Consumer Finance Monitor Podcast (Season 9, Episode 40): Cantero II: Circuit Split and OCC Preemption Determination Set Up Likely Supreme Court Review

Speakers: Alan Kaplinsky and Art Wilmarth

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 Founder and former Practice Group Leader for 25 years, and now Senior Counsel of the Consumer Financial Services Group at Ballard Spahr. And I'm delighted to be moderating today's program.

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Today, we're going to discuss what I consider to be one of the most important banking law developments currently working its way through the courts. It seems like it's been working its way through the courts since when the National Bank Act was enacted in, I think, 1856 or something like that. That is the scope of the National Bank Act preemption of state laws. In this case, state laws requiring payment of interest on mortgage escrow accounts.

Joining me today is a person who has set the record for the most number of guest appearances on our podcast show. And of course, I'm referring to Professor Emeritus Art Wilmarth of George Washington University Law School, who is certainly one of the country's leading banking law scholars and a longtime commentator on national bank preemption, et cetera, many, many other topics as well.

Art, truly delighted to have you back on our show.

Art Wilmarth:

Well, thank you so much, Alan. And I look forward to our discussion.

Alan Kaplinsky:

Okay. Well, our discussion today is going to focus primarily on the fairly recent decision by the United States Court of Appeals for the 2nd Circuit in Cantero v. Bank of America, which I'm going to call Cantero II because there was an earlier 2nd Circuit opinion by the same case, same name that went up to the Supreme Court and got remanded back to the 2nd Circuit. And the Cantero II is the opinion of Cantero upon consideration of the Supreme Court opinion in Cantero.

As many listeners know, this litigation concerns a New York statute requiring mortgage lenders to pay a prescribed minimum rate of interest on mortgage escrow accounts that are maintained for borrowers. I'm going to tell you now about the procedural history of the case because it is very important to understanding the discussion that Art and I are going to have, after I'm finished bringing everybody up to date on where we are procedurally and the fact that Cantero is not the only case that's up there before the US Supreme Court again. But there are two other cases, one that we'll get into, one in the 9th Circuit, and one in the 1st Circuit.

Initially, the 2nd Circuit in Cantero I held that the National Bank Act preempted the New York statute because the law would exert control over a national bank's federally authorized real estate lending powers, regardless of the magnitude of its effects. The borrower sought Supreme Court review and cert was granted. And in 2024, the Supreme Court vacated the 2nd Circuit's decision and remanded the case for reconsideration under the framework established by Barnett Bank v. Nelson, and that was codified later in Section 25b of the Dodd-Frank Act.

Importantly, the Supreme Court upon considering the 2nd Circuit opinion in Cantero, rejected both positions taken by the plaintiffs and the position taken by Bank of America. It rejected the borrower's argument that preemption exists only when state law makes it impossible for a national bank to exercise its powers, but it also rejected the proposition of Bank of America that any degree of interference is sufficient. Instead, the court instructed lower courts to engage in what they characterize as a practical and nuanced analysis of whether the state law "prevents or significantly interferes" with the exercise of national bank powers.

On remand, however, the 2nd Circuit once again concluded that the New York statute is preempted. The court purported to do the practical and nuanced analysis that was instructed to do by the US Supreme Court in Cantero. And indeed, the 2nd Circuit did look at several Supreme Court opinions dealing with national bank preemption and tried to analyze which ones were more akin to the facts in Cantero versus those that were easily distinguishable.

What happened next is that the court, after hearing oral argument, rendered its opinion. It emphasized the operational burdens and multi-state compliance complications that were associated with requiring national banks to comply with varying state mortgage escrow interest requirements. The court also concluded that the statute intrudes upon the federally authorized power of national banks to administer mortgage escrow accounts as part of their real estate lending operations.

Now, this ruling is highly significant because it directly conflicts with the 1st Circuit opinion in the Conti case that we'll be talking about and arguably conflicts with the 9th Circuit opinion in the Kivett case, which we'll also be referring to. But there's more of what I call a stark contrast with the 1st Circuit than the 9th Circuit, because the 9th Circuit decided it based... Without doing the nuanced analysis that Cantero instructed but did it on another theory that's not really germane to the topic that we're talking about today. As a result of this, we now have a clear and mature circuit split on this issue of enormous significance to the banking industry and to the consumers that the banks deal with.

At the same time while all this is going on, we had another significant development and that is that the Office of the Comptroller of the Currency has very forcefully entered the debate. And in response to the Supreme Court's Cantero decision and the growing circuit conflict, the OCC recently issued a final regulation and a final interpretive order, which were both published in the federal register, that addressed mortgage escrow accounts. And the OCC concluded that national banks and federal savings associations possess the authority to establish and maintain mortgage escrow accounts without being subject to state laws requiring the payment of a minimum amount of interest on the escrow accounts. And OCC further concluded such laws are preempted because they significantly interfere with the national bank's exercise of federally authorized lending powers. Not surprisingly, the OCC initiatives have generated intense reaction from industry groups, trade groups, consumer advocates, state regulators, with many viewing the actions as an effort by the OCC to restore a more robust conception of national bank preemption, notwithstanding Dodd-Frank's limitations that I referred to earlier.

