No. 19-15899

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 others 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 THE BANK POLICY INSTITUTE, THE AMERICAN BANKERS ASSOCIATION, AND THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICI CURIAE* SUPPORTING DEFENDANT-PETITIONER AND REVERSAL

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rules of Appellate Procedure 29(a)(4)(A) and 26.1, the Bank Policy Institute ("BPI"), the American Bankers Association ("ABA"), and the Chamber of Commerce of the United States of America ("The Chamber"; together, "*Amici*") each states that it is not a subsidiary of any other corporation. *Amici* are non-profit trade groups and none has shares or securities that are publicly traded.*

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* Under Federal Rule of Appellate Procedure 29(a)(4)(E), *Amici* state: (i) no party's counsel authored this brief in whole or in part; (ii) no party or its counsel contributed money intended to fund the preparation or submission of this brief; and (iii) no person other than *Amici*, their members, or their counsel contributed money that was intended to fund the preparation or submission of this brief. Under Federal Rule of Appellate Procedure 29(a)(2), each party to this action, by counsel, has consented to the filing of this *amicus* brief.

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STATEMENT OF INTEREST OF *AMICI 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.

ABA is the voice of the nation's $17 trillion banking industry, which is comprised of small, regional, and large banks that together employ more than two million people, safeguard $13 trillion in deposits, and extend nearly $10 trillion in loans.

The Chamber is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country.

Amici have an interest in this case because the district court's decision that preemption by the Home Owners' Loan Act ("HOLA") of the application of certain state laws and regulations to loans originated by federal savings associations ("FSAs") terminates after such loans are sold into the secondary market: (i) upsets the long-settled expectations of *Amici*'s members regarding which laws apply to the terms and pricing of FSA-originated loans; (ii) discourages *Amici*'s members from purchasing such loans; (iii) harms *Amici*'s members by devaluing and impeding the securitization and marketability of such loans; and (iv) thus substantially interferes

with *Amici*'s members' ability to conduct the business of banking in a safe and sound manner under a national regulatory system.

INTRODUCTION

Over decades, under comprehensive federal government supervision, FSAs have originated trillions of dollars of loans to consumers, and then sold or securitized those loans to third parties on the understanding that HOLA shields those loans from state regulation throughout their lifecycle, regardless of who holds them. Indeed, federal regulators responsible for FSAs and the majority of district courts both inside and outside this Circuit have long opined that HOLA preemption applies to FSA-originated loans "regardless of whether the loans in question are sold by the [FSA] to a third party." FHLBB Op. General Counsel, 1985 FHLBB LEXIS 178, at *4, 5 (Aug. 13, 1985); *see Guzman* v. *Wells Fargo Bank, N.A.*, 2018 WL 6930764, at *11 n.7 (C.D. Cal. Sept. 19, 2018) (collecting cases). These regulatory and judicial authorities are buttressed by the fundamental principle of contract law—well known to the enactors of HOLA and vital to the efficient functioning of the market—that contracts valid when made will remain valid regardless of subsequent events, including the contracts' sale or assignment.

The district court's decision that HOLA does not preempt state laws regulating the terms and prices of FSA-originated loans after such loans are sold to non-FSAs is wrong on the law and upends long-settled expectations regarding the

scope of HOLA preemption and the validity of FSA-originated loans in the secondary market. If not corrected by this Court, the district court's decision will substantially harm FSAs, other market participants, and consumers in this Circuit.

The district court's decision rested, at least in part, not on a strictly legal analysis but on the erroneous assumption that, "[a]t most, non-preemption would make [FSA-originated] loans slightly less attractive to prospective buyers." *McShannock* v. *JP Morgan Chase Bank N.A.*, 354 F. Supp. 3d 1063, 1077 (N.D. Cal. 2018). In reality, if affirmed by this Court, the district court's decision will have broad-ranging effects on the primary and secondary FSA loan markets and will harm all participants therein, including consumers. If the decision below is affirmed, secondary market purchasers of FSA-originated loans (or securities backed by such loans) could suddenly find that the assets they purchased—valid when originated and valid when sold—are no longer valid or enforceable in their hands, or have diminished value. FSAs and prospective loan purchasers and underwriters will be required to conduct complicated and burdensome due diligence to ensure that the loans they hold, purchase, sell, and securitize comply with 50 different applicable state laws. The securitization of FSA-originated loans will be inhibited by cost and complexity. In addition, the stability of the market as a whole could suffer because, in times of financial crisis, financial institutions like Petitioner JPMorgan Chase Bank, N.A. ("Chase") will be reluctant to purchase and assume the liabilities of

failing FSAs because they will lack sufficient time to reliably value the FSA's assets. Ultimately, these compliance costs and risks will be passed on to consumers in the form of higher interest rates and reduced credit availability. Low-income consumers living in this Circuit are likely to bear the brunt of this fallout.

