No. 22-529

IN THE
Supreme Court of the United States

ALEX CANTERO, ET AL., INDIVIDUALLY AND ON BEHALF OF ALL OTHERS SIMILARLY SITUATED,
Petitioners,

v.

BANK OF AMERICA, N.A.,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF FOR FLAGSTAR BANK, N.A. AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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INTEREST OF *AMICUS CURIAE**

Flagstar Bank, N.A., is a federally chartered national bank that originates, purchases, sells, and services mortgage loans in all 50 States. Flagstar is also the petitioner in *Flagstar Bank, N.A. v. Kivett*, No. 22-349, which is being held for the decision here. Flagstar's petition seeks review of the Ninth Circuit's decision holding that California Civil Code § 2954.8(a)—which requires banks to pay at least 2% interest on funds held in mortgage escrow accounts—is not preempted as to federally chartered banks. Under that incorrect ruling, Flagstar is subject to a $9 million judgment and a permanent injunction requiring it to pay interest on escrow to its California customers going forward.

INTRODUCTION

Petitioners, joined by respondents in the parallel *Flagstar* petition, advocate for an unprecedented approach to National Bank Act (NBA) preemption that would upend the dual banking system Congress carefully designed. In doing so, they ignore the critical role that mortgage escrow accounts play in stabilizing the mortgage market and protecting borrowers and lenders, as well as the significant economic repercussions

* Under Rule 37.6, no counsel for a party has authored this brief in whole or in part, and no person other than *amicus curiae*, its members, or its counsel made a monetary contribution to fund the preparation or submission of this brief. Although one undersigned attorney appeared on the brief for respondent in the court of appeals, that attorney is not counsel for any party here.

that subjecting national banks to state interest-on-escrow laws would have for all market participants.

Petitioners and their amici characterize mortgage escrow accounts as interest-free loans to lenders. In truth, escrow accounts offer borrowers significant benefits at no cost, despite the administrative burden they present to lenders, and are essential to lenders' ability to offer mortgage loans on the most competitive terms. Simple economics dictate that requiring national banks to comply with a patchwork of state interest-on-escrow laws would significantly impact banking operations in ways that would ultimately reduce competition and raise costs across the board. In that scenario, it is consumers who would suffer the most.

For these reasons, and those convincingly set out by respondent, the Court should reject petitioners' and the government's novel and costly approach to NBA preemption, and affirm the decision below.

SUMMARY OF ARGUMENT

I. Mortgage escrow accounts are a central part of the mortgage lending and servicing that federally chartered banks perform in exercising their powers under the NBA. These accounts serve both borrowers and lenders by reducing the risks of foreclosure and property loss, while also providing borrowers stability and relieving them of the burden of tracking and paying taxes and other expenses themselves.

II. The Real Estate Settlement Procedures Act (RESPA) extensively regulates the terms on which

federally chartered banks can operate mortgage escrow accounts. Although RESPA regulates how much federally chartered institutions may collect or hold in escrow, it does not require those institutions to pay interest on those funds.

III. If federally chartered banks were required to comply with state interest-on-escrow laws, their operations would be affected in ways that would ultimately harm consumers.

Federally chartered banks participate in the primary and secondary mortgage markets by originating, reselling and purchasing, and servicing or subservicing mortgage loans. Mandatory compliance with state interest-on-escrow laws would impact each of these activities. Such a regime would make it more costly to originate and to service mortgage loans and make both the loans and their servicing rights less desirable on the secondary market. When, as a result, federally chartered institutions are unable to extend as much credit to consumers or do so only on less attractive terms, it will be consumers that suffer from higher costs and fewer options in the mortgage market.

These harms cannot be dismissed by pointing to the fact that some national banks voluntarily comply with state interest-on-escrow laws, while state-chartered banks are required to do so. Federally chartered banks come in different shapes and sizes—just as state interest-on-escrow laws do—and the assessment will differ for each as to how paying interest on escrow in a particular amount in a particular State might impact the exercise of their federal banking powers. Federally chartered banks should maintain

the ability to make that assessment for themselves, consistent with federal law and regulations, rather than be lumped in with state-chartered banks. Only by doing so can they continue to offer consumers competitive products in the dual banking system that Congress intended when it enacted the NBA.

