-Frank. I mean, before Dodd-Frank, I mean, obviously it was more of a contest, but I think after Dodd-Frank, I don't think those arguments can fly any longer.

But I'll stop here. And I know other people have different views on Conti than I have.

Alan Kaplinsky:

All right. Well, thank you, Art. Let's go to John. You've got the weight of the industry on your shoulders, John, go ahead.

John Culhane, Jr.:

Well, Conti's wrong. So I'll just lay that out and then explain why I think that's the case. It's wrong for two reasons. First, I don't think that the court engages in this nuanced comparative analysis that it's required to engage in. And secondly, I think the conclusion is wrong. I don't think it engages in the nuanced comparative analysis where it makes a practical assessment of the nature and degree of the interference because it doesn't really make any assessment of the nature and degree of the interference, among other things. The court starts out by looking at the seven cases that it's supposed to use as guideposts, and it throws out two of the federal preemption cases, Barnett and Fidelity, because it says those only are relevant when there's an express conflict, and then it throws out McClellan and Commonwealth and says they're only relevant when you're dealing with a law of general applicability, which sort of the Conti Court will always be applicable without regard to the impact that it would have.

So I think it's not doing the kind of analysis it's supposed to do and it sort of turned the test in this discussion here into one of express or clear conflict so that it would only throw out a law if there were the express conflict with a federal statute, as in the case with Barnett Bank, if there were an express conflict with a federal regulation that was viewed as, I guess, persuasive or valid, as was the case in De La Cuesta. And it sort of treats Franklin National Bank as a conflict case, concluding that there's a conflict between an implicit power to market your savings accounts or your deposit accounts and a state law restriction that as you discussed, deals with the use of terminology. So that really only leaves the San Jose case on the preemption side. And I kind of think that there's some San Jose issues here that aren't really fully thought through by the court.

And San Jose is somewhat unique and maybe a product of its times in some respect because it's a depression era case. And if you told depositors or potential depositors at that time that the state was going to take their money, they might very well not put it in a bank. That's, I think, a pretty material aspect here. And the Conti Court simply doesn't grapple with the notion that if you tell potential mortgage borrowers that your mortgage lender, if it holds your escrow accounts, is going to have to pay interest on them, that they aren't going to conclude that that money's got to be coming from somewhere or compensated from somewhere, and they're going to be charging higher rates, and they're going to flee for that basis. There's simply no connection of the paying interest on escrow accounts and charging interest on mortgage loans. And I think that's a big deficiency in the analysis.

If you view this as a conflict preemption case, it seems to me that it presents a more direct conflict than Fidelity. It's directly conflicting with the power granted to national banks in Section 371 of 12 U.S.C to make real estate loans. And the only conditions placed on that power are that those real estate loans are made subject to OCC regulation. There's nothing there that says subject to state restrictions or anything of that sort. I know we've talked about the OCC regulations maybe not having the strength that they used to have, but it's certainly possible that they should have, or it seems to me that they should at least have some relevance to the discussion here and that they're simply dismissed here.

More significantly, I think the big point here that Justice Kavanaugh made during oral argument is that regulating pricing is a pretty significant interference with the operations of a bank and potentially a much more significant interference than just an interference with advertising.

And the law in the Conti case, I think everybody has overlooked the fact that the law in the Conti case actually interferes in two ways. First, it restricts what banks can do with mortgage escrow accounts, but secondly, and to me significantly, it places restrictions on the interest rates that banks can charge on other savings accounts because banks can't raise their interest rates on savings accounts unless they also pay that same interest rate on mortgage escrow accounts. So there's a level of interference here, not just with mortgage lending, but also with the offering and collection of deposits. And that doesn't seem to be acknowledged, probably wasn't argued by Citizens Bank in the case, but I think it's nonetheless an important part of this case. Conti sort of fails to recognize that there's a pretty robust federal regulatory scheme around mortgage escrow accounts under the Real Estate Settlement Procedures Act, which limits how much money banks can collect, tells them how to pay it out, makes them liable for failing to pay any leftover funds, refund any leftover funds.

And there's just this limited exception, which I think certainly was overblown in Kivett, this very limited exception in the Truth and Lending Act tied into the regulations around high cost mortgage loans, where interest on escrow accounts is required if required by federal or state law, applicable federal or state law. And significantly, Congress declined to require, affirmatively require through RESPA the payment of interest on escrow accounts on at least three occasions.