To avoid these harms and restore stability to the FSA loan market, this Court should reverse the district court's erroneous and misguided decision and make clear that HOLA preemption continues to apply to FSA-originated loans throughout their lifecycle, including after they are sold into the secondary market.

DISCUSSION

I. THE DECISION BELOW UPSETS LONG-SETTLED EXPECTATIONS CONCERNING THE WORKINGS OF THE MULTI-BILLION DOLLAR MARKET FOR FSA-ORIGINATED LOANS.

A. The secondary loan market is critical to FSAs and the availability of consumer credit.

There are currently 305 FSAs operating in the United States, including 21 headquartered in the Ninth Circuit.[1] FSAs provide consumers vital access to credit that supports economic growth, in particular home ownership, and sustains households through income fluctuations. Mortgages comprise a significant portion of the loans extended by FSAs, but FSAs also extend other important forms of credit,

[1] *Institution Directory Report – Insured Savings Institutions with Federal Charter*, Federal Deposit Insurance Corporation ("FDIC"), https://www5.fdic.gov/idasp (last visited August 2, 2019).

including consumer loans, student loans, and small business loans. As of March 31, 2019, FSAs held assets of over $773 billion and net loans and lease financings of over $354 billion, including real estate loans of over $197 billion.[2]

FSAs depend on the ability to sell or assign loans they originate to raise further money to support their lending operations. The vast majority of real-estate loans originated by FSAs are sold into the secondary market. Indeed, in 1970, Congress created the Federal Home Loan Mortgage Corporation (Freddie Mac) to "establish secondary markets for conventional mortgages," including, importantly, the many mortgages originated by FSAs. H.R. Rep. No. 91-1131, at 4 (1970); *see also* S. Rep. No. 91-761, at 1 (1970). If mortgages and other loans could not be resold by FSAs, or the ability to do so were restricted, FSAs would be required to reduce vastly the amount of credit they extend and/or increase the cost of borrowing.[3] 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).

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[2] *Download Data – Statistics on Depository Institutions (SDI)*, FDIC, https://www5.fdic.gov/sdi/main.asp?formname=customddownload (last visited August 2, 2019).

[3] FSAs are subject to "regulatory capital requirements" and therefore cannot lend if their assets/capital ratios exceed those requirements. 12 C.F.R. § 167.2.

Data made available pursuant to the Home Mortgage Disclosure Act of 1975 confirms "the importance of the secondary market for home loans."[4] Approximately 85.5% of all home-purchase loans and 84% of all refinance loans originated in the first three quarters of 2016 were sold into the secondary market by year's end.[5] The volume of outstanding FSA-originated loans and securities backed by such loans that are traded in the secondary market is thus predictably much greater than the approximately $197 billion in real estate loans currently held by FSAs.

In summary, because such a high percentage of mortgage loans is sold into the secondary market, the long-standing congressional doctrine of federal preemption for federally chartered financial institutions becomes a nullity if it is terminated by such sales. This is judicial negation of a congressional decision without a constitutional basis.

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[4] 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, A45 (Dec. 2010), https://www.federalreserve.gov/pubs/bulletin/2010/pdf/2009_HMDA_final.pdf.

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

B. Regulators and courts have long held that HOLA preemption continues to apply to FSA-originated loans after they are sold into the secondary market.

Given the importance of the secondary market to FSAs, federal regulators and courts have long held that HOLA preemption applies to FSA-originated loans after they are sold into the secondary market, because (i) FSAs' power to sell loans free from state regulation is essential to their ability to operate under a uniform, federal regulatory regime, and (ii) the ability to convey loans to non-FSAs on the same terms upon which they were originated is integral to FSAs' power to sell. Market participants have reasonably relied on these authorities.