IV. In their amicus brief supporting petitioners here, the *Flagstar* respondents advocate for some kind of factbound, "practical" approach to NBA preemption that they assert was applied by the lower courts in *Flagstar*. They are wrong on the law and the record. No one, including the *Cantero* petitioners and the government, has articulated what exactly that standard would look like or how it would operate.

Nor did the lower courts in *Flagstar* apply any preemption standard that examined the factual degree to which state interest-on-escrow laws might impact Flagstar's (or any other national bank's) exercise of national bank powers. Contrary to the *Flagstar* respondents' assertion, the lower courts did not find a lack of significant interference based on any factual record. Instead, the trial court and Ninth Circuit both held that state interest-on-escrow laws were not preempted based on a view that the plaintiffs in both *Flagstar* and *Cantero* once advanced but have now abandoned: that Congress decided such laws are not preempted when it enacted the Truth in Lending Act (TILA)'s Section 1639d(g)(3) requiring compliance with "applicable" state interest-on-escrow laws as to certain escrow accounts. No court has adopted or applied the inadequately articulated and legally incorrect standard the *Flagstar* respondents and *Cantero* petitioners now propose. This Court should not either.

ARGUMENT

I. Mortgage Escrow Accounts are a Critical Risk-Mitigation Tool that Benefit Both Mortgage Lenders and Borrowers.

Most residential mortgages originated and serviced by federally chartered banks include a mortgage escrow account. *See, e.g.*, FHFA & CFPB, *A Profile of 2016 Mortgage Borrowers: Statistics from the National Survey of Mortgage Originations* 1, 27, 30 (2018) (around 79% of mortgages originated in 2016 included a mortgage escrow account). With good reason. These accounts play a central role in offsetting the administrative burdens of and the risks attendant to mortgage lending and thereby provide stability and certainty to borrowers and lenders alike.

Mortgage escrow accounts ensure that taxes, insurance, and other charges relevant to a mortgaged property are paid. To operate the account, the lender collects money from the borrower that will fund the amounts the borrower will periodically owe in property taxes, insurance premiums, and other charges related to the property. Typically, the lender makes a yearly estimate of the total amount that will be owed, and the borrower pays one-twelfth of that amount with each mortgage payment she makes to maintain what the lender has determined (consistent with applicable laws and regulations) is the appropriate minimum balance for the escrow account. The lender deposits the escrow portion of the mortgage payment into the escrow account and then uses the escrowed funds to directly pay the borrower's taxes, insurance

premiums, and other charges (such as mortgage insurance) when due. Each year, the lender re-assesses the amounts needed to fund the escrow account and will refund any excess funds held or collect additional funds to address any shortage.

By ensuring that relevant charges are timely and fully paid, this system avoids problems like tax liens on a property, lapses in insurance coverage, or default on the mortgage loan (which can result from failure to pay taxes or maintain insurance). And although the lender incurs administrative costs to operate the mortgage escrow account in this manner—and can be liable for any penalties for missed or late payments—there is generally no charge to the borrower for this service.

For borrowers, a mortgage escrow account thus provides stability and simplicity in their housing. The account eliminates the obligation she would otherwise carry to budget for and manage her own taxes and insurance payments. *See* CFPB, *What is an escrow or impound account?*, https://bit.ly/CFPBescrow ("An escrow account makes it easier to budget for your large property-related bills by paying small amounts with each mortgage payment."). It reduces her risk of default. And it lessens the risks of (1) foreclosure for failure to pay property taxes and (2) property loss for failure to pay insurance premiums. *See id.*; Decl. of S. Mansell ¶ 15, *Smith v. Flagstar Bank, FSB*, 3:18-cv-5131, ECF No. 125-1 (N.D. Cal. filed Dec. 5, 2019) ("Mansell Decl."). Borrowers also benefit more broadly from the lower interest rates and greater credit that the lender can offer consumers because of these reduced risks of default, foreclosure, or property loss. *Id.* ¶ 16.