The other thing that strikes me as wrong about this case in the analysis that, Art, that you're engaging in is this notion that significantly interfere, which I think that where the Conti court ends up anyway, this notion that significantly interfere is tantamount to crippling the ability of the financial institution to stay in business.

That's not what the statute says. It says significantly interfere. And the Conti Court basically ends up looking at these cases and concluding that you have to have a federal law that expressly preempts a state law, or that the potential effects are of such magnitude that customers would flee or the national bank's ability to compete would be seriously crippled. I think that's actually a higher standard than the standard that's in the words in the statute. I also think that we don't really see an analysis of these cases that focuses on the fact that none of these cases that find no preemption deal with states dictating the terms between national banks and their customers on... The terms under which national banks are offering consumer financial services to their customers. And I know that the court has sort of been... The Conti court is dismissive of the efficiency and flexibility argument and the burden argument from a patchwork of state laws, but they don't really make any effort to drill down on efficiency and flexibility or the nature of the burden. They don't analyze all of the state laws and explain why they think there's no burden. They simply just dismiss the patchwork argument out of hand.

So I'm going to stop there because I think we're getting a little bit short on time. I want to say a few words about why I think Kivett is wrong. Well, Kivett is a non-decision decision, basically. As Art explained, the Kivett Court looked at this issue and essentially decided that it was constrained by the cases that govern the circumstances under which one panel of the Ninth Circuit can ignore or overrule a prior decision of a panel of the Ninth Circuit and felt that it didn't have the direction from... I think it felt wrongly, I think, that it didn't have the direction from the Supreme Court that it needed to meet that high standard. The standard under Miller versus... Actually, I don't know how to pronounce the other party's name, Gammie, is that a panel can't overturn or ignore a prior decision unless the Lusnak case is clearly irreconcilable with the reasoning or the result in Cantero.

And this panel just simply wasn't prepared to accept that the reasoning or the result were completely irreconcilable. I think it engaged in some gymnastics to get to that point in part by Cantero... The real holding of Cantero is that there's no categorical test, and that was the approach in Lusnak, no categorical test. And then that the result isn't inconsistent in part because Cantero didn't get to the merits and the Lusnak panel did apply the present or significantly interfere test.

The panel does acknowledge that they didn't cite or discuss any of the preemption cases, the six preemption cases discussed in Barnett Bank and recounted in Cantero, but they nevertheless conclude that the results aren't irreconcilable. I think there's one interesting comment in this in the majority decision in that it's really hard for a court to tell what to do here. And I think rather than grapple with the issue, the majority decided that since neither of the cases, either the strongest preemption case, Franklin National or the strongest anti-preemption case, Anderson National Bank seemed particularly applicable here, that things weren't really irreconcilable and they would just stand pat and wait for a request for en banc review, which they clearly invited and I guess we all expect is going to be forthcoming. I think we talked earlier that the deadline for requesting en banc review is likely to be November 17th.

By contrast, the Kivett dissent has no difficulty reaching the conclusion that Cantero analysis has to result in a finding that these laws are preempted, particularly because of the focus on pricing. I'm going to stop here just because we've still got a lot to cover and I want to make sure that I don't use up all of Joseph's time.

Alan Kaplinsky:

Yeah. Thank you, John, very much. You did a terrific job defending the industry position. Out of fairness to Art though, but I can't give you Art more than, let's say, two or three minutes, give you an opportunity to respond to what John said, because we want to get to Joseph's very important presentation about what should national banks be doing right now.

Artur Wilmarth:

Yeah, I would just say very briefly, I agree with John completely in terms of the majority in Kivett certainly acted as though they felt their hands were tied by the very high bar for overruling a panel decision in Lusnak. And I think they had a reasonable basis for saying that the result was not irreconcilable. I think certainly their decision was not enthusiastic. I do have problems with the dissent. The dissent is rhetorically powerful, but I think the dissent uses the same kind of efficiency, flexibility, patchwork arguments that I think Conti, in my view, persuasively rejected. I would agree with many of John's points about the difficulty of this case had Dodd-Frank not intervened. I think Dodd-Frank, I Changes the waterfront very considerably and adopts this default rule that national banks have a significant burden, in my opinion, of showing that a state consumer financial law that is not discriminatory is preempted.