HOLA empowered the Federal Home Loan Bank Board ("FHLBB") and its successor, the Office of Thrift Supervision ("OTS"), to regulate FSAs and "preempt conflicting state law." *Campidoglio LLC* v. *Wells Fargo & Co.*, 870 F.3d 963, 971 (9th Cir. 2017).[6] To ensure FSAs "would be governed by what the [federal agency]—not any particular State—deemed to be the 'best practices,'" *de la Cuesta*, 458 U.S. at 161-162, and to "give [FSAs] maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation" and "efficiently deliver[] low-cost credit to the public free from undue regulatory

[6] Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, on July 21, 2011, the functions and authority of OTS relating to FSAs were transferred to the Office of the Comptroller of the Currency ("OCC"). *See* 12 U.S.C. § 5412(b)(2)(B).

duplication and burden," FHLBB and then OTS "occupie[d] the entire field of lending regulation for [FSAs]," 12 C.F.R. § 560.2(a) (2018).[7] Since the 1930s, regulations promulgated by these agencies—which were "'so pervasive as to leave no room for state regulatory control,'" *Silvas* v. *E*Trade Mortg. Corp.*, 514 F.3d 1001, 1004 (9th Cir. 2008)—governed "the powers and operations of every [FSA] from its cradle to its corporate grave," *de la Cuesta*, 458 U.S. at 145.

FHLBB and OTS issued implementing regulations specifically empowering FSAs to sell mortgages without regard to state laws, *see* 12 C.F.R. § 560.2(b)(10) (2018), and consistently opined that HOLA preemption continues to apply to FSA-originated loans after they are sold to a non-FSA. In 1985, FHLBB determined that "state laws or regulations which would impose upon [FSAs] obligations to pay interest on escrow accounts other than those provided for in their loan contracts are preempted" as to FSA-originated loans "regardless of whether the loans in question are sold by the [FSA] to a third party, are being serviced by a third party, or whether the escrow deposits are held at [an FSA] while the loans have been sold in the secondary market." FHLBB Op. General Counsel, 1985 FHLBB LEXIS 178, at *4, 5 (Aug. 13, 1985). In 2003, OTS reaffirmed that, because the application of state laws to FSA-originated loans in the secondary market "might interfere with

[7] *See also* Lending and Investment, 61 Fed. Reg. 50,951, 50,965 (Sept. 30, 1996).

the ability of [FSAs] to sell mortgages that they originate under a uniform federal system," "loan terms should not change simply because an originator entitled to federal preemption may sell or assign a loan to an investor that is not entitled to federal preemption." OTS Opinion Letter, P-2003-5, 2003 WL 24040104, at *4 n.18 (July 22, 2003).

Courts have likewise recognized that the continued application of HOLA preemption to FSA-originated loans in the secondary market is necessary "'to allow [FSAs] themselves greater freedom from state interference.'" *Romero* v. *Wells Fargo Bank*, 2015 WL 12781210, at *4 (C.D. Cal. Dec. 22, 2015); *see also Planters' Bank* v. *Sharp*, 47 U.S. 301, 323 (1848) ("in discounting notes and managing its property in legitimate banking business, [a bank] must be able to assign or sell those notes"). The majority or totality of district courts in every Circuit to have considered this issue—including this Circuit,[8] as well as the First, Second, Fourth, Fifth, and Eighth Circuits[9]—have ruled that HOLA preempts state regulation

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[8] *See Guzman*, 2018 WL 6930764, at *11 n.7 (collecting cases).

[9] *See In re Thomas,* 476 B.R. 691, 698 (Bankr. D. Mass. 2012) ("CitiMortgage, Flagstar's assignee, is likewise protected" under HOLA.), *aff'd sub nom. Thomas* v. *CitiMortgage, Inc.*, 2013 WL 4786060 (D. Mass. Sept. 5, 2013); *Im* v. *Bayview Loan Servicing LLC*, 2018 WL 840088, at *7 (S.D.N.Y. Feb. 12, 2018) (accepting concession that "HOLA preemption followed the loan as it passed to different assignees"); *Jones* v. *Home Loan Inv.*, 718 F. Supp. 2d 728, 740-41 (S.D. W. Va. 2010) ("To the extent plaintiff's claims have been dismissed against Home Loan, the claims are consequently dismissed as against Home Loan's assignee, Citimortgage."); *Ayiba* v. *Wells Fargo Bank, N.A.*, 2011 WL 13248493, at *9 n.7

of FSA-originated loans even after such loans are sold or assigned to a third party. As the Southern District of Texas explained in a decision affirmed by the Fifth Circuit as "correct in all respects," even if a secondary purchaser "is not a Federal savings association, and is therefore not itself protected by HOLA," the purchased loan nevertheless remains subject to HOLA preemption if it "originated with" an FSA. *Ayiba*, 2011 WL 13248493, at *9 n.7, *aff'd* 497 F. App'x 434 (5th Cir. 2012).

C. For almost two hundred years, it has been well established that a valid loan cannot be rendered invalid by its sale or assignment to a third party.