And I will say at the outset that my good friend Art Wilmarth and I have some very different views about these issues, which should make for hopefully a lively discussion. Art, again, delighted for you to be back. And in terms of thinking about how to organize our discussion, I thought we would start with the Supreme Court's Cantero decision because I want to build that foundation for our listeners and then we'll get to what the 2nd Circuit did.

Beginning with the decision in Cantero in 2024, what did the court actually hold, if anything, and what guidance, if anything, did it provide regarding the proper preemption analysis under the Barnett Bank opinion and 25b of Dodd-Frank?

Art Wilmarth:

Thank you, Alan. I think the first major thing the court did was to say that the Barnett Bank standard, which as you say is does the state consumer financial law prevent or significantly interfere with the exercise of a national bank power that is in fact the controlling legal standard? That's the words they use, controlling legal standard for deciding all National Bank Act preemption cases that involve a state consumer financial law as defined by Dodd-Frank.

Now, one could say why is that so important? Because for many years, even after Dodd-Frank, the national banking industry and the OCC refused to accept that prevent or significantly interfere was actually the governing standard, even after it was codified by Dodd-Frank in very specific terms. They would try to draw out other language from Barnett Bank to say, "Well, it doesn't really mean prevent or significantly interfere. It means something less than that." Well, the Supreme Court said in Cantero, "No, it means what it says. That's what the statute says." It quoted Barnett Bank. That is the controlling legal standard so you can't try to pull out other language from Barnett Bank and pretend that it isn't. That was the first major point.

Alan Kaplinsky:

I want to ask you a question though, Art. You would agree, would you not, that the Barnett Bank involved an actual conflict with state law?

Art Wilmarth:

Oh yes, no question. It was close to a virtual prohibition.

Alan Kaplinsky:

Yeah. It dealt with selling insurance in towns of less than 5,000-

Art Wilmarth:

Yeah. Basically what the National Bank Act says is that if you're a national bank and you have an office in a town of 5,000 or less, you can sell insurance as an agent through that office. And what Florida said was not if you're a subsidiary of a bank holding company, which would prevent most but not quite all national banks from doing it. It was a virtual prohibition, not quite but a virtual prohibition. That was an easy case on the facts.

Alan Kaplinsky:

Well, yeah, but couldn't you argue that the only holding in the case really is if there's an actual conflict because that's what the facts involved there, then there is preemption where they did say or significantly interfere? But couldn't you argue that's dictum in the Supreme Court opinion?

Art Wilmarth:

Well, I would say this, since it was not a total prohibition, I think the significantly interfere language was important. In other words, because it didn't prevent all national banks, it prevented most national banks. I agree that... But I think the Supreme Court was actually trying to send a signal because in Barnett, of course, it cited many of the cases that Cantero cited. And clearly in some cases, there was some degree of interference and yet the state laws were upheld anyway as not being preempted. I think the Supreme Court realized it's not only prevents, it's not only interferes because there clearly is a class of cases where there was some degree of interference but not enough to justify preemption.

Alan Kaplinsky:

Okay. Okay. I'm sorry for interrupting your thought.

Art Wilmarth:

The second thing the court said was, as you said, preemption is not all or nothing so it's not correct to say that all state laws that have any effect on national banks are preempted, which was essentially the position of Bank of America. They sort of said, "Well, maybe generally applicable laws would be okay." But they also said, "But if those laws actually interfered with national bank powers, they wouldn't be okay either." And as you say, the plaintiffs took the position that it almost had to be an impossibility of performing your power before preemption would kick in. And I think impossible is not the same as significant.

The court said it's not all or nothing. Congress did not and neither did the Supreme Court draw a bright line so it's a contextual matter. And they said, "Okay. To address this contextual issue of preemption, which is really significant interference, you have to say, you must make a practical assessment of the nature and degree of interference actually caused by the state law with the exercise of a national bank power." That to me is a very pragmatic contextual test. And they also said, as you indicated, "And you have to make a nuanced comparative analysis of these seven Supreme Court cases, four including Barnett that said preemption and three others that said no preemption. And you have to decide which side of the line this particular state law falls on. Is it more akin to the preemptive laws or is it more akin to the non-preemptive laws?" To me, the Supreme Court was telling all lower courts, including the 2nd Circuit, it has to be a pragmatic, contextual, comparative analysis. It isn't a blunt all or nothing analysis.

Alan Kaplinsky:

Yeah. And you'd probably agree with me that the Supreme Court rejected a categorical approach to preemption and...

Art Wilmarth:

Yes, because the 2nd Circuit's control test was a categorical test. They said if a state law exerts any degree of control over the exercise of a national bank power, it's preempted, full stop. And as you say, we don't look to the magnitude of effects. And the Supreme Court said that clearly is not correct.

Alan Kaplinsky:

Right. Right. Right. The Cantero opinion was a nine and nothing opinion, it was a no dissents. And it just has always struck me as for whatever reason, they wanted to come down with the unanimous opinion and so they wrote an opinion that provided... It just regurgitated all the national bank preemption cases that they dealt with over the years. Including one, by the way, that didn't deal with national bank preemption-

Art Wilmarth:

Yes, the Fidelity case. Right.