For lenders, mortgage escrow accounts protect the lender's investment in the mortgaged property by preventing uninsured property loss and tax liens. After all, if insurance ever lapsed, any property loss would harm the lender, as well as the borrower, by diminishing or eliminating the property's value as collateral. Bruce E. Foote, Cong. Rsch. Serv., *Mortgage Escrow Accounts* 1 (1998). And a tax lien would take priority over the mortgage lien, thereby reducing a lender's recovery in case of any defaults. *Id.*

In sum, mortgage escrow accounts form a critical part of federally chartered banks' mortgage lending—one that ensures borrowers stay current on their obligations, retain their property, and enjoy an array of lending options at competitive interest rates.

II. RESPA Regulates Mortgage Escrow Accounts at the Federal Level.

Federally chartered banks' operation of mortgage escrow accounts is extensively regulated by the Real Estate Settlement Procedures Act of 1974 ("RESPA"), 12 U.S.C. § 2601 *et seq.*, and the CFPB's implementing regulation, "Regulation X," 12 C.F.R. § 1024.17. RESPA's provisions, along with those of Regulation X, reflect the various protections borrowers enjoy with respect to these accounts. These provisions are meant to ensure that consumers in the mortgage market are fully and timely informed about mortgage settlement costs, including those involved in escrow accounts. 12 U.S.C. § 2601(a). And they are "designed to help borrowers deposit the correct amount of escrow funds into the escrow account, and to avoid instances of over or

under contributing to the escrow account." *In re Pope*, 647 B.R. 597, 608 (Bankr. D.N.H. 2022).

Consistent with these aims, RESPA and Regulation X limit the maximum balance that federally chartered banks can hold in escrow or require borrowers to pay into mortgage escrow accounts. *See* 12 U.S.C. § 2609; *see Allison v. Liberty Sav.*, 535 F. Supp. 828, 830 (N.D. Ill. 1982), *aff'd*, 695 F.2d 1086 (7th Cir. 1982) (this provision "was intended to benefit primarily, if not solely, persons . . . who borrow funds under federally-related mortgage loans" and "places an obligation upon lenders that runs directly in favor of borrowers"). Mortgage lenders and loan servicers must conduct an "escrow account analysis" (using a specified "aggregate accounting method") upon opening the account and annually thereafter to determine how much the borrower must deposit into the account and whether any surplus, shortage, or deficiency exists. 12 C.F.R. § 1024.17(c)(2)-(4), (d). Lenders cannot require borrowers to deposit funds into escrow that exceed (1) the total amount of estimated annual charges for taxes, insurance, or other related charges, plus (2) a small "cushion" that does not exceed one-sixth of the estimated total amount of annual payments. 12 U.S.C. § 2609(a); *see* 12 C.F.R. § 1024.17(c)(1), (5).

The law also requires lenders to make timely payments from escrow accounts when charges become due and to promptly return (within 20 business days) any escrowed funds after a mortgage is paid off. 12 U.S.C. § 2605(g). In the same vein, any surplus of more than $50 must be refunded to the borrower within 30 days of its discovery during an escrow account analysis. 12 C.F.R. § 1024.17(f)(2).

Last, RESPA and Regulation X require lenders to provide borrowers with statements and notifications about escrow account balances and charges, including notice of any shortage in the account and itemized statements reflecting the charges to be paid. 12 U.S.C. § 2609(b)-(c); 12 C.F.R. § 1024.17(g)-(j). Banks may not charge borrowers any fees for providing these statements, while failure to provide the required statements can subject lenders to civil penalties. 12 U.S.C. §§ 2609(d), 2610.

What RESPA does *not* do is require banks to pay interest on funds held in mortgage escrow accounts.

III. Requiring Federally Chartered Banks to Pay Interest on Mortgage Escrow Accounts Would Impact Those Banks' Operations in Ways That Will Harm Consumers.

If state laws are applied to require federally chartered banks to pay interest on mortgage escrow funds, those laws will impact federal banking operations in ways that will inflate interest rates and origination fees, reduce the amount of credit extended to borrowers, and even diminish lender participation in the market—all results that will harm consumers.

A. Federally Chartered Banks Originate, Resell, and Service Mortgage Loans.

Federally chartered banks participate in real estate lending in several ways.

First, federally chartered banks originate mortgage loans—meaning they underwrite, process, and

extend mortgage loans to consumers. In doing so, federally chartered banks determine the contractual terms and pricing on which a mortgage loan is offered to a consumer, including the amount of credit extended at what interest rate and the accompanying terms governing that extension of credit.

