No. 19-80030

In the

United States Court of Appeals for the Ninth Circuit

SUSAN McSHANNOCK, as Executrix of the Estate of Patricia Blaskower, on behalf of the Estate of Patricia Blaskower and all other similarly situated *et al.*,

Plaintiffs-Respondents,

v.

JPMORGAN CHASE BANK, N.A., dba Chase Bank

Defendant-Petitioner.

On Appeal from the United States District Court
for the Northern District of California
(The Honorable Edward M. Chen)
Case No. 3:18-cv-01873

BRIEF OF *AMICUS CURIAE* THE BANK POLICY INSTITUTE IN SUPPORT OF DEFENDANT-PETITIONER'S PETITION FOR PERMISSION TO APPEAL UNDER 28 U.S.C. § 1292(b)

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Pursuant to Federal Rule of Appellate Procedure 26.1, The Bank Policy Institute ("BPI") states that it is not a subsidiary of any other corporation. BPI is a non-profit trade group and has no shares or securities that are publicly traded.*

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* Under Federal Rule of Appellate Procedure 29(a)(4)(E), BPI states: (1) neither party's counsel authored the brief in whole or in part; (2) neither party nor their counsel contributed money that was intended to fund the preparation or submission of this brief; and (3) no person other than BPI, its members, or its counsel contributed money that was intended to fund the preparation or submission of this brief. Under Circuit Rule 29-2(a), each party to this action, by counsel, has consented to the filing of this *amicus* brief.

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STATEMENT OF INTEREST OF *AMICUS CURIAE*

BPI is a nonpartisan policy, research, and advocacy group. BPI's members include universal, regional, and foreign banks that routinely originate, purchase, and sell loans in the United States. BPI has an interest in this case, because the uncertainty over the applicability of federal preemption to loans originated by federal savings associations ("FSAs") after those loans are sold into the secondary market (i) exposes many of BPI's members to the significant uncertainty of which law applies to the terms and pricing of those loans, (ii) discourages BPI's members from purchasing those loans, and (iii) thus substantially interferes with BPI's members' ability to conduct the business of banking in a safe and sound manner under a national regulatory system. None of BPI's members is an FSA.

INTRODUCTION

Whether the Home Owners' Loan Act ("HOLA") preempts state laws regulating the terms and prices of FSA-originated loans that are sold to non-FSAs is a critical question affecting the U.S. mortgage market. Unfortunately, the district courts in the Ninth Circuit have split substantially on this question, thereby fueling uncertainty, imposing meaningful burdens on the everyday operations of FSAs and other market participants, and risking harm to consumers, especially those with lower credit scores. The courts' divide also undermines the very predictability and uniformity that HOLA was intended to guarantee by "enabl[ing]

[FSAs] to deliver low-cost credit to the public free from undue regulatory duplication and burden." Lending and Investment, 61 Fed. Reg. 50,951, 50,965 (Sept. 30, 1996). The frequent recurrence of this question over the past seven years and its significance to the efficient functioning of the loan market merit its resolution by this Court. Appellate review is also warranted here because the district court's decision is incorrect and should be reversed. Accordingly, this Court should grant the petition of JPMorgan Chase Bank, N.A. ("Chase") for interlocutory appeal.

ARGUMENT

I. PERMISSION TO APPEAL SHOULD BE GRANTED, BECAUSE THE CURRENT UNCERTAINTY REGARDING HOLA PREEMPTION IN THE SECONDARY FSA LOAN MARKET HARMS FSAS, OTHER MARKET PARTICIPANTS, AND CONSUMERS.

A. Loans originated by FSAs are critical to the U.S. lending industry.

There are currently 308 FSAs operating in the United States, including 21 headquartered in the Ninth Circuit.[1] As of December 31, 2018, FSAs

[1] *Institution Directory Report—Insured Savings Institutions with Federal Charter*, FDIC, https://www5.fdic.gov/idasp (accessed Mar. 14, 2019).

held assets of over $768 billion and net loans and lease financings of over $352 billion, including real estate loans of over $192 billion.[2]

After origination, the vast majority of loans originated by FSAs are sold into the secondary market, and many are thereafter pooled and securitized. *See Escuadro* v. *JPMorgan Chase Bank, N.A.*, 2012 WL 10423223, at *3 (C.D. Cal. June 4, 2012) ("The securitization and pooling of mortgages is an exceedingly common . . . practice."). As the U.S. Supreme Court has recognized, "[t]he marketability of a mortgage in the secondary market is critical to [FSAs], for [they] thereby can sell mortgages to obtain funds to make additional home loans." *Fidelity Fed. Sav. & Loan Ass'n* v. *de la Cuesta*, 458 U.S. 141, 155 n.10 (1982).