And I think the Senate and Kivett creates a presumption in favor of preemption. Under this price control approach, that would be a different argument for a different day, but I don't think the fact that this deals with price is definitive in any way. The dissent also relied on some cases that are not included in the list in Cantero. They relied on Easton, which is an old case that I think is no longer relevant. They relied on waters, which in my view, Waters has been overruled by Dodd-Frank and Cuomo if you look at them together. I don't think Waters has any continuing precedential impact after Cuomo and Dodd-Frank. So the dissent reached out to cases that, in my view, are not on the plate for application here. So I'm not persuaded by the kibbutz dissent, but I do agree that en banc review seems quite likely here.

Alan Kaplinsky:

Okay. I'm going to go now to Joseph. And Joseph, I know you have a few slides to present-

Joseph Schuster:

I do .

Alan Kaplinsky:

about compliance, but I want you to, if you wouldn't mind, to answer this question at the outset. And that is, in light of what I consider to be some pretty good arguments that were made by John as to why the economy opinion is wrongly decided, why at this stage embark upon making major changes if you're a national bank going, here's all the things you're going to go through because that's, I think, what a lot of our clients have asked us.

Joseph Schuster:

Great question. There's probably, I'd say, three reasons. Number one, we don't have a circuit split yet. So the reasons for why it may be wrong, it's still been decided in the manner in which it's been decided. The second one that I would say is that there's liability out there for changes to the extent that there is a difference. So Cantero was decided May 30th, 2024. We're almost coming up on... We're 18, 19 months out from that. As you think about state laws, and this goes to the third point that I have, which is that arguably Dodd-Frank did change something with preemption. What exactly? I think that's where we can quibble on the margins there, but something did change. And state banks have been following these laws for a long time. The sooner that national banks... And we saw from our clients, a lot of clients changed things right after the Cantero decision.

They're now 19 months out. If you look at state statutes of limitations, a lot of them are at the two-year mark. You're coming up on an area where you're hitting relative safety in some cases. There are some statute of limitations with some of these that extend longer than that, but the sooner that changes are implemented... And again, they're not difficult laws with which to comply. I would argue generally. I'd say that the escrow law is one of the more difficult ones that you have. But generally, these are laws that state charter banks, which don't have that same preemption authority as national banks have been complying with for a very long time. So that's my short answer to your question.

Alan Kaplinsky:

Okay. Yeah. Go ahead. Why don't you... I know you've been doing work for a lot of national banks and you've given a lot of thought to how they should go about this. So why don't you go ahead.

Joseph Schuster:

Yeah. And that really goes to the litigation implications here too. We've been talking about these few decisions today. We are seeing decisions at lower courts as well. State courts, we're seeing in our arbitration, their national bank preemption arguments are not succeeding as much as they were prior to Cantero. So it is an issue that's out there in litigation. And there are some banks who are making adjustments as litigation discover some of these different things. But I'd say from the same point of if you're looking at a change, how you can make that change, there's really... And I'm going to say it's not difficult, but I guess perhaps I've added more steps than necessary here. But if you look at, you have a list of all of your products, you can identify all the possible state laws that apply. Our talked about the patchwork of state law approach being rejected and the efficiency and flexibility.

And this is something that state banks have been following for some time. So there is a path that's out there that can be followed. So once you have your products, if you identify the state laws that can possibly apply to those problems, you start, I'd say, with the same list that a state chartered bank's going to be looking at with respect to products that are out there. Then you can remove certain state laws. A number of state laws, but just by complying with federal law, you're complying with the state law. So you're complying with the state law, not a big deal. There's another category where you're going to say, "All right, there's a state law that may apply to our product and your business practices may already comply with that as well." Maybe you're sending statements on something that federal law doesn't necessarily say you need to be sending statements on a closed end loan or something of that nature, but you're doing it as a best practice or as a business practice already. So you can remove those laws.

You're then kind of a remainder, I'd say. And of those, you can say, "All right, where are there no compliance or really business concern with adopting this approach that we could follow that state law?" Those I think are going to be easier ones. Maybe you're adding a couple of disclosures to your terms, you're making sure that policies are updated in particular ways so that you're providing additional protections to people who are identified by state law, whatever the case is there. You're left with the ones where the compliance team or the business team are saying, "These are difficult and they'd really effect us." And that's where you need to do this preemption analysis for those to say, "Does that significantly interfere? And to what degree does that significantly interfere?" If there is that belief that it does significantly interfere, having the analysis of comparing it to some of these cases is going to be the best strategy so that if it is raised by the state, if it's raised by a private litigant, you have the analysis under Cantero in order to say that that law is actually preempted. And I think that's what you're going to actually need to look at as opposed to the OCC regulations that are out there.

