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MORTGAGE BANKERS ASSOCIATION

Summary of Flagstar Bank, FSB v. Kivett

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On Wednesday, November 23, MBA and other trades filed a joint amicus brief supporting a petition for a Writ of Certiorari requesting the Supreme Court hear an appeal of the recent Ninth Circuit U.S. Court of Appeals decision in *Flagstar Bank, FSB v. Kivett*. The issue is whether a California law requiring lenders, including national banks, to pay at least 2% annual interest on mortgage escrow accounts is preempted by the National Bank Act (NBA). MBA has previously weighed in on this issue in the Ninth Circuit in *Lusnak v. Bank of America, NA*, arguing that the NBA preempts California's statute.

Below is a summary of the amicus brief.

Overview of Argument

In *Kivett*, the Ninth Circuit held that California Civil Code Section 2954.8, which requires lenders to pay at least 2% annual interest on all mortgage escrow accounts, is not preempted by the NBA. This holding relied on the Ninth Circuit's earlier decision in *Lusnak v. Bank of America, N.A.*, where the Court concluded that the California law did not "significantly interfere" with mortgage escrow accounts because 2% is not a "punitively high" amount.

Now a recent decision by the Second Circuit (*Cantero v. Bank America, N.A.*) — which considered whether the NBA preempts a New York law mandating the same 2% interest payments on mortgage escrow accounts as in the California law—expressly rejected the Ninth Circuit's holding in *Lusnak*. Rather, the Second Circuit held that such state laws are preempted under the "ordinary legal principles of preemption." There is now a circuit split with the Second Circuit on this issue.

Reasons Why the Petition Should be Granted

I. Review is warranted to resolve the express split between the 2nd and 9th Circuits.

In *Lusnak* and *Kivett*, the 9th Circuit sought to apply its version of the "significant interference" test to determine whether the California statute is preempted. Specifically, the 9th Circuit looked to the "magnitude" of the statute's interference with national bank powers. The court held that the 2% interest rate presents only "minor" interference and thus is not preempted. Of note is that the court did not offer any guidance as to what mandated rate might constitute significant interference.

The 2nd Circuit's decision in *Cantero* expressly addressed and rejected the analysis in *Lusnak* and *Kivett* and instead found that "[i]t is the nature of an invasion into a national bank's operations—not the magnitude of its effects—that determines whether a state law purports to exercise control over a federally granted banking power [and the powers incidental thereto] and is thus preempted."

So, the 2nd Circuit held that the New York law is preempted by the NBA because, "[b]y requiring a bank to pay its customers in order to exercise [its power to create and fund escrow accounts], the law would exert control over banks' exercise of that power," and, "if taken to a greater degree, . . . could infringe on national banks' power to use mortgage escrow accounts altogether." In sum, the 2nd Circuit said the 9th Circuit erred by seeking to establish a novel standard that a national bank's core powers could be regulated by a state if the regulation were not punitive.

II. Review is warranted to correct the 9th Circuit decisions.

A. The decision wrongly empowers states to "significantly interfere" with national banks' powers. The brief provides two reasons:

i. First, the 9th Circuit fundamentally misunderstood this Court's "significant interference" doctrine. From the NBA's inception, a national bank's powers have extended not only to core banking functions—such as "making, arranging, purchasing, or selling loans or extensions of credit secured by liens on interests in real estate," but also to "all such incidental powers as shall be necessary to carry on the business of banking," Under the 9th Circuit's approach that looks at the "magnitude" and whether the state law was punitive, rather than the character, of interference with national banks' powers to determine whether a state law is preempted, federal courts would be placed in the impossible position of evaluating whether certain rates that states sought to impose on national banks crossed the line from insignificant to significant interferences with national bank powers. Overall, California's attempt to regulate a national bank's pricing for a product that is key to that bank's core banking powers is the type of law the NBA was designed to preempt.

ii. Second, even if this Court were correct in using a "magnitude" analysis, the Court failed to recognize the significant negative consequences that state interference with national banks' ability to utilize mortgage escrow accounts[1] could have on the national banking system.

B. The decision risks turning the national banking system into a patchwork, fifty-state, banking system.

MBA recognizes that our members successfully operate in a patchwork, fifty-state regulatory system. The main point of this section is that such a patchwork of regulations is contrary to the NBA and the 9th Circuit ruling creates an unworkable standard.

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[1] "Mortgage escrow accounts are crucial tools that lenders use to facilitate the vast majority of home loans across the United States. In these accounts, borrowers keep sufficient funds to make their tax and insurance payments on the property. These payments are needed to ensure that (i) lenders do not lose all or part of the value of their security interest in a foreclosed-upon property due to various governmental entities' claims for taxes, and (ii) lenders do not incur unreimbursed loss in the value of the collateral property in case of damage to the property. The benefits of mortgage escrow accounts also redound to homeowners by providing a convenient method for paying property taxes and insurance. Borrowers also benefit from these accounts because, without them, lenders would face substantially increased risks on mortgage lending. Lenders could be forced either (i) to require higher down payments and higher mortgage interest rates, or (ii) simply not to loan to certain borrowers with riskier credit profiles." See pages 6-7 of the brief.

What is interesting is that this Court's decisions have "made clear that federal control shields national banking from unduly burdensome and duplicative state regulation." Yet, this decision would do the very opposite by exposing banks to differing mortgage escrow laws as to pricing and other terms, as each of the fifty states may choose to assert them.

III. Review is warranted to correct the 9th Circuit's erroneous holding that the TILA amendment overrides NBA preemption.

The 9th Circuit held that the TILA amendment expressed congressional intent to eliminate NBA preemption as to all state laws concerning mortgage escrow account rates. A finding of implicit congressional override of NBA preemptions is strongly disfavored.[2]

The 9th Circuit erred by holding that the amendment to TILA[3]—which made no "express" mention of national banks or preemption— nonetheless demonstrated Congress's intent to allow States to force national banks to pay certain interest rates on mortgage escrow accounts. The brief provides at least four reasons as why the 9th Circuit's reading of the TILA amendment is incorrect.

We will continue to monitor any new development and will inform members of the Supreme Court's decision. If you have any questions, please contact Justin Wiseman at JWiseman@mba.org or Alisha Sears at asears@mba.org.

[2] See *Barnett Bank of Marion County, N.A. v. Nelson* on the standard for NBA preemption. *Barnett's* threshold turns on whether state regulation exerts "control" over a national bank's exercise of its powers granted by the federal government, and not on the magnitude of control.

[3] The amendment of TILA reads: Applicability of payment of interest. If prescribed by applicable State or Federal law, each creditor shall pay interest to the consumer on the amount held in any impound, trust, or escrow account that is subject to this section in the manner as prescribed by that applicable State or Federal law.