Alan Kaplinsky:

Yeah, the Fidelity v. De la Cuesta opinion which dealt with due-on-sale clauses. And they didn't want to do the work, they could have themselves.

Art Wilmarth:

If you go back to the oral argument, there were clearly divisions on the court that were exposed by the oral argument. I think there were some justices that were inclined to take the view that the New York law was essentially a price setting law and any such law was out of bounds. And then I think there were justices on the other side that said, "No, this looks like a consumer protection statute to us. It's not a prevention." It's not, in their view, a severe interference, and therefore it could be okay. And I think there was a real division on the court and they decided not to work out that division at that point. But as you say, to send it back with instructions. Now, the question would be, are the instructions helpful? I think they are because as I said, up until Cantero, the OCC and many national banks were still arguing that prevent or significantly interfere was not the controlling standard where it clearly was. And the Supreme Court put that to rest, that's the controlling standard.

I think the two instructions they gave did give some guidance, not nearly enough. And that's why we still have a split, because what does it mean to say a practical assessment of the nature and degree of interference? Now, people on my side would say, "You have to look at the facts. You have to decide, well, just how much interference is this? How costly? How burdensome? Is it clear that the national banks really can't exercise this power in an effective way if they have to comply with this law?"

Now on the banks side, and I have to say the Supreme Court opinion leaves this open, they would say, "No. No. No. No. No facts. We don't consider any facts. We just look at these seven cases and common sense." Although to me, common sense has to be fact-based. There's this big argument about whether or not any facts should be looked at or any real world effects should be looked at. Now, when we get to the 2nd Circuit on remand, they said, "We're not looking at real world effects." And I think that's a mistake but clearly the Supreme Court is going to have to work that out. And then of course you have these seven cases and then...

One thing that I think is important about the seven cases is the Supreme Court did not include McCulloch versus Maryland in that list. And I think McCulloch is off the table where the national banks and the OCC wanted to use it because McCulloch, which was about the Second Bank in the United States, is close to a sweep the field preemption. And I think by not mentioning it, I think the court was saying McCulloch is not really relevant. And I've argued that it certainly isn't relevant that national banks today are not in any way, shape or manner the same as the Second Bank in the United States, which was a true federal instrumentality. The second thing about it is they didn't put in Waters either, the 2007 case. And I've argued that Waters shouldn't have any further force at this point but clearly the national banks continue to cite Waters all the time. But it's not on the list so those two omissions were pretty significant in my opinion.

Alan Kaplinsky:

Yeah. Yeah. Well, let's now turn to the 2nd Circuit's decision on remand. What was your reaction to the court's analysis? How did that analysis differ from the analysis that they provided in Cantero I?

Art Wilmarth:

Yeah. It's very interesting because in Cantero II, unlike Cantero I, you have a very strong dissent. And the dissent, which I agree with, said the 2nd Circuit really didn't do anything differently on remand than they did in their first case. What did they do? They basically said, "In our view, any state law that impedes the efficient exercise of a national bank power is presumptively preempted." They didn't quite say per se but very close so this impedes the efficient exercise. That to me sounds a lot like control the exercise because efficiency would mean operating at lowest possible cost. That'd be the economic definition, you're operating at the lowest possible marginal cost with the fewest possible impediments.

If any state law that impedes the efficiency of national banks in exercising their powers is preempted, I don't see how that isn't the same blanket across the board preemption as control the exercise. Certainly, the dissent says you've essentially relabeled and reframed the same control test you used before. That would be my position. Obviously, Bank of America and the OCC would argue differently.

Alan Kaplinsky:

Well, before you jump to the dissent, and you're absolutely right, that was the main criticism. But the other two judges on that panel did purport to do a practical nuanced analysis. Right? They did. They went through. They seemed to be following the instructions that the Supreme Court provided in Cantero, they just came out with a different conclusion after looking at these other precedents. Right? What-

Art Wilmarth:

I would say this, that they went through the motions of that but I think they tipped their hand in Footnote 5. Because in Footnote 5, they said, "We reject the plaintiff's submission and argument that we must look at the practical impact of the law on the exercise of national bank powers." And they said, "We do not look at any record evidence of real world effects." To me, that tipped their hand. Because if you say, "We do not consider any record evidence of real world effects." You're essentially saying, "We're not really looking at the factual impact of this law. We're saying it impedes the efficiency." Now, you're right. Now, they certainly point out why that would be true. If you have to comply with a state law that is different from other state laws, your costs will go up. That's certainly true. And if there are different laws with different interest rates, which there are, obviously your compliance burden would be greater.

Now this is where Conti disagrees, because Conti has a passage where they say, "Well, Citizens Bank is arguing that Rhode Island's interest on escrow law impedes their efficiency and their flexibility, and it gums up the works." And the 1st Circuit said, "But that can't be enough." They said, "If impeding efficiency or flexibility would be enough, then basically all state laws that had anything to do with national bank powers would be overridden." And the 1st Circuit said, "There would be no requirement to decide whether the state law's impact was significant, which is what Barnett Bank and Dodd-Frank require." Of course, we're talking about semantics here. But to me, impedes the efficiency is not the same as significant. It's a much lower burden-

Alan Kaplinsky:

But yet you-

Art Wilmarth:

...almost anything that raises any cost.