Market participants' understanding that HOLA preemption continues to apply after FSA-originated loans are sold into the secondary market is independently rooted in the cardinal rule (centuries older than HOLA itself) that, where a contract was "valid when made," "no subsequent event"—including its transfer or assignment—may invalidate its terms. *Tate* v. *Wellings*, 100 Eng. Rep. 716, 721 (K.B. 1790) (Buller, J.); *see also In re Rent-Rite Superkegs W., Ltd.*, 2019 WL 2179688, at *15 (Bankr. D. Colo. May 20, 2019) (under "'valid-when-made' rule," non-usurious promissory note cannot "be transformed into a usurious promissory note by virtue of assignment"). Thus, a loan valid when made—"wholly

(S.D. Tex. Dec. 5, 2011), *aff'd*, 497 F. App'x 434 (5th Cir. 2012); *Bazil* v. *Wells Fargo Bank, N.A.*, 2011 WL 4442835, at *2 (D. Minn. Sept. 22, 2011) ("Bazil does not dispute that, because his loan was originated through Wachovia Mortgage, FSB, a federal savings bank, the provisions of HOLA apply to his loan.").

innocent in its origin, and binding and valid, upon every legal principle"—cannot by operation of state law be "rendered, at least, valueless, in the hands of the otherwise legal holder" the moment it is sold or assigned to a non-FSA. *Nichols* v. *Fearson*, 32 U.S. 103, 110 (1833). This bedrock rule of law predates the founding of the United States, *Tate*, 100 Eng. Rep. at 721, and therefore "courts may take it as given that Congress has legislated with an expectation that the principle will apply." *Astoria Fed. Sav. & Loan Ass'n* v. *Solimino*, 501 U.S. 104, 108 (1991).

The valid-when-made doctrine remains critical to the efficient functioning and stability of the secondary loan market. It is broadly relied upon by FSAs and other market participants because it enables them to buy, sell, and securitize FSA-originated and other loans without fear that those loans will, upon transfer, become subject to challenge—and, ultimately, invalidation—under state laws. As one court noted earlier this year, a "contrary legal standard would interfere with the proper functioning of [the market] and risks a myriad of problems," *Rent-Rite*, 2019 WL 2179688, at *15, because it would, in certain circumstances, effectively "prohibit—make uneconomic—the assignment or sale by [FSAs] of their commercial property to a secondary market." *LFG Nat. Capital, LLC* v. *Gary, Williams, Finney, Lewis, Watson, & Sperando P.L.*, 874 F. Supp. 2d 108, 125 (N.D.N.Y. 2012). The notion that a loan term would be applicable or interest rate valid if enforced directly by an FSA, but not if enforced by an FSA's assignee,

"makes little logical sense" and would defeat the reasonable expectations of market participants by permitting the validity of loans "to turn entirely on the vagaries of [their] current ownership." *Rent-Rite*, 2019 WL 2179688, at *16; *see also Olvera* v. *Blitt & Gaines, P.C.*, 431 F.3d 285, 287 (7th Cir. 2005) (higher interest rates permitted by state license enforceable even after assignment of loans to unlicensed third party because contrary view would lead to "senseless result"). Yet, the decision below holds just that.

II. THE DECISION BELOW SUBSTANTIALLY HARMS FSAS, OTHER MARKET PARTICIPANTS, AND CONSUMERS IN THIS CIRCUIT.

The district court misapprehended the substantial risks and adverse effects its decision will create. Because, according to the district court, "nothing in the record . . . suggest[ed] that requiring national banks to comply with state laws . . . would threaten the stability of the secondary mortgage loan market for federal savings associations," the district court assumed that, "[a]t most, non-preemption would make the loans slightly less attractive to prospective buyers." *McShannock*, 354 F. Supp. 3d at 1077. The district court—which made its decision without any evidence in the record and contrary to the considered views of the expert bank regulators at the FHLBB and OTS, *see supra* Part I.B—was grossly mistaken. In fact, if affirmed by this Court, the district court's decision will: (i) destabilize the secondary loan market for FSA-originated loans, significantly impede securitization, and harm all secondary mortgage market participants, *see infra* Section II.A;

(ii) adversely affect the primary FSA loan market and harm consumers, who will ultimately be made to bear increased transaction and compliance costs in the form of higher interest rates and/or decreased credit, *see infra* Section II.B; and (iii) imperil the safety and soundness of the market as a whole by discouraging banks and other non-FSAs from acquiring failing FSAs in times of crisis, *see infra* Section II.C. Should this Court affirm the district court's decision, it will be the only Court of Appeals to hold that HOLA preemption does not extend to FSA-originated loans sold into the secondary market. Market participants and consumers in this Circuit will therefore bear the brunt of this fallout.