Data made available pursuant to the Home Mortgage Disclosure Act of 1975 confirms "the importance of the secondary market for home loans."[3] For example, approximately 85.5% of home-purchase loans and 84% of refinance loans originated in the first three quarters of 2016 were sold into the secondary

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[2] *Statistics on Depository Institutions Report—Total Assets and Net Loans and Leases*, FDIC (December 31, 2018), https://www5.fdic.gov/sdi/main.asp?formname=customddownload (data for 310 FSAs).

[3] Robert A. Avery et al., *The 2009 HMDA Data: The Mortgage Market in a Time of Low Interest Rates and Economic Distress*, Fed. Reserve Bulletin, A39, A45 (Dec. 2010), https://www.federalreserve.gov/pubs/bulletin/2010/pdf/2009_HMDA_final.pdf.

market by year's end.[4] If the ability of FSAs to sell or securitize the loans they originate were impaired, FSAs would need to either reduce the number of loans they make, or make those loans on terms that are less favorable to borrowers.

B. There is a substantial split among district courts in the Ninth Circuit as to what law applies to FSA-originated loans after they are sold.

Over the past seven years, over a dozen district court decisions in this Circuit have considered whether HOLA preemption applies to an FSA-originated loan after it is sold to a non-FSA in the secondary market. *See McShannock* v. *JPMorgan Chase Bank, N.A.*, 354 F. Supp. 3d 1063, 1073–75 (N.D. Cal. 2018). Those decisions have variously concluded that (i) HOLA preemption applies; (ii) HOLA preemption does not apply; and (iii) HOLA preemption applies, but only with respect to claims arising from the conduct of the FSA before the sale. *Kenery* v. *Wells Fargo Bank, N.A.*, 2014 WL 129262, at *4 (N.D. Cal. Jan. 14, 2014). These competing decisions create meaningful legal and market uncertainty, and seemingly permit the vagaries of geography and individual judges to determine the validity of terms of FSA loans.

[4] Neil Bhutta et al., *Residential Mortgage Lending in 2016: Evidence from the Home Mortgage Disclosure Act Data*, Fed. Reserve Bulletin, Nov. 2017, at 22, https://www.federalreserve.gov/publications/files/2016_hmda.pdf.

C. The broad split among district courts in this Circuit means that holders of FSA-originated loans cannot know *a priori* what legal regime governs those loans.

The district court below held that, after an FSA loan is sold to a non-FSA, HOLA does not preempt California Civil Code § 2954.8, which requires borrowers to receive a designated rate of annual interest on certain mortgage escrow accounts. *See McShannock*, 354 F. Supp. 3d at 1077. But, given the split in authority among the district courts, secondary purchasers of loans originated by FSAs do not know whether there needs to be compliance with § 2954.8 *until they are sued and find out their particular judicial assignment*.

Moreover, the question of whether HOLA continues to preempt a state law after a loan is sold to a non-FSA is scarcely cabined to mortgage escrow accounts. It extends to numerous other state lending laws, including those governing the rate of interest a lender may charge, *see, e.g.*, CAL. CONST. art. XV, § 1 (limiting permissible interest rate), prepayment penalties, *see, e.g.*, Cal. Civ. Code § 2954.9(a)(2) (permitting prepayment penalties), and negative amortization, *see, e.g.*, Cal. Fin. Code § 4973(c) (prohibiting negative amortization), to name but a few.

Worse still, if HOLA preemption does not apply to FSA-originated loans after they are sold, the purchasers of those loans will need to determine *which* state law(s) applies to the particular loan or pool of loans they have

purchased—a daunting process. The California law at issue here provides a useful illustration. Even among those states that, like California, require a minimum interest rate be paid on escrow accounts, there is inconsistency as to both the mandated minimum rate and the circumstances in which the requirement applies. *See, e.g.*, Cal. Civ. Code § 2954.8 (2%, applicable to one- to four-family residences); Wis. Stat. § 138.051(5) (5.25%, applicable to all loans); N.Y. Gen. Oblig. Law § 5-602 (2%, applicable to one- to six-family owner-occupied residences and co-ops).

D. Uncertainty regarding the terms of FSA loans in the secondary mortgage market harms FSAs, other market participants, and consumers.