Alan Kaplinsky:

Yeah. But yet you agree that the Supreme Court was not looking for the 2nd Circuit to send it back to the district court for there to be more of developing factual record.

Art Wilmarth:

Yes, they did-

Yeah. They did not insist on that, you're correct. I think one of the great unanswered questions from the first Cantero decision is, can a court make a determination about preemption in terms of significant interference without looking at the factual record? Now, in the case of Cantero, the district court had made a number of factual statements, which obviously the 2nd Circuit majority did not agree with. But to the extent that there are statements about the fact at the District Court level, the District Court said, "This is insignificant. This is modest." I don't know if they use the word immaterial but they clearly said, "This is a modest requirement that doesn't impose any significant burden on the bank." I agree with you, that's-

Alan Kaplinsky:

The problem I have with your approach is where do you draw that line? Let's assume New York's minimum interest requirement, that they had something much higher that required that you pay 10%-

Art Wilmarth:

5% or 10% right.

Alan Kaplinsky:

...or something that was way above market, way above what they paid on their deposits. How would you react to that? Would you say-

Art Wilmarth:

I do think that the plaintiffs should suggest some kind of limiting principle. And so my limiting principle, just speaking entirely personally from my own personal viewpoint, and I've made this argument in a law review article and a policy brief I've written, to me, if the national bank can show that a state law would render the exercise of a particular power, unprofitable, impose a net loss. I think that raises a very severe question about whether that's significant. If you can't operate at a profit and you would have to suffer a loss, I think that would be a very troubling issue for the state to deal with. Now in this case, there's no evidence of any such thing.

Alan Kaplinsky:

No. No. And I don't think the Supreme Court expected that the lower courts were going to get into that kind of granularity to figure out... Because the problem with that-

Art Wilmarth:

An interesting comment, which I would point out. The 2nd Circuit said, "Another factor we might look at would be whether the state law would make the particular product, in this case, the mortgage escrow account, unattractive to customers." And what the 2nd Circuit said was, "We can't reach any kind of conclusive determination on that because we acknowledge that paying interest on escrow balances actually might make the escrow account more attractive to customers." I think that indicates that it's a pretty tenuous case for the national banks if you really look at what's really the practical impact of this law. How are they really suffering as a result of this law other than simply they have to comply and they have to have some burden of compliance?

It's worth remembering these funds are the borrower's funds. These are not bank funds. These are essentially funds that the borrowers required essentially to deposit with the bank and keep on deposit to pre-fund the payments of insurance and property taxes. Is it really fair for the banks to take all this money and invest them and get all the returns and give nothing to the borrower? I think that's a question that I've tried to emphasize in my own writing. These are not the bank funds. These are the borrower's funds.

Alan Kaplinsky:

But would you agree that you can't have a test of national bank preemption that's going to vary bank to bank? A big bank like one of the Bank of America or one of the other larger banks in the country, if you look at what's the impact of this on profitability, of course it's -

Art Wilmarth:

I agree. I think it has to be...

Alan Kaplinsky:

It's got to be a-

Art Wilmarth:

It can't be a bank to bank. I do think it can be-

Alan Kaplinsky:

It can't be bank to bank. Right.

Art Wilmarth:

I think it can be state to state though. I think it can be state to state. And I agree with you, I think you would have to look at aggregate banking information. One thing I looked at was what has been the average return on earning assets for the banking industry when they invest assets and get average returns? And the FDIC gives you that information. And the lowest it ever was, was about 2.75%. And usually it's been in the 4% to 6% range for the entire period of time since 2009. That would suggest that you're not going to suffer a loss if you have to pay 2% on something that you're earning at least 3%, 4%, 5%, 6% on based on average returns. I agree with you that at some point of granularity, it's not possible to go further. But I don't see why it's not possible to look at aggregate industry trends and make determinations.

Alan Kaplinsky:

Yeah. Let's turn now, Art, to the circuit split. Would you agree with me that it is a very stark conflict in the circuits and-

Art Wilmarth:

I would agree. I think the 1st Circuit decision is clearly 180 degrees different from the 2nd Circuit. It could be pointed out, which I think no one has emphasized very much, that the interest rate required by Rhode Island is considerably lower because it only has to be essentially the average savings rate paid on savings deposits. It's probably somewhere in the 0.25% to 0.5% range or something like that as opposed to 2%. But I don't think those interest rate differences make a difference in result. As you say, if it were 10% versus 0.25% or 0.5%, that would make a difference in my view.

Alan Kaplinsky:

Yeah. Now, am I right that the 1st Circuit case, Conti versus Citizens Bank, that the Supreme Court denied cert before Cantero II was decided?

Art Wilmarth:

That is correct.

Alan Kaplinsky:

They were fairly close in proximity to one another.