A. The decision below destabilizes the secondary loan market for FSA-originated loans and harms all market participants.

The district court did not recognize that subjecting FSA-originated loans in the secondary market to patchwork regulation by 50 states would significantly complicate loan sales and impose meaningful burdens and costs on FSAs and other secondary market participants. Its decision is also likely to inhibit the securitization, hinder the marketability, and decrease the value of FSA-originated loans.

1. The decision below creates uncertainty, imposes substantial compliance costs, and impedes the securitization of FSA-originated loans.

Instead of loan purchasers being able to rely on FSAs to originate and sell HOLA-compliant loans, the decision below requires loan purchasers (except for

other FSAs) to conduct individual due diligence for countless aspects of the loans they acquire in order to determine whether they will in fact be able to collect on the original terms of those loans in light of applicable state laws.

The decision also impedes, and potentially prevents, securitization by introducing significant uncertainty and increasing costs. *See Pinter* v. *Dahl*, 486 U.S. 622, 652 (1988) (noting that the securities laws are "an area that demands certainty and predictability"). "The securitization and pooling of mortgages is an exceedingly common . . . practice," *Escuadro* v. *JPMorgan Chase Bank, N.A.*, 2012 WL 10423223, at *3 (C.D. Cal. June 4, 2012), because it makes originating loans less risky by "allow[ing] entities to more efficiently share risks," Adriana Z. Robertson, *Shadow Banking, Shadow Bailouts*, 43 Del. J. Corp. L. 459, 469 (2019). Securitization thereby "reduce[s] funding costs" and leads to lower interest rates for borrowers. *Id*. Securitization is essential if FSAs are to fulfill their mission to provide credit to consumers and the economy more broadly and to encourage home ownership, and the vast majority of mortgage loans made by FSAs are securitized.

Yet, under the decision below, FSA-originated loans could no longer be pooled together and securitized without regard to their state of origin because otherwise identical loans from different states could be subject to very different requirements. Underwriters will need to engage in a laborious and costly exercise to ensure that each loan in the pool being securitized complies with applicable state

laws, and will need to charge for these efforts. Moreover, all participants in the securitization process—from underwriters and investors to service providers—will need to charge more to account for the additional compliance risk they incur due to potential liability or invalidation of loans under state laws.

These costs and risks are no small burden. The district court here held that, after an FSA-originated loan is sold to a non-FSA, HOLA no longer preempts 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 the impact of the district court's decision is scarcely cabined to state laws requiring payment of interest on mortgage escrow accounts. The broader issue of whether HOLA preempts state regulation after a loan is sold to a non-FSA implicates 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.[10]

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[10] *See also, e.g.*, *Haehl* v. *Wash. Mut. Bank, F.A.*, 277 F. Supp. 2d 933, 940-42 (S.D. Ind. 2003) (state conveyance fees preempted by HOLA); *Lopez* v. *World Sav. & Loan Assn.*, 105 Cal. App. 4th 729, 733-45 (1st Dist. 2003) (HOLA preempts state law regulating fees for payoff demand statements); *Meyers* v. *Beverly Hills Fed. Sav. and Loan Ass'n*, 499 F.2d 1145 (9th Cir. 1974) (HOLA preempted field of prepayment penalties for mortgages); *U.S.* v. *State Tax Comm'n*, 481 F.2d 963 (1st Cir. 1973) (HOLA preempts state tax law on FSA deposits and income); *Akopyan* v.

Moreover, if HOLA preemption does not apply to FSA-originated loans after they are sold, the purchasers of those loans (or underwriters of securities referencing pools of those loans) will need to determine *which* state laws apply to the particular loan or pool of loans they have purchased. "Navigating the various [potentially applicable state] regulatory frameworks can be cumbersome—and costly—for firms that work in multiple states,"[11] yet such a determination would be critical given the substantial discrepancies among the numerous state laws relating to mortgage loans. For instance, different states have different statutory interest rate ceilings (often different ceilings depending on the type and amount of the loan) and different methodologies for calculating those rates.[12] The California law at issue here provides a useful illustration. Even among those states that, like California,

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Wells Fargo Home Mortgage, Inc., 155 Cal. Rptr. 3d 245, 255-66 (2013) (state law limiting late payment charges preempted by HOLA).

[11] The Pew Charitable Trusts, *How Can Regulators Promote Financial Innovation While Also Protecting Consumers?* 11 (August 2018), https://www.pewtrusts.org/-/media/assets/2018/08/financial-innovation_report.pdf; *cf.* Cong. Research Serv., RL34286, *Insurance Regulation: Federal Charter Legislation* 3 (2011) (federal regulation would enable insurers to "avoid higher costs of state regulation due to the need to comply with up to 50 state regulators").