The present uncertainty concerning HOLA preemption significantly impairs the functioning of the FSA loan market. Unpredictability as to which laws will apply to an FSA loan post-sale makes valuing FSA loans more difficult and imposes substantial legal risks and transaction costs on market participants. As the Fifth Circuit has explained, "[l]egal uncertainty—which raises the specter of costly litigation in addition to an adverse result—is itself a factor that must be taken into account when appraising the fair market value of an . . . interest." *Adams* v. *United States*, 218 F.3d 383, 384 (2000).

More broadly, continued unpredictability will reduce the attractiveness of FSA-originated loans and depress the entire secondary FSA loan

market. Risk- and cost-conscious market participants are apt to view such loans disfavorably given the uncertain validity of their terms and the additional transaction costs they carry. *See Robishaw Eng'g Inc.* v. *United States*, 891 F. Supp. 1134, 1149 (E.D. Va. 1995) ("[A]ny 'cloud' or uncertainty about the enforceability of a legal right diminishes its market value."). As a result, market participants are less likely to purchase such loans, even on economically sensible terms. *See* John E. Calfee & Richard Craswell, *Some Effects of Uncertainty on Compliance with Legal Standards*, 70 Va. L. Rev. 965, 966 (1984) (one reaction to uncertainty about a legal standard is "'overcomplying,' that is, modifying [one's] behavior beyond the point that would be socially optimal").

This broader market reaction can also be expected to permeate the primary FSA lending market. As explained above, FSAs "rely on the secondary market to supply funding for the mortgages they originate."[5] A shrinking secondary market for FSA loans can therefore deplete FSAs' liquidity and reduce credit availability. Further, the normally "vast secondary market" for FSA loans "makes it much easier . . . to balance risks in . . . portfolios."[6] The curtailment of

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[5] Cong. Budget Off., Pub. No. 4021, *Fannie Mae, Freddie Mac, and the Federal Role in the Secondary Mortgage Market* 16 (2010).

[6] Joe F. Lassiter, III, *The Marketability of Loans Under Alabama Law Where the Original Loan Documents Were Lost, Destroyed or Stolen*, 53 Ala. L. Rev. 1289, 1291 (2002).

that secondary market is likely to (i) require FSAs to hold riskier loans, thus increasing their exposure; (ii) disincentivize FSAs from issuing further loans to higher-risk but otherwise qualified applicants; and/or (iii) require FSAs to make loans on terms less favorable to borrowers.

These anticipated effects on FSAs and their customers are not theoretical: they are entirely consistent with the effects that uncertainty concerning federal preemption has previously had on loan markets. Testifying before Congress in 2004 concerning preemption with respect to national banks, then-Comptroller of the Currency John D. Hawke, Jr. described how "continuing uncertainty" about federal preemption and "the applicability of State laws has . . . negatively affected national banks' ability to lend in certain markets and to access the secondary market."[7] This, in turn, he explained, "has the potential to adversely affect credit availability" and make loans unattractive in securitization pools, thereby requiring banks to "hold more of these loans to maturity" and "t[ying] up more of [their] capital," ultimately harming banks' ability "to originate or acquire other real estate loans."[8]

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[7] *Review of the National Bank Preemption Rules: Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs*, 108th Cong. 108–864 (2004).

[8] *Id.*

Likewise, in 2015, after the Second Circuit disrupted the consumer-lending industry by holding that the National Bank Act did not preempt New York usury laws as applied to loans originated by national banks and sold to non-national banks, *see Madden* v. *Midland Funding, LLC*, 786 F.3d 246 (2nd Cir. 2015), there was "significant uncertainty about the legal enforceability of a large volume of outstanding consumer loans" while a petition for a writ of *certiorari* laid pending.[9] This uncertainty had far-reaching effects on both consumers and the market. Lenders limited credit availability to higher-risk borrowers within the Second Circuit, and even those "borrowers who received loans received smaller loans than would be expected." *Madden* Study, at 702. These impacts also rippled into the secondary market for consumer loans, as "debt holders adjusted to increased legal risk by paying less for notes" in New York and Connecticut affected by the *Madden* decision. *Id.* at 709.

Absent this Court's prompt intervention, similar consequences can be expected in the FSA loan market, including harm to FSAs, their customers, and market participants.

[9] Colleen Honigsberg et al., *How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment*, 60 J. of Law & Econ. 673, 709 (Nov. 2017) ("*Madden* Study").