Art Wilmarth:

Right. Which is interesting because you might've thought they could have held it. And it's interesting that you have to get four justices to vote for cert, which would indicate, does that mean that four justices were not unhappy with Conti? You can never read much out of denials of cert but it gives you some signal. I don't know, that's a very interesting question. Based on the oral argument and what was said during the oral argument, I would've thought that at least two or three justices would've been unhappy with Conti, would've been my guess. It's interesting that there doesn't seem to have been a fourth justice that was unhappy. I agree with you that it surprised me that they would've denied cert without waiting to see what Cantero and Kivett did.

Alan Kaplinsky:

Right. Right. Right. But in any event, I think Citizens Bank filed a motion for rehearing or reconsideration of the denial of cert petition. I don't think it's been acted on yet.

Art Wilmarth:

I think you're right. I should have checked but I didn't. But I think you're right.

Alan Kaplinsky:

And in the meantime, a cert petition got filed very quickly by the... They didn't wait... I think you're allowed 120 days after the mandate comes down. They were very, very quick in filing their cert petition because I'm sure it was important to them that they be the lead case. They didn't want their destiny to be controlled by the Kivett case.

Art Wilmarth:

By Kivett, right.

Alan Kaplinsky:

And then what about the Kivett case? We've referred to that a few times.

Art Wilmarth:

Well, as you say, Kivett was...

Alan Kaplinsky:

Why is that an oddball?

Art Wilmarth:

Right. It's a strange case in the sense that apparently the 9th Circuit has very restrictive rules for en banc review. And essentially, as I understand the 9th Circuit rule, it is either that the 9th Circuit has overturned the applicable precedent, which in this case is Lusnak, a 2018 case in which the Supreme Court denied cert, or a subsequent Supreme Court case is viewed as being so incompatible with 9th Circuit precedent that they disregard it. And so two justices in the 9th Circuit said, "We believe Lusnak still controls." Yes, it didn't do the Cantero analysis that the Supreme Court subsequently explained. It did look at Barnett, it didn't look at the other cases. It didn't look at this practical assessment much but no subsequent 9th Circuit cases overruled it. And we don't think the two judges said, "We don't think it's so incompatible with Cantero that we have to disregard it."

Now, Judge Nelson in dissent disagreed strongly and said Lusnak can't be right after Cantero. And he made a very strong argument pretty much along the lines of the 2nd Circuit that California's interest in escrow law, which is also 2%, should be preempted under Cantero, under the Supreme Court's Cantero analysis. You have 2-1 in favor of preemption in the 2nd Circuit, you have 2-1 against preemption in the 9th Circuit, you have 3-0 against preemption in Conti. What happened in Kivett was that they did seek rehearing en banc after the 2-1 decision. Apparently, the 9th Circuit was not interested in taking it, didn't take it. And now just recently, the counsel for Flagstar Bank has filed for cert on behalf of review of the 9th Circuit decision.

Interestingly, you have the Cantero plaintiffs asking for cert but you also have the Kivett defendant, Flagstar Bank asking for cert. And it wouldn't at all surprise me if Bank of America, I would think if they would respond to the Cantero petition, that they would agree that, okay, let's take cert and resolve it. Of course, they might not respond at all. They might just decide, well, we won't respond and let the court take it. But that'll be interesting to see.

Alan Kaplinsky:

Yeah. I'm not sure the timing or what their deadline is, they may have gotten an extension of time too to respond to the cert petition. Well, now let's turn to something that I know is really going to get you riled up.

Art Wilmarth:

The good old OCC.

Alan Kaplinsky:

Yeah, the OCC. They decided to get back in the game a little bit late but they certainly did get back. Let's discuss their recent initiative, namely the issuance of a final regulation and a final interpretive order. Let me ask you first of all, why do you think they did both? Why did they do an interpretive order and a regulation?

Art Wilmarth:

Yes, I thought the regulation which basically says national banks have the incidental power to offer escrow accounts seemed like gilding the lily to me. By itself, it's not particularly controversial. I think people have accepted that national banks have an incidental power to do mortgage escrow accounts for many, many years, and they issued a number of interpretive letters way back in the day saying that was true. I guess that they must have thought that by doing a notice and comment rulemaking, that would beef up the issue.

I think they may have also wanted to say, "Oh, now we have a notice and comment rulemaking." Which is what we had in Fidelity with the old Federal Home Loan Bank Board, now we can point to a direct conflict with a notice and comment rule. But I think that doesn't quite work in the sense that the rule that simply says national banks may offer escrow accounts, it doesn't go one step further and say, "Oh, and by the way, the states cannot possibly require national banks to pay interest on those accounts." The OCC, as you said, published a separate preemption determination saying the states may not require the payment of interest.

It was a strange bifurcation, I thought.

Alan Kaplinsky:

They did that coming out with that order, that's what's required under Dodd-Frank. Right? Aren't they...

Art Wilmarth:

Yes. Yes.

They essentially made the required preemption determination. And the problem is they didn't make it lawfully and correctly, we can get into that.

Alan Kaplinsky:

Now I'm going to ask you a rhetorical question. What's wrong with the interpretive order? Why do you think they're off base?