Second, federally chartered banks service mortgage loans, both loans they originated and those originated by others. If a federally chartered institution owns the servicing rights to a loan, it oversees the administrative aspects of a loan until the time the loan is paid off. This loan servicing includes collecting monthly payments, collecting and paying taxes and insurance (while managing associated escrow funds), remitting funds to the note holder, and addressing any delinquencies.

Third, federally chartered banks sell and purchase both mortgage loans and mortgage servicing rights (the contractual right to service an existing mortgage) on the secondary mortgage market, where loans and servicing rights are repackaged into securities and sold off by the institution that originated them. Participation in this secondary market is a critical aspect of federally chartered banks' business, especially because selling mortgage servicing rights enables these institutions to obtain the funds needed to make more mortgage loans. Decl. of C. Chang ¶ 6, *Smith v. Flagstar Bank, FSB*, 3:18-cv-5131, ECF No. 125-2 (N.D. Cal. filed Dec. 5, 2019) ("Chang Decl.").

Finally, federally chartered banks may also subservice loans originated and owned by other institutions. In this scenario, the institution does not own

the mortgage servicing rights; it simply performs administrative, compliance, and financial servicing activities on behalf of another entity in exchange for a fee from that entity.

B. Applying State Interest-on-Escrow Laws to Federally Chartered Banks Will Materially Impact Each of These Activities.

1. A requirement to comply with state interest-on-escrow laws would significantly affect how federally chartered banks originate, sell, and service mortgage loans.

First, when underwriting and originating a mortgage loan, federally chartered banks like Flagstar calculate the borrower's relative risk levels in part based on the bank's understanding of the risk reduction provided by an escrow account and the costs to the bank associated with maintaining one. Mansell Decl. ¶ 17. If those risks or costs increase, that change would impact federally chartered banks' willingness to originate mortgage loans and the terms they are willing and able to offer. *Id.* ¶¶ 18-19.

The interest rates that California Civil Code § 2954.8(a), New York General Obligations Law § 5-601, and other existing state interest-on-escrow laws would require banks to pay are significant (and, in New York's case, effectively uncapped). A 2% interest rate exceeds by many multiples the average interest rates paid on savings accounts and certificates of deposits during the operative class periods here. *See* Br. of Amici Curiae Bank Policy Institute et al., *Bank of Am., N.A. v. Lusnak*, No. 18-212, 2018 WL 4464737, at

*12 (Sept. 17, 2018) (noting that a 2% interest rate is "six times higher than the long-run average of .32% paid by FDIC-insured U.S. depository institutions on certificates of deposit[s]"); Fed. Deposit Ins. Corp., National Rate on Non-Jumbo Deposits (less than $100,000): 12 Month CD, available at https://fred.stlouisfed.org/series/CD12NRNJ.

Banks cannot merely absorb those costs without altering their offerings or operations. As a matter of simple economics, the considerable increase in costs that these laws would cause would alter how and whether federally chartered banks originate new loans and on what terms. They may also alter the risk assessment for a mortgage, if the increased cost leads an institution to decide against operating a mortgage escrow account at all for loans where it is not otherwise required. And these effects would be especially profound for smaller institutions. Mansell Decl. ¶ 20.

*Second***,** mandatory interest-on-escrow laws would impact federally chartered banks' activities on the secondary mortgage market and their servicing of mortgage loans. When deciding whether to purchase the servicing rights for a mortgage loan, participants in the secondary mortgage market consider whether a mortgage loan has or contractually authorizes a mortgage escrow account. Chang Decl. ¶ 4. The escrow account's existence and attendant costs, as well as any accompanying risk of loss, factor into those entities' pricing calculation and ultimate decision whether to purchase. *Id.* ¶ 5. If a mortgage loan has an escrow account on which mandatory interest must be paid, that loan and its servicing rights would be less marketable because of the higher costs it would impose.

Id. ¶ 7. The federally chartered bank that originated the loan would therefore have less success in reselling the loan or its servicing rights on the secondary market.