[12] *Compare, e.g.*, Colo. Rev. Stat. § 5-12-103(1) (interest rate may not exceed 45% per year "when the rate of interest was calculated on the unpaid balances of the debt on the assumption that the debt is to be paid according to its terms and will not be paid before the end of the agreed term"), *with* Wis. Stat. § 138.05(1)(a) (interest rate may not exceed 12% "for one year computed upon the declining principal balance of the loan or forbearance"), *with* N.Y. Banking Law § 14-a (civil usury cap of 16% per year).

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). A prospective loan purchaser would plainly need to determine which of these laws apply to a loan before assessing the loan's validity. And a securitization typically involves hundreds (and sometimes thousands) of loans to borrowers residing in multiple states.

Determining which laws govern any single loan—much less the hundreds or thousands of loans in a securitization—can be a daunting and complex process. Relevant laws could include the law of the state in which the borrower resides, the state in which the loan was made, and/or the law chosen to govern the loan agreement. In *Rent-Rite*, for example, when the validity of the loan at issue "all [came] down to the applicable law," the U.S. Bankruptcy Court for the District of Colorado was required to engage in a "very complex and difficult choice of law analysis" to determine whether the parties' promissory note was governed by Colorado, Wisconsin, or federal law. *Rent-Rite*, 2019 WL 2179688, at *1. The district court's decision here would require secondary market participants to engage in a similarly burdensome analysis with respect to each FSA-originated loan they

hold, purchase, or underwrite, at great expense to themselves, other market participants, and—as discussed below, *see infra* Section II.B—consumers.

2. The decision below hinders the marketability and decreases the value of FSA-originated loans and loan securitizations.

The aforementioned transaction and compliance costs generated by the district court's decision are likely to constrict the availability of liquidity in the FSA loan and loan-backed securities markets. Market participants are likely to view FSA-originated loans and securities backed by such loans as having considerably less value than at present given the uncertain validity of their terms and the additional costs and risks they carry.[13] Although certain large and highly sophisticated market participants and underwriters may have the resources and motivation to due diligence each individual FSA-originated loan in a securitization to ensure compliance with all applicable state laws, many other market participants do not. In practice, this will impede the sale of FSA-originated loans and securities. Moreover, to the extent market participants do purchase such loans or interests in loan securitizations, they are likely to do so only at a discount to reflect the risk they take of receiving loans that are not collectible on their terms or are entirely invalid. *See*

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[13] *See* Ronald Coase, *The Problem of Social Cost*, 3 J.L. & Econ. 1, 15 (1960) (transaction costs, including cost of "inspection" and "so on," are "extremely costly, sufficiently costly at any rate to prevent transactions"); *accord Natl. City Bank, N.A.* v. *Prime Lending, Inc.*, 737 F. Supp. 2d 1257, 1262 (E.D. Wash. 2010) ("sluggish loan processing would drive away customers").

Adams v. *United States*, 218 F.3d 383, 384 (5th Cir. 2000) ("Legal 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.").

The effects of the district court's decision on FSA-originated loans that have already been sold to non-FSAs and/or pooled and securitized is no less meaningful. Many FSA-originated loans currently in the secondary market are not fully compliant with all potentially applicable state laws. Under the district court's decision, any entity that has purchased or sold such loans would face the risk that those prior transactions may be invalidated or become the subject of innumerable disputes, including lawsuits against purchasers for acting on loan agreements valid at origination and claims by purchasers against loan sellers seeking to recover for the loss in value of the loans they purchased. Furthermore, loans in debt pools underlying securities that have been valid for years may become subject to legal challenge under state laws, creating uncertainty as to the value of such securities and, at a minimum, making them more difficult to market. *See Robishaw Eng'g Inc.* v. *United States*, 891 F. Supp. 1134, 1149 (E.D. Va. 1995) ("uncertainty about the enforceability of a legal right diminishes its market value").

B. The decision below harms FSAs, the primary FSA loan market, and consumers by increasing the costs and limiting the availability of credit.

The damaging effects of the district court's decision will not be limited to the secondary loan market, contrary to what the district court seemed to believe. Rather, the decision's adverse effects will permeate the primary loan market, impose substantial compliance burdens on FSAs, and harm consumers.

As explained above, FSAs "rely on the secondary market to supply funding for the mortgages they originate."[14] The district court's decision will therefore require FSAs themselves to comply with state law requirements applicable to secondary-market purchasers so as to maintain the marketability of their loans—thus destroying HOLA's purpose of having national regulation of FSA loans. Moreover, a shrinking secondary market for FSA-originated loans will deplete FSAs' liquidity, reduce their ability to issue credit, and increase their exposure to the impact of interest rate fluctuations and credit cycles on portfolio loans, making it more difficult "to balance risks in . . . portfolios."[15]

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

[15] 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).

