The Bank Preemption Ripple Effects After Cantero, Flagstar

By **Franca Harris Gutierrez, Julie Williams and Andrew Lindsay** (August 30, 2024)

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On May 30, the U.S. Supreme Court issued a unanimous decision in Cantero v. Bank of America, vacating and remanding a decision by the Second Circuit that concluded that the federally authorized powers of national banks under the National Bank Act preempted a New York state law requiring banks to pay at least 2% interest on mortgage escrow accounts.[1]

Then, on June 10, the court summarily vacated and remanded a decision by the U.S. Court of Appeals for the Ninth Circuit in Kivett v. Flagstar Bank FSB that had held that a California law mandating payment of interest on a mortgage escrow account was not preempted under the National Bank Act because the 2% required rate of interest was not "punitively high" enough to significantly interfere with a bank's ability to set prices for its products.[2]

The Supreme Court has now directed do-overs by both circuits, concluding that neither decision applied the appropriate analysis of Federal preemption.

What is next for national bank preemption? What did the court resolve? What questions remain? Why does this matter?

The concept of federal preemption for national banks is not a historical relic, and these questions have real business consequences for banks.

Federal preemption of state regulation and control does not mean national banks escape regulation. Far from it. They are highly regulated under a generally uniform and nationwide set of federally defined powers, federal regulations and federal agency oversight.

The application of uniform national standards is increasingly important with the growth of interstate operations and the ability of institutions to operate on a national basis enabled by technology and not confined by state lines.

The importance of federal preemption for national banks will only increase as technology-driven innovations in creation and delivery of banking products evolve. That's why the Cantero decision and the direction of national bank preemption has real modern-day significance for national banks.

How does Cantero direct future analysis?

The court's remand in Cantero did not result in the bright-line test some parties were seeking, but it did prescribe an approach to analyzing preemption issues that is familiar and well-established prior to enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The decision resolved the controversial question of whether Dodd-Frank contained a new

standard for national bank preemption of state consumer financial laws.[3] The court concluded that it did not, and directed that courts should apply the balanced and nuanced preemption analysis of Supreme Court decisions preceding Dodd-Frank, notably the 1996 decision in Barnett Bank of Marion County v. Nelson.[4]

In so doing, the court provided a helpful — and familiar — road map for preemption analysis going forward, pointing to several cases as examples of the types of state law interference with national bank powers that would, or would not, be preempted.[5]

Notably highlighted in addition to Barnett itself was the Supreme Court's 1954 decision in Franklin National Bank of Franklin Square v. New York. According to the Cantero opinion, the facts of Franklin were a "paradigmatic example of significant interference identified by Barnett."[6] The New York law found to be preempted prohibited banks from using one word — "saving" or "savings" — in advertising.[7]

The Franklin court found that limitation to be an impermissible interference with the national bank's power to effectively advertise that it was in the business of receiving savings deposits.[8]

Cantero also references the court's 1982 decision in Fidelity Federal Savings & Loan Association v. De la Cuesta.[9] In Fidelity, federal law "allowed" the inclusion of due-on-sale clauses in contracts, and California law limited that right to certain circumstances.[10]

As characterized by Cantero, the Supreme Court's Fidelity decision "ruled that the California law was preempted because the savings and loan could not exercise a due-on-sale clause 'solely at its option'" and "the California law thus interfered with 'the flexibility given' to the savings and loan by Federal law."[11]

A third case highlighted in Cantero as an example of the type of interference warranting preemption was the high court's 1923 decision in First National Bank of San Jose v. California,[12] where a state law purported to claim deposits that had not been claimed for 20 years, but without evidence that the deposits had been abandoned.

The court found that the California law "attempt[ed] to qualify in an unusual way agreements between national banks and their customers," which could cause customers to "hesitate" before depositing funds at the bank — and would thus interfere with the "efficiency" of the national bank in receiving deposits.

Other cases were discussed in the decision where the court had found state law not to be preempted. These included a generally applicable state tax law,[13] a state law requiring abandoned deposits to be turned over to the state,[14] and a generally applicable state contract law.[15] These cases, even though they do not find preemption, are instructive as well because they express what interference national bank powers is sufficiently significant to result in preemption.

The Supreme Court in Cantero now directs lower courts to refer to Barnett, Franklin, Fidelity, First National Bank of San Jose and the other precedents cited in Barnett and to compare the interference caused by a given law to that of state laws in these cases — and conduct a practical assessment of the nature and degree of the interference based on the text and structure of the state law, precedent and common sense.[16]

Using this "nuanced comparative analysis," courts should determine whether the state law's interference aligns more closely with cases where interference was found to be significant or

with cases where it was not.[17]

Thus, future preemption analyses must be undertaken with a holistic approach comparable to that used before enactment of Dodd-Frank, focusing on whether the state law significantly interferes with the exercise of a national bank power.

The court explicitly rejected a preemption test proposed by the plaintiffs that would have required a fact-intensive examination of the state law's quantitative impact on national banks, reasoning that such an approach "would preempt virtually no non-discriminatory state laws."[18]

Although the decision was not the bright line that some litigants had been seeking, the preemption precedents cited by the court displayed a sensitivity to state law intrusions on the ability of national banks to fully exercise their express and implied powers under federal law.

What's next?

Here's where things stand as we head into the rest of the year:

- Cantero goes back to the U.S. Court of Appeals for the Second Circuit, and Kivett goes back to the Ninth Circuit. The result in the latter should displace the Ninth Circuit's 2018 Lusnak v. Bank of America decision that the Kivett court was forced to follow.