Third, this reduced demand for resold loans would have other ripple effects across federally chartered institutions. It could deplete federally chartered banks' liquidity, reduce their ability to issue credit, and increase their exposure to the effect of interest rate fluctuations. *Id.* ¶ 9. Any one of these challenges would then impact federally chartered banks' ability to offer competitive mortgage products to consumers. *Id.*

2. That some federally chartered institutions—generally the largest ones—may *voluntarily* comply with some state interest-on-escrow laws does not eliminate the tradeoffs involved or minimize the significant impact that *mandatory* compliance with the full patchwork of state interest-on-escrow laws would have on national banks. The *Flagstar* respondents are wrong to suggest otherwise. *See Flagstar* Respondents Amicus Br. 3-4.

Every federally chartered institution currently makes its own calculation of how paying interest on escrow would increase its costs and pricing in originating, servicing, or reselling mortgage loans, along with the impact on its ability to offer competitive products alongside its competitors. The institution then assesses how to balance such considerations in deciding whether to pay interest on funds held in escrow. This calculation is different for each federally chartered bank. It is especially different for smaller institutions like Flagstar that are federally chartered and operate

across all 50 States but do not approach the size of some other national banks. *See, e.g.*, Mansell Decl. ¶ 20. Even within a single institution's loan portfolio, the calculus may differ between States, depending on that State's particular interest-on-escrow law and other relevant considerations. Paying interest on escrow may make sense and be feasible in one State but not another, just as it may make sense for one federally chartered institution but not another.[1]

Such voluntary, case-specific compliance is worlds apart from the mandatory, uniform compliance that petitioners' position would require. Requiring federally chartered banks to comply with all state interest-on-escrow laws under all circumstances would deprive those institutions of the choice and flexibility to appropriately respond to market conditions.

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[1] Contrary to the *Flagstar* respondents' suggestion, Flagstar's compliance with state interest-on-escrow laws as to subserviced loans says nothing about the impact that mandatory compliance would have on Flagstar as to loans it itself originates or services. *Contra Flagstar* Respondents Amicus Br. 5. Companies for which Flagstar subservices mortgage loans have made their own assessment of whether and under what circumstances to pay interest on escrow. When Flagstar (or any other federally chartered bank) subservices those loans, it has not purchased or sold those loans, nor is it directly paying interest on escrow—it is simply carrying out the administrative tasks needed by the entity that originated or retains the loan. As the *Flagstar* respondents acknowledge, it is the owners of the servicing rights that actually pay the interest on the escrowed funds. *Flagstar* Respondents Amicus Br. 5.

C. Applying State Interest-on-Escrow Laws to Federally Chartered Banks Will Harm Consumers.

Ultimately, the most detrimental effects of a mandatory interest-on-escrow regime would not be felt by federally chartered institutions, but by consumers.

1. With mandatory interest-on-escrow compliance, consumers in the mortgage market would likely face higher costs with less available credit and fewer product options.

These issues would begin at loan origination. Given the increased costs of operating escrow accounts if federally chartered banks must pay interest on escrow funds, those institutions would be forced to charge higher interest rates, assess larger origination fees, or extend less credit to consumers when originating mortgage loans. Mansell Decl. ¶¶ 18-19. Consumers would thus have more difficulty obtaining mortgage loans or might be able to obtain loans only at higher interest rates and prices.

In the same vein, if federally chartered institutions prove unable to sell mortgage servicing rights or are hampered in their ability to do so because of the increased costs of escrow accounts, they would struggle to generate the funds required to make new mortgage loans. Chang Decl. ¶ 6. With less funds to originate loans, these institutions would have to cut the amount of credit they could extend to borrowers and increase the costs imposed on borrowers when they did extend credit. *Id.* ¶ 7.

On the whole, because federally chartered banks would be less able to effectively compete in the primary and secondary mortgage markets, they would be constrained in their ability to offer consumers a competitive array of options for mortgage loan products.

2. It is no answer to these problems that state-chartered banks are already subject to state interest-on-escrow laws. Indeed, those state-chartered banks' existence further reflects how petitioners' approach would produce only consumer harm without any meaningful countervailing benefit. The dual banking system is designed to create a competitive regulatory system in which the federal and state systems can address trade-offs of regulations in different ways, and consumers can choose to participate in either system based on how those trade-offs affect the costs and options available. Petitioners' approach would deprive consumers of that choice and diminish the competition the dual banking system promotes.