FSAs will be forced to compensate for these greater attendant risks and increased transaction and compliance costs by originating fewer loans to higher-risk but otherwise qualified applicants and/or imposing higher interest rates on the loans they still do originate. That could lead to significant negative effects for consumers, who may be unable to obtain loans, or able to obtain loans only at considerably higher rates. Indeed, scholars have long noted that "restrictions in credit markets hurt highest-risk borrowers the most." William F. Baxter, *Section 85 of the Nat'l Bank Act and Consumer Welfare*, 1995 Utah L. Rev. 1009, 1023 (1995).

The aftermath of the Second Circuit Court of Appeals' decision in *Madden* v. *Midland Funding, LLC* is instructive on the harmful effects the district court's decision is likely to have on both FSAs and consumers. In *Madden*, the Second Circuit held that the National Bank Act does not preempt the application of New York state usury laws to loans originated by national banks after those banks charge-off the debt and sell the entire account to a secondary purchaser. 786 F.3d 246 (2d Cir. 2015). On petition for a writ of *certiorari*, the Solicitor General and OCC submitted an *amicus curiae* brief on behalf of the United States asserting that "[t]he court of appeals' decision is incorrect."[16] Brief for the United States as *Amicus*

[16] Despite arguing that the Second Circuit's decision in *Madden* is incorrect, the Solicitor General and OCC recommended that *certiorari* be denied because, in their view, "there [was] no circuit split on the question presented; the parties did not present key aspects of the preemption analysis to the courts below; and petitioners may still prevail on remand despite the error in the court of appeals' interlocutory

Curiae, *Madden*, 2016 WL 2997343, at *6 ("Properly understood, a national bank's . . . authority [under the National Bank Act] to charge interest up to the maximum permitted by its home State encompasses the power to convey to an assignee the right to enforce the interest rate term of the agreement").[17]

Like the decision below, *Madden* did not directly affect the applicability of federal preemption to loans originated and held by the entities directly benefiting from such preemption (*i.e.*, national banks) before those loans were sold into the secondary market. Yet, empirical studies confirm that national banks in the Second Circuit nevertheless reacted to *Madden* by (i) changing their lending practices to align with state laws that do not otherwise apply to national banks under settled federal law and (ii) curtailing the size and volume of loans to low-income Americans. Colleen Honigsberg *et al.* found that lenders "restricted credit availability—measured by loan size and volume—after the [*Madden*] decision, with the largest impact being on higher-risk borrowers" who could not find

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decision." Brief for the United States as *Amicus Curiae*, *Midland Funding, LLC* v. *Madden*, 136 S. Ct. 2505 (2016), No. 15-610, 2016 WL 2997343, at *6.

[17] *See also Rent-Rite*, 2019 WL 2179688, at *14-17 & n.57 (reasoning that promissory note is enforceable "despite assignment" because preemption analysis focuses on originating entity, not assignee, and remarking that "the Court respectfully disagrees with *Madden*").

lower-cost credit in the market.[18] Loans to such borrowers are higher risk, default at higher rates, and therefore, to be commercially viable, must carry higher interest rates and fees that may be prohibited under certain state laws.[19] Among borrowers with FICO scores below 625, there was a 52% decline in the number of loans issued in the Second Circuit, despite a 124% increase outside the Second Circuit during the same period. Honigsberg *et al.* at 697. *Madden* also reduced loan sizes by an average of $400, with a greater reduction for borrowers with lower credit scores. *Id.* at 701.

Piotr Danisewicz and Ilaf Elard similarly found that *Madden* reduced credit access in the Second Circuit for low-income households. Following the decision, lending to households with income below $25,000 dropped 64% relative to the control group, while households with income above $100,000 were largely unaffected.[20] Danisewicz and Elard identified statistically significant drops in the

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[18] *How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment*, 60 J.L. & Econ. 673, 709 (2017).

[19] Subprime lending and the loosening of underwriting standards contributed to the 2008 financial crisis; however, Congress and federal regulators, consistent with these loans being governed by federal law, have taken myriad actions to reduce the consumer, safety and soundness, and financial stability risk of such loans. *See generally*, Baird Webel, Cong. Research Serv., R41350, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Background and Summary* (2017).