- Cantero directs courts to apply the type of analysis that courts were applying before the enactment of Dodd-Frank and provides meaningful guidance on the level of interference that gives rise to preemption. The examples of levels of interference highlighted by the court favor finding preemption based on interference with a national bank's ability to fully exercise express or incidental powers.

- Cantero makes clear that analysis is based on the interference with a national bank's powers, based on the text and structure of the law in question, not the magnitude of impact on the business of the particular bank — which could have resulted in different answers bank-by-bank.[19]

- A footnote at the very end of Cantero leaves open two potential additional avenues for national banks to argue federal preemption: Office of the Comptroller of the Currency preemption regulations and Title 12 of the U.S. Code, Section 371, and the OCC regulations thereunder governing the authority of national banks to make real estate loans.[20]

    - OCC preemption regulations existed prior to the enactment of Dodd-Frank and were adopted, supported by additional Barnett-based analyses, post-Dodd-Frank.[21]

    - Dodd-Frank recognizes that state laws may be preempted by federal law "other than title 62 of the Revised Statutes."[22] One such provision is Title 12 of U.S. Code, Section 371, a broad authority for national banks' real estate lending, which subjects that authority only to regulation by the OCC and to certain safety and soundness prudential real estate lending standards adopted on an interagency basis by the federal banking agencies. The statute is explicit that national banks' real estate lending powers are subject to

regulation from only those two sources; there is no mention of state law, and the regulations provide that national banks may make real estate loans without regard to state law limitations concerning escrow accounts, impound accounts and similar accounts.[23]

- What will the OCC do? Will it file an amicus on an issue it had previously characterized as "a matter of foundational consequence to the OCC and the federal banking system"?[24]

- What other types of state laws may be in play?

Conclusion

The ability of financial institutions to operate under uniform and consistent national standards is critical, as the delivery of financial products and services is increasingly digital and not defined by state-by-state borders.

The value of achieving uniform and reliable national standards takes on even new significance today as some states adopt requirements that would dictate banking practices based on particular political considerations. This is exactly the type of state fragmentation that the National Bank Act was designed to supersede.

Cantero gives us a familiar road map for analysis for certain types of preemption questions. Preemption issues in areas not covered by the Dodd-Frank provisions should be able to look to a broader set of preexisting precedents.

Together, there is a strong fabric supporting the ability of national banks to operate under nationally set standards in broad areas of their business.

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[1] Cantero v. Bank of Am., N.A., No. 22-529, slip op. at 12 (U.S. May 30, 2024).

[2] 2022 WL 1553266 (9th Cir. May 17, 2022).

[3] Cantero, slip op. at 12.

[4] Id. at 13.

[5] See id. at 8-11 (discussing Fidelity Federal Savings & Loan Association v. De la Cuesta, 458 U.S. 141 (1982), Franklin National Bank of Franklin Square v. New York, 347 U.S. 373 (1954), Anderson Nat'l Bank v. Luckett, 321 U.S. 233 (1944), and First Nat'l Bank of San Jose v. California, 262 U.S. 366 (1923)).

[6] Cantero, slip op. at 8.

[7] Franklin, 347 U.S. at 378–379.

[8] Id. at 377–378.

[9] 458 U.S. 141 (1982).

[10] Id. at 155.

[11] Cantero, slip op. at 9 (citing Fidelity, 458 U.S. at 155).

[12] 262 U.S. 366 (1923).

[13] Nat'l Bank v. Commonwealth, 9 Wall. 353 (1870).

[14] Anderson Nat'l Bank v. Luckett, 321 U.S. 233 (1944).

[15] McClellan v. Chipman, 164 U.S. 347 (1896).

[16] Cantero, slip op. at 7–9 & 12 n.3.

[17] Id. at 13.

[18] Id.

[19] Id. n.3 (noting that in "each of the previous precedents, the Court reached its conclusions about the nature and degree of the state laws' alleged interference with the national banks' exercise of their powers based on the text and structure of the laws, comparison to other precedents, and common sense."). See also Transcript of Oral Argument, Cantero v. Bank of Am., N.A. (No. 22-529), at 17–18.

> JUSTICE ALITO: Do you -- do you think that the significant interference test should be applied on a bank-by-bank basis or on an industry basis?
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> MR. TAYLOR: No, it's not bank by bank. That's not how it works in our view. If you look at the statute, it's clear that when the OCC makes preemption determinations, it -- it does so on a law-by-law basis, not a bank-by-bank basis.

[20] Id. n.4. ("During the course of the litigation, the parties have raised two other issues that the Court of Appeals did not address and that it may address as appropriate on remand: first, the significance here (if any) of the preemption rules of the Office of the Comptroller of the Currency; and second, the relevance here (if any) of the Dodd-Frank provision that preempts state consumer financial laws if a federal law "other than title 62 of the Revised Statutes" preempts the state law, 12 U. S. C. §25b(b)(1)(C).").

[21] Office of Thrift Supervision Integration; Dodd-Frank Act Implementation, 76 Fed. Reg.

43,549, 43,555 (July 21, 2011); Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904, 1910 (Jan. 13, 2004).

[22] 12 U. S. C. §25b(b)(1)(C).

[23] 12 C.F.R. §34.4(a)(6).

[24] Brief of Amicus Curiae Office of the Comptroller of the Currency in Support of Defendant-Appellant Bank of America at 3, N.A., Hymes v. Bank of Am., N.A., No. 21-403 (2d Cir. filed June 2021); Brief of Amicus Curiae Office of the Comptroller of the Currency in Support of Appellee's Petition for Rehearing En Banc at 5, Lusnak v. Bank of Am., N.A., No. 14-56755 (9th Cir. filed Apr. 2018);