IV. The *Flagstar* Litigation Does Not Show the Workability or Fairness of Petitioners' Factbound Approach.

Finally, the Court should find no comfort in the *Flagstar* respondents' assertion that "the *Flagstar* litigation illustrates" that petitioners' and the government's standard for preemption is "workable and fair." *Flagstar* Respondents Amicus Br. 8 (capitalization omitted). Contrary to their contention, neither the district court nor the Ninth Circuit in *Flagstar* applied a factbound preemption standard nor denied the real-world impact of state interest-on-escrow laws on Flagstar or other banks. In fact, the *Flagstar* respondents

previously admitted as much in their brief on appeal, where they expressly stated that "the district court never reached the factual issues" surrounding interference with Flagstar's operations. Answering Br. of Pltfs.-Appellees at 16, *Kivett v. Flagstar Bank, FSB*, No. 21-15667 (filed Nov. 22, 2021) (*Flagstar* Answering Br.).

Instead, both the district court and Ninth Circuit resolved the preemption question by summarily adhering to the Ninth Circuit's previous decision in *Lusnak v. Bank of America, N.A.*, 883 F.3d 1185 (9th Cir. 2018). There, the Ninth Circuit took a view that the *Flagstar* respondents and *Cantero* petitioners have since abandoned and no party before the Court advances: namely, that TILA's Section 1639d(g)(3) reflects Congress's view that state interest-on-escrow laws do not prevent or significantly interfere with the exercise of national bank powers. *See id.* at 1194-97. In *Flagstar*, the district court and the Ninth Circuit both concluded that "*Lusnak* applie[d]" without any analysis of the factual record before them. *Flagstar* Pet. App. 26 (district court; *see id.* at 3).

To be sure, Flagstar sought to distinguish *Lusnak* by providing extensive and unrebutted evidence of how, as a factual matter, state interest-on-escrow laws would impact its operations.[2] But neither the district

[2] And the *Flagstar* respondents misrepresent that evidence when they assert that Flagstar employees could not testify about any impact that compliance with state interest-on-escrow laws would have on Flagstar's business. *Flagstar* Respondents Amicus Br. 5. To the contrary: multiple Flagstar witnesses provided evi-

court nor Ninth Circuit considered those facts. Instead, the district court held that "*Lusnak* applie[d] to the claim in this case," and none of Flagstar's proposed "exceptions" to *Lusnak*'s categorical preemption rule were "persuasive." *Flagstar* Pet. App. 26. The Ninth Circuit similarly reasoned that "*Lusnak*'s language is unqualified: 'no legal authority establishes that state [interest-on-escrows] laws prevent or significantly interfere with the exercise of national bank powers, and Congress itself, in enacting [TILA's Section 1639d(g)(3)], has indicated that they do not.'" *Id.* at 3 (quoting *Lusnak*, 883 F.3d at 1197). And throughout, the *Flagstar* respondents advocated for exactly this approach, asserting that *Lusnak* "addressed a question of law without recognizing (or remotely suggesting) any fact-based exceptions to its holding." *Flagstar* Answering Br. at 21.

Given their reliance on *Lusnak*'s rule—which did not involve any factual inquiry—the lower courts in *Flagstar* made no "practical" assessment of significant interference with banking powers. *Flagstar* thus provides no insight into how such an inquiry might be made or how it would play out in any case. It certainly does not show that Flagstar was "unable" to "make an evidentiary showing of any significant interference"

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dence of the potential impacts on Flagstar's mortgage lending operations. *See generally* Chang Decl.; Mansell Decl. The testimony respondents cite from one of those witness's depositions reflects only that he testified (1) that he could not opine definitively on whether Flagstar would stop offering escrow accounts because he would not be the person making that business decision, and (2) that he simply "[did not] know" as a certainty whether compliance would otherwise affect Flagstar's loan servicing business specifically. *Flagstar* SER-91–92.

under petitioners' standard. *Contra Flagstar* Respondents Amicus Br. 8. Instead, the *Flagstar* proceedings underscore that no lower court has adopted or applied the ill-defined (and incorrect) preemption approach for which petitioners now advocate.

CONCLUSION

For the foregoing reasons, this Court should affirm.

Respectfully submitted,

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