I agree with Art. I think that just relying on the OCC preemption regulations is a difficult position right now with respect to litigation. If you look at it from an examination perspective at the federal level, maybe you're okay just with where things are currently, will that change in the future? Probably. But I think the bigger risk right now is with respect to private litigants. So then I just want to just touch on briefly, so the topics that you consider when you're looking at these state laws, we've been covering the mortgage escrow. I think you can kind of break these into a number of different categories. You have your marketing origination, your account terms, payments, servicing, you have your customer communications, data and reporting, and then you have some special populations, post default matters and things of that nature.

In each of those categories, there are different items that state laws can apply to. Like I said, state banks already maintain charts by these different topics of what state laws apply, and then they have their products. Does it apply to this particular product? And you have a nice chart. Here's the law, we satisfy, we comply with it by complying with federal law, or we don't, it applies to these products, here are the implications, and here's how we comply with it. So I'd say the patchwork of state laws, it is a patchwork of state laws, sure. But it's a patchwork with which compliance is very much possible. And I was hoping through this to try to say how easy it can be. I'm not sure that I really conveyed that, but I do think that it can be a fairly simplified process because it's one that it's not new ground. It has been done by other institutions for some time. And so I think that's just looking at when to evaluate whether there are some additional state laws with which you might want to be compliant.

With that, I'll turn it back over to you Alan or to Ron.

Ronald Vaske:

So looking forward, I think one thing, there may be a lot of disagreement on where the scope of national bank preemption is and what it should be, but one thing is certain is that we think we can all agree that we're going to hear a lot more about it in the coming months and the coming years. For starters, we're going to hear from the court in Cantero again, heard oral arguments in March in the Cantero case, haven't heard since, but the decision of the panel there is likely to come out at any time. We also heard recently from the Ninth Circuit in the Kivett case, a very controversial case there. And if there's going to be a request, a petition filed for rehearing en banc, which I think everyone agrees there will be and that it's likely to be granted, that that petition will be filed by November 17th, the week from today.

And it's likely to be granted because this is a case of very significant national importance. There's a very strong defense or dissent that's part of that case. And so we think it's very, very likely that this is going to be reheard by the Ninth Circuit en banc. And it's hard to say which way they're going to go with that. Even if there isn't a conflict among the circuits, and it's very possible that there will be either in the holding on whether mortgage escrow accounts or national banks are required to pay interest, or if there is just a difference in the way they approach the issue, there would be a circuit split. And the Supreme Court would be very possibly would be interested in settling that split. But even if they don't want to wade back into the issue of escrow interest, payments of interest on escrow accounts, Joseph just gave you a list of four categories of different types of laws that are going to be at issue. We're going to see, I believe, litigation, a number of those issues, and eventually that may percolate back up to the Supreme Court. I think undoubtedly those things will, means this is probably potentially going to be going on for a number of years.

I think we're likely to hear from the comptroller and new regulations on this topic. I think Professor Wilmarth mentioned that the comptroller gave a speech last week where he very passionately defended preemption, definitely vowed to continue that defense and argue for it, including he suggested that they may need to, that would be supportive of preemption. Whether those regulations would have much effect on what the courts ultimately decide is to be determined, they would not have the effect that they were required to have under the former Chevron deference standard that was overturned last year, but I think they're likely to chime in here with new rules.

I think there could be some interest in Congress to amend the standard. Probably, I think no one would imagine that anything is going to come out of Congress. I don't think there's probably support of 60 votes in the Senate for any kind of change there. That's assuming that the filibuster rule survives in the Senate, but probably not going to be anything coming out of Congress.

So the question becomes, what is the value of a national bank charter anymore? And I think in part, it's going to depend on how these preemption cases come out. So it remains to be seen, at least with respect to consumer financial. The one thing that is clearly not applicable is the National Bank's Interest Rate Authority, Section 85 of the National Bank Act is not subject to this standard. There's no doubt that national banks will continue to be able to export their interest rates to consumers in other states, and that may turn out to be a significant advantage of a national bank charter.