[20] Piotr Danisewicz & Ilaf Elard, *The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy*, at 28 (2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3208908.

volume of loans for debt refinancing (15%), small businesses (33%), and medical procedures (68%), and concluded that there was "a significant reduction in the volume and number of marketplace loans following *Madden*, particularly to those individuals who may be in greater need of external funding to sustain income shocks or unexpected expenses, particularly medical bills, and to refinance their existing debts at cheaper rates." Danisewicz & Elard at 26. After accounting for a range of potential variables, Danisewicz and Elard found that the reduced availability of credit caused by *Madden* led to an 8% increase in personal bankruptcy filings in the Second Circuit relative to non-Second Circuit states. *Id.*

These results were entirely foreseeable, as they are here: as the United States explained in its *amicus* brief, national banks in the Second Circuit had to conform their lending practices to otherwise preempted state laws because "the marketability (and therefore the value) of [their] loan portfolio[s] could be significantly diminished if [they] could not transfer to assignees the right to charge the same rate of interest that [they themselves] could charge." Brief for the United States as *Amicus Curiae*, *Madden*, 2016 WL 2997343, at *9. The decision below is likely to affect FSAs in the same way. Like national banks, FSAs must ensure the marketability of their loans and cannot devote liquidity to originating loans that will be invalid in the hands of a purchaser and therefore impossible to sell or securitize. *See de la Cuesta*, 458 U.S. at 155 n.10 (1982) ("The marketability of a mortgage in

the secondary market is critical to [FSAs].").[21] The decision below thus subjects FSAs, for all practical purposes, to the very costs and "undue regulatory duplication and burden" that HOLA and the regulations promulgated thereunder were intended to avoid. 12 C.F.R. § 560.2(a).

The empirical research on *Madden*'s impact clearly rebuts the district court's erroneous conclusion that, "[a]t most, non-preemption would make [FSA] loans slightly less attractive to prospective buyers." *McShannock*, 354 F. Supp. 3d at 1077. Subjecting FSA-originated loans in the secondary market to 50-state patchwork regulation will harm FSAs, other market participants, and consumers in this Circuit.

C. The decision below discourages financial institutions from acquiring failing FSAs and thereby limits the FDIC's alternatives for efficiently dealing with financial crises and resulting risk exposures.

By creating uncertainty about the terms and validity—and therefore value—of FSA-originated loans if they are sold to non-FSAs, the decision below also imperils the loan market at large by discouraging banks from purchasing and assuming the assets of failed FSAs, as Chase did here at the federal government's

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[21] Indeed, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which established the OTS and reformed the federal savings and loan system, was enacted in a context in which lenders were "increasingly reluctant to make loans that cannot be sold easily in the secondary market." H.R. Rep. No. 101-54, pt. 1, at 458 (1989).

request following the failure of Washington Mutual Bank, FA ("WaMU") during the 2008 financial crisis. *See* Chase Br. Section I.C.

When an FSA fails, as WaMu did, the FDIC acts as receiver and can either liquidate the institution or sell its assets and liabilities to a healthy institution through a purchase and assumption, or "P&A," agreement. *See FDIC* v. *Jenkins*, 888 F.2d 1537, 1539-1540 (11th Cir. 1989). A P&A transaction is "considered more desirable than a liquidation for several reasons, including that a bank closing deteriorates public confidence in the banking system, that closing a bank disrupts the operation of other solvent banks, that a liquidation may force depositors to wait for months to recover the insured portion of their funds, and that uninsured portions may never be recovered." *Id.* at 1540. Indeed, P&A agreements were crucial to recovery from both the savings and loan ("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.[22]

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

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). In such circumstances, the FDIC must "rely on the books and records of the failed [FSA] in assessing its potential liability under a purchase and assumption vis-a-vis a liquidation," *Jenkins*, 888 F.2d at 1544, and the prospective purchaser must be able to appraise quickly and accurately the failed FSA's assets and liabilities. The FDIC and the purchaser can do so only based on the loan terms that the FSA applied—not speculation about which state laws may govern post-sale, the extent to which such laws will invalidate the terms of the failed FSA's loans, and the purchaser's potential exposure to liability under such laws.

Here, Chase "purchase[d] substantially all of the assets and assume[d] all deposit and substantially all other liabilities" (including plaintiffs' loans) of WaMu from the FDIC receiver pursuant to a P&A transaction that was completed in mere weeks, from start to finish. ER212; *see also* Chase Br. at 32. It did so on the understanding that it would apply to the purchased loans the "same terms as agreed to by [WaMu] as existed as of Bank Closing." ER219. Yet, such "great speed" and such terms would be impossible absent the continued applicability of federal preemption, and the corresponding guarantee that, following the P&A, the failed FSA's assets will retain the value they had in the FSA's hands. Concerns that