

Federal Court Holds that National Banks are not Preempted from New York Requirement to Pay Interest on Mortgage Escrow Accounts

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A federal court in New York has held that a national bank must comply with a New York State law requiring mortgage lenders to pay interest on certain residential mortgage escrow accounts despite the arguments of the lender and the Office of the Comptroller of the Currency (OCC) that such law is preempted as to national banks. Although the New York case is consistent with a federal appeals court ruling in California last year, there had been hope that the California case would be an outlier and other federal courts would uphold the long-held preemption argument. This new case, although subject to appeal by the lender, significantly impacts that hope.

The opinion in the class-action lawsuit, *Hymes v. Bank of America*, No. 18-CV-2352 (RRM) (ARL), 2019 WL 4888123 (E.D.N.Y. Sept. 30, 2019), generally follows the same analysis of the 9th Circuit Federal Court of Appeals in the case of *Lusnak v. Bank of America*, No. 14-56755, 2018 WL 1122298 (9th Cir. Mar. 2, 2018), which was the subject of a [prior Cullen and Dykman LLP advisory](#). The New York court found that federal statutes show “a clear congressional purpose to subject *all* mortgage lenders to state escrow interest laws.” The court acknowledged that the OCC, the primary regulator of national banks and federal savings associations, has a regulation specifically stating that state laws regulating escrow accounts are preempted. Nonetheless, the court determined that the OCC’s position did not properly reflect the current state of preemption analysis.

As a result of this case, federally-chartered institutions that have not been paying interest on mortgage escrow accounts based on preemption should reconsider that position. New York General Obligations Law § 5-601 requires that any mortgage investing institution which maintains a mortgage escrow account on any one to six family residence occupied by the owner or on any property owned by a cooperative apartment corporation must, for each quarterly period in which such escrow account is established, provide a minimum rate of interest on such accounts at a rate of no less than two percent per year.

In 2018 the New York State Department of Financial Services (“DFS”) provided New York chartered institutions some relief from the requirement to pay a minimum two percent interest rate on mortgage escrow accounts. On January 19, 2018, Maria T. Vullo, Superintendent of DFS, issued an [Order](#) under Section 12-a of the New York State Banking Law changing the standard for the interest rate that must be paid by certain mortgage investing institutions on escrow accounts. The Order sets the minimum rate of interest to be paid by New York-chartered banks, private bankers, trust companies, savings banks, savings and loan associations and credit unions on

escrow accounts in connection with loans secured by mortgages during any calendar quarter at least equal to the *lesser of two percent or the six-month yield on United States Treasury securities on the last business day of the immediately preceding calendar quarter.*

The basis for this “wild card” Order was the belief, at the time of the Order, that federally-chartered institutions were not subject to the payment of interest on mortgage escrow accounts based on preemption and OCC regulations. The Order was intended to ease the financial burden arising from the lack of parity for state-chartered institutions. An interesting issue now, in light of the recent New York federal court ruling that General Obligations Law Section 5-601 is not preempted, is whether federally-chartered institutions can take advantage of the lower interest rate that the DFS Order has permitted for state-chartered institutions specifically.

We will continue to monitor developments on this issue. If you have any questions regarding this case or federal preemption issues for federally-chartered institutions in general, please feel free to contact Joseph D. Simon at (516) 357-3710 or via email at jsimon@cullenanddykman.com, Kevin Patterson at (516) 296-9196 or via email at kpatterson@cullenanddykman.com, Elizabeth A. Murphy at (516) 296-9154 or via email at emurphy@cullenanddykman.com, or Mandy Xu at (516) 357-3850 or via email at mxu@cullenanddykman.com.

Practices

- Banking and Financial Services

Attorneys

- Elizabeth A. Murphy
- Joseph D. Simon