I think that depends on how the Tenth circuit case in the Industrial Bankers case versus Weiser case that's before the Tenth circuit right now that's looking at the scope of Section 27 of the FDIC Act preemption. There, state bank interest rate authority is identical to national banks except for one thing. In the state bank case, states have the ability to opt out of federal interest rate preemption. The Tenth Circuit right now is looking at that and the litigation there is terms on what does it mean, what is the effect of an opt-out? Does that mean that the consumers that are resident of the state that opts out, that you can't export rates to those consumers, or does it mean that banks that are located in that state, that there would be no exporting or that federal interest rate preemption would not apply to banks that are located in the state? It's a hotly contested issue waiting for the Tenth Circuit could have a decision from them at any time, and that may change the equation of what the value is for a national bank charter.

With that, Alan, I'll turn it back to you unless any of my other panelists have anything they'd like to add.

Alan Kaplinsky:

Yeah. Well, let me start, and I want to start by asking Art a question. And the question is the following: Do you think, Art, that if you're operating a national bank and your regulator, your principal regulator, the comptroller of the currency for national banks, issues of regulation stating very, very clearly categories of state law that you don't have to worry about. Wouldn't you think that it would be reasonable for a bank at that time, and let's assume there hasn't been any further litigation, as we know there has been here, to be able to rely on what the National Bank has told them. Now, granted, the Loper Bright Enterprises Supreme Court opinion that has came down a couple of years ago, has gotten rid of the Chevron Deference Doctrine. The Supreme Court also came out and said that they're not going to apply Loper Bright Enterprises retroactively.

And it seems like they did that because of some great concern that they themselves, the Supreme Court, had issued an opinion several years ago in a case I know you're familiar with, Smiley v. Citibank, where the court held that a late fee on a credit card constituted interest within the meaning of Section 85 of the National Bank Act. And the court relied exclusively on the OCC regulation that got issued pretty late in the game. I guess I could say at the 11th hour. So my question relates to what's reasonable. Now, maybe today things have changed because you've got a lot of waters floated over the dam. We've got other opinions that have come down, but shouldn't national banks that have relied on their regulator, shouldn't they be protected in some fashion? It just seems unfair to me that a court is going to say, "No, you shouldn't have accepted what your regulator told you."

I like your reaction to that.

Artur Wilmarth:

Yeah. I mean, so I think fortunately from the point of view of Smiley, because that's a Section 85 case, and that's kind of a protected category, I think that that one is not going to be revisited. But I think with regard to cases outside of 85, remember that Dodd-Frank itself, and I can't give you the subparagraph of 25b, took away Chevron deference from OCC preemption determinations well before Loper Bright. So after 2010, OCC preemption rules and determinations only get a Skidmore deference, not Chevron. So to me, that creates a lot of problems with trying to have a conclusive reliance on an OCC preemptive rule or determination.

The second thing is, I mean, you look at these cases and none of them have relied on the OCC 2011 rules, even though, as you say, that issue is still open for the Second Circuit. And I keep coming back to the fact that they haven't done the five-year review that they were required to have.

So under other circumstances, I might say yes, normally you can presumptively rely on an authorized regulation by your primary regulator, but I think in this case, the OCC rules are carrying a lot of baggage. And I would tend to agree with Joseph that if you rely on the OCC rules conclusively, I don't think you foreclose the possibility that either courts or arbitrators are going to disagree and say, "We don't think these rules have any persuasive force under Skidmore any longer."

Alan Kaplinsky:

So you would say things would've been reasonable for a national bank to rely on those regulations from the time they got issued, which I think was '04, if I'm not mistaken.

Artur Wilmarth:

Yeah. Yeah.

Alan Kaplinsky:

Until Dodd-Frank became law in 2010.

Artur Wilmarth:

Yeah. Yeah.

Alan Kaplinsky:

At that point, that's when National Bank should have started doing the kind of review that Joseph-

Artur Wilmarth:

Right. And I think you could further make the argument that until the Cantero opinion, the Supreme Court opinion came out, there was a lot of doubt as to whether or not Dodd-Frank meant exactly what it said. And it's interesting to me that even Kavanaugh was willing to say Dodd-Frank means exactly what it says. And I think since the 2011 rules, as well as the 04 rules are completely incompatible with Dodd-Frank, I think that throws a tremendous cloud over them when you realize that even under the Dodd-Frank Act, you're going to be applying Skidmore. You're not going to be applying Chevron.

Alan Kaplinsky:

I want to thank all of our presenters today, but particularly our special guests, Professor Art Wilmarth, John Culhane and Ron Ronald Vaske and Joseph Schuster for presenting their thoughts today. When the Cantero opinion comes down, I think there's a pretty good chance that we will put, depending upon what that court says, we might very well have another webinar or at least a podcast.

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