Art Wilmarth:

I think that there are I would say three big things wrong with it. The first is that I think if you take its rhetoric seriously, it is a clear attempt to restore the 2004 across the board, what I call de facto field preemption regime which was repudiated by the Supreme Court in Cuomo in 2009, the rationale for it. And as you say, was essentially overruled by Dodd-Frank in 2010, although the OCC has never admitted that. And as you know, they reissued rules in 2011 that look a lot like the 2004 rules but the courts have given those rules very little credence as a result.

But this new preemption determination makes incredibly sweeping claims like national banks have the right to effectively and efficiently exercise all their powers in accordance with their business judgment and discretion, and states cannot in any way get involved in limiting that. And that's pretty breathtaking in my opinion, that national banks get to decide I need to do this to efficiently and effectively and flexibly exercise my powers based upon my management's business judgment and discretion, and states have nothing to do with that. I think that's an extraordinary claim. And that's very similar to the claim they made in 2004 but I think those claims were repudiated for reasons I've said.

Secondly, there are two things that the OCC must do that are not expressly binding on courts. The first is that they have to show substantial evidence in support of their preemption determination made on the record of the proceeding. Again, that substantial evidence requirement is not expressly applicable to courts. Although my view that how can courts make a decision without substantial evidence, but that's another point.

What substantial evidence did they present? Essentially none. In the preemption determination, they said, "We made no cost benefit analysis. We made no determination that state interest and escrow laws would make national bank operations unprofitable or cause any kind of a loss or any other kind of a financial impact because we don't have to." They said, "We don't have to find any financial impact at all." And so as a result, the preemption determination from my perspective is devoid of any substantial evidence that would support it. As I say, the Cantero case leaves open whether a court can do that as the 2nd Circuit in my view did. But Dodd-Frank certainly does not leave it open in terms of the OCC's ability to... And the OCC actually quotes the 2nd Circuit opinion by saying, "We don't have to consider the real world effects of a state law to deem it preempted." As I say, it's one thing for a court to say that but for the OCC to say that with a substantial evidence requirement, I think is completely out of bounds.

The second big problem they have is that Dodd-Frank says that OCC preemption determinations have to be made on a case by case basis, you have to consider the impact of each particular state law that you're deciding to preempt unless you can show that the law you're deciding to preempt is substantively equivalent to a law that you've already preempted. Well, what did they do? They preempted 14 different state interests on escrow laws. They're not the same. As I said, Rhode Island and Wisconsin and there are a couple of others basically have an effective interest rate of somewhere between a quarter and a half of 1%. Hawaii has an effective interest rate of about 1.7%. California and New York have interest rates of 2%. They didn't do...

And what the OCC said was, "We acknowledge that there are differences between these laws. They're not all the same. They vary." But then the OCC said, "But we don't have to get into any of those details because all of the state laws, again, interfere, burden the efficient, effective, and flexible exercise of National Bank powers in accordance with their discretion and business judgment." They just... In the same way with substantial evidence, they basically just swept it aside. The same with case by case, they said, "We don't need to look at any of the details of these laws because they're all bad for the same reason." Which is, in my view, a preempt the field approach. And Dodd-Frank made clear that preempt the field is not the approach for the OCC to take.

Alan Kaplinsky:

Right. Right.

Art Wilmarth:

I think the OCC rules are in great trouble and I've written a policy brief about it. We'll see with-

Alan Kaplinsky:

You wrote a letter to the OCC comptroller.

Art Wilmarth:

I had submitted a comment letter to the OCC and then I turned it into a policy brief that's posted on SSRN and Scholarly Commons but it's based on the comment letter I filed. And some of their responses in their final rulemaking were directed at me.

Alan Kaplinsky:

They did respond to you, you're saying?

Art Wilmarth:

Not by name but they responded to particular arguments I made. They said, "One commenter said that this amounts to de facto field preemption. We are not doing that." They said. But of course, they are. "We're not doing de facto field preemption," they said.

Alan Kaplinsky:

Right. Right. Right. Now I take it, assuming the Supreme Court grants cert, which I think is a pretty good assumption, at that point, I would think the OCC will weigh in with their amicus brief or maybe it'll be the solicitor general, I can't remember.

Art Wilmarth:

Right. They do have a friendly solicitor general this time. As you remember, in 2024, they had an unfriendly solicitor general, and the solicitor general in the brief took an anti-OCC position which made them very angry. Right. Right.

One thing I would say about the rule is that... The preemption determination, not the general rule but the preemption determination, the 2nd Circuit cited the proposed preemption determination in support of its opinion. Of course, the final one didn't come out until later. But I would think that by citing it, it would now be an issue before the Supreme Court. And as you say, it will bring back what we saw in the Smiley case, that if the OCC intervened in the middle of litigation and issued this preemption determination, how much deference should they give it. Of course, in Smiley, they felt they had to give it Chevron deference. Chevron deference no longer exists so we'll even get Skidmore deference, that'll be interesting to see.

Alan Kaplinsky:

Yeah. And of course, even before... Drawing a blank on the case that overruled Chevron.

Art Wilmarth:

Loper Bright, yeah.