E. Uncertainty regarding the law governing FSA loans after they are sold discourages the acquisition of FSAs, including in times of financial crisis.

Uncertainty as to the applicability of HOLA preemption to FSA loans after they are sold to a non-FSA and the corresponding challenge of valuing such loans will also discourage banks and other non-FSAs from purchasing and assuming the assets of failed FSAs, as Chase did here at the federal government's request during the 2008 financial crisis.[10] Such "purchasing and assuming," or "P&A," agreements were crucial to recovery from both the savings and loans ("S&L") crisis in the 1980s and 1990s and the 2008 financial crisis. P&As were used to resolve 1,461 of 2,043 financial institution failures during the S&L crisis and 463 of 489 financial institution failures during the 2008 financial crisis, including the failures of hundreds of thrifts during the two crises.[11]

Minimizing fallout from FSA failures requires banks to execute P&As "with great speed, usually overnight, in order to preserve the going concern value of the failed bank." *Langley* v. *FDIC*, 484 U.S. 86, 91 (1987) (internal quotation marks omitted). Such "great speed" is impossible absent the ability to value

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[10] *JPMorgan Chase Acquires Banking Operations of Washington Mutual*, FDIC (Sept. 25, 2008), https://www.fdic.gov/news/news/press/2008/pr08085.html.

[11] *See Bank Failures & Assistance Data*, FDIC, https://banks.data.fdic.gov/explore/failures (1986–1995 data for S&L crisis; 2008–2013 data for 2008 financial crisis).

quickly and accurately the worth of a failed FSA's loans, a task heavily burdened by legal uncertainty as to the validity of the terms of those loans and the potential exposure of the purchaser to liability under varied state lending laws.

A reduced ability to resolve failed or failing FSAs through P&As would mean depletion of the federal Deposit Insurance Fund and, potentially, reduced confidence in the U.S. financial system.

II. THE DISTRICT COURT'S DECISION IS INCORRECT.

As explained in Chase's Petition, the district court's decision is incorrect and should be reversed. This Court should grant permission to appeal and make clear that HOLA preemption attaches to loans issued by FSAs and follows those loans in the secondary market, thereby guaranteeing the validity of their terms and safeguarding their economic value. Denying non-FSA purchasers of FSA loans the benefits of HOLA preemption is apt to have the same broad-ranging, negative effects on the FSA loan market as those caused by the present uncertainty regarding whether preemption applies. *See supra* Section I.

Curtailing HOLA preemption in the case of mortgage escrow accounts would also threaten to upend the basic "valid-when-made" doctrine, a bedrock rule that, if a contract is legal at the time it was formed, "no subsequent event" may invalidate its terms. *Tate* v. *Wellings*, 100 Eng. Rep. 716, 721 (K.B. 1790) (Buller, J.); *see also* Brief for the United States as *Amicus Curiae* at 8,

Midland Funding, LLC v. *Madden*, 136 S. Ct. 2505 (2016) (No. 15-610) (power conferred on national banks to originate loans without regard to other states' usury laws "carries with it the power to use the loans once originated for their usual commercial purposes, which include assignment of such loans to others"). To hold otherwise would mean that "a contract, wholly innocent in its origin, and binding and valid, upon every legal principle, [would be] rendered, at least, valueless, in the hands of the otherwise legal holder." *Nichols* v. *Fearson*, 32 U.S. 103, 110 (1833). Because the valid-when-made rule was "well established" in American jurisprudence by the time Congress enacted HOLA in 1933, Congress is presumed to have "legislated with an expectation that the principle will apply." *Astoria Fed. Sav. & Loan Ass'n* v. *Solimino*, 501 U.S. 104, 108 (1991). Under this doctrine, the terms of FSA loans cannot be invalidated by state laws purportedly rendered applicable only by the loans' lawful sale.

CONCLUSION

For the foregoing reasons, this Court should grant Chase's Petition for Permission to Appeal the district court's December 7, 2018 order.

March 15, 2019

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I hereby certify that a true and correct copy of the foregoing brief was filed electronically on March 15, 2019 and will therefore be served electronically on all counsel of record.

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CERTIFICATE OF COMPLIANCE

This document complies with the type-volume limit of Fed. R. App. P. 29(a)(5) because, excluding the parts of the document exempted by Fed. R. App. P. 32(f), this document contains 2,600 words. This document complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type-style requirements of Fed. R. App. P. 32(a)(6) because this document has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in 14-point Times New Roman.

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