Alan Kaplinsky:

Loper Bright Enterprises. Dodd-Frank required-

Art Wilmarth:

What's pretty interesting about Dodd-Frank is Dodd-Frank removed Chevron deference for preemption determinations. The OCC, what they tended to do in response was to issue interpretive rule opinions that would say, "National banks may do this but they wouldn't talk about preemption." But then when a case came up, they would say, "Oh, look, we said they could do this. There's a conflict." Well, Loper Bright now takes all Chevron deference away so it doesn't matter whether it's preemption determination or interpretation.

Alan Kaplinsky:

What do you make of... This is something I've been scratching my head about ever since I've read that footnote in the Supreme Court opinion in Cantero, where they said in a footnote that upon remand, the court may consider the OCC's... I think they said-

Art Wilmarth:

2011 rules. Those were the 2011 rules-

Alan Kaplinsky:

Yeah. Yeah.

Art Wilmarth:

Yeah.

Alan Kaplinsky:

Did that surprise you?

Art Wilmarth:

Yes. I think that there were probably at least two or three justices, from my observation of the oral argument, who probably thought those 2011 rules were okay. And I'm quite sure that there were at least three, if not more justices who thought they were not okay. As you remember, Gorsuch said, "Why hasn't the OCC done what Dodd-Frank told it to do?" He said that during the oral argument. I think this issue about whether or not the 2011 rules had any validity after Dodd-Frank was a matter of division on the court, and I'm sure that's one of the reasons why this OCC has come out with this new preemption determination to try to beef up the 2011 rules, if you like.

Alan Kaplinsky:

Now, the 2011 rules still exist. Right?

Art Wilmarth:

They still exist and they're largely a repetition of the 2004 rules, which I've argued was totally unlawful, totally bogus, but they're still there.

Alan Kaplinsky:

Crystal balling it now, let's assume the Supreme Court takes the case. It won't be argued until probably sometime in the fall of this year. Maybe...

Art Wilmarth:

And maybe not even until early in '27. Right. Right.

Alan Kaplinsky:

Yeah. Probably early '27, we'll have an opinion. What do you think the Supreme Court is going to do in listening to that earlier oral argument? It's going to be sharply divided I would think.

Art Wilmarth:

I think the court is clearly divided, in my opinion. It's much harder to say how divided. Based on my observation of the oral argument and reading of the transcript, it seemed to me that Kavanaugh and Alito were probably pretty clearly on Bank of America's side, and I thought pretty clearly Gorsuch, Sotomayor, and Ketanji Jackson were on the plaintiff's side. And I thought it was very hard to figure out where the other four justices came down. I don't believe that Thomas made any particular comments, I can't remember. And the comments made by Roberts, Barrett, and Kagan were ambiguous at best. I would suspect it's going to be similar to Cuomo where the court was pretty closely divided. Obviously, I'm hopeful that we'll get a result similar to Cuomo but that's going to be a very interesting thing to do.

Alan Kaplinsky:

And it's got to be hard for them to punt like they did the last time.

Art Wilmarth:

I would think so. The only thing I can imagine is that they could say, "Well, hey, now the OCC has issued this preemption determination, which is what happened in this White v. case also in Illinois so I'm going to remand it back to the lower courts to see what to do with it." But since the OCC preemption determination essentially covers no new ground, it rehashes all the arguments that have been made repetitively, I would find that odd to say we'll punt it back, because we know all the arguments are the ones that have been circulating around these three cases, as you say, for three, four years now. I would be surprised if they punt it back.

Alan Kaplinsky:

Let's talk about, in the remaining minutes that we have, some of the broader implications of this opinion. Now the opinion is going to deal with mortgage escrow accounts but that's the least of the banking industry's worries, that's a contained issue in certain states.

Art Wilmarth:

Yes, it's an enormously important case.

Alan Kaplinsky:

Very. Yeah, because in talking- let's tell our listeners why it's important beyond mortgages.

Art Wilmarth:

Well, I think if the 2nd Circuit decision were to prevail... And as I say, the 2nd Circuit decision is pretty much in agreement with the OCC's preemption determination, they actually cite each other. The 2nd Circuit cited the proposed preemption determination and the final preemption determination cited the 2nd Circuit. Essentially, they're on the same wavelength that you can't impede the efficiency or flexibility or effectiveness that you can't interfere with any of that. That would be going back to the 2004 regime where I think state laws would essentially not apply unless they were of the most generally applicable type like contracts, property transfers, zoning. It would be really questionable how many state consumer financial laws would still apply if the 2nd Circuit's decision is upheld and the OCC's ruling is upheld either implicitly or explicitly. I certainly hope that's not the result.

If the 1st Circuit's position is upheld, that to me creates a very different situation where in order for state law not to apply, there has to be a persuasive factual showing that it really does significantly interfere with an authorized national bank power. And it can't be simply an inconvenience, it has to be something significant. And I think that would very much change the landscape for national bank compliance, their view about compliance, and it would certainly push back the OCC considerably as well.

Alan Kaplinsky:

Yeah. If they were to come out the way that you're urging that they support the 1st Circuit opinion in Conti, then you've got a real problem, another problem on our hands. Aside from how does that get applied in other contexts with respect to other laws, I would think most national banks in setting up their lending programs, deposit account programs, et cetera, et cetera, follow the OCC regulations. They assume that they are lawful. They bet on-

Art Wilmarth:

And the OCC will support them in litigation if it comes to that. Right. Right.

Alan Kaplinsky:

There's a further question here in my mind whether the Supreme Court might say that any national bank that's relied on the OCC regulations is okay for now, anything they've done in the past, and we're only going to apply this thing prospectively after some reasonable period of time. Do you think that might happen?

Art Wilmarth:

Yeah, that would be consistent with Loper Bright. Right? Because they said we are essentially abolishing Chevron deference but we're not doing it retroactively, that we're not disturbing any of the decisions that have relied on Chevron deference in the past. And I agree. I think that the OCC's 2011 rules could not survive, in my opinion, upholding to the 1st Circuit opinion. But I think the Supreme Court would say, "Look, they've been valid up until now. No one has ever struck them down." If you follow the 2011 rules up until the date of this decision, I don't think that should be subject to being unwound, it seems to me. That's just my personal opinion.

Alan Kaplinsky:

Yeah. I take it you wouldn't have a problem if they said that.

Art Wilmarth:

Yes, I agree that they should take a similar position to Loper Bright. It would be different if the 2011 rules had ever been really struck down but they haven't. They've been criticized but they've never been struck down.

Alan Kaplinsky:

If you were giving advice to a national bank as to what they ought to do, would your advice to them be just wait this out, wait till the Supreme Court deals with it. Don't worry if you've been following the OCC regulations, you will be...

Art Wilmarth:

No, that's a tough call. Certainly I think in the 1st Circuit and the 9th Circuit, you better be complying with the state laws. I think the 1st Circuit and 9th Circuit, I think you can't take that position that the authoritative judicial decisions in the First and 9th Circuit are that you have to follow these laws. In the other circuits, I would say that it wouldn't be irrational to say, "Well, hey, we can rely on the 2011 rules until the Supreme Court decides otherwise." But if you were taking a more defensive view, I think you might begin to say, "Is it really so difficult for us to comply with this law? If it's not really so difficult, let's go ahead." Now...

Alan Kaplinsky:

But the mortgage escrow law, yeah, sure. Right?

Art Wilmarth:

Right. Now if you're talking about something like-

Alan Kaplinsky:

But what about other state laws?

Art Wilmarth:

Yeah. If you're talking about something like the White v. law in Illinois, that's a much harder case because the compliance burden there is tremendous. No, I think that case has its own set of complexities.

Alan Kaplinsky:

Yes, it does.

Art Wilmarth:

But I would agree that if the burden of compliance is tremendous, you might make a more pragmatic decision then about what you're willing to do and not to do. But I would say in the 1st and 9th Circuit, I would say you better comply with the interest and escrow laws.

Alan Kaplinsky:

Yeah. Okay. We've come to the end of our program for today but I have a few concluding remarks based on our discussion and I thought I would summarize it. And give you a final opportunity, Art, after I finish to basically offer your concluding remarks as to whether you agree with me or not.

This discussion that we have had today highlights that National Bank Act preemption remains one of the most consequential and contested issues in banking law. The renewed Cantero decision from the 2nd Circuit together with the contrary rulings of the 1st and 9th Circuits, has created a major circuit split over the extent to which states may regulate the interest that gets paid on mortgage escrow accounts that are maintained by national banks. At the same time, the OCC's final regulation and interpretive order signaled a renewed willingness by the OCC to assert federal preemption aggressively in defense of national banks.

I think there are a few important themes that emerge from our discussion. First of all, despite the Supreme Court's effort in Cantero to clarify the governing standard, substantial uncertainty remains concerning how courts should apply that prevents or significantly interferes tests under Barnett Bank and Dodd-Frank. You've heard two different views of that today, of course. But it's certainly not, at least in my view, clear either way how that gets applied in the context of mortgage escrow accounts.

Second, the current circuit split almost assures everyone that the Supreme Court will grant cert. There are now essentially two cert petitions and a request for rehearing or reconsideration of a third cert petition in the 1st Circuit case in Conti. They're going to rehear that case, I don't have any doubt about that.

And finally, the outcome of these disputes could have far-reaching consequences, not only for mortgage escrow accounts and what interest rate you have to pay on them, but also the broader balance of power between the federal banking authority and the state consumer financial regulators and regulations.

You agree with that, Art?

Art Wilmarth:

Yes, I agree with all those conclusions, Alan. I think you did it very well.

Alan Kaplinsky:

All right. Thank you.

Art Wilmarth:

As the Chinese say, we're living in very interesting times.

Alan Kaplinsky:

Yeah, for sure. Again, I want to thank you, Art, for taking the time and sharing your views and thoughts on this issue that you have spent, I'm sure, a large part of your career on. I know I have. And it's going to be very interesting to see how this all shakes out. I want to thank, in addition to Art, thank all of our listeners for joining us today. And I hope everybody enjoys the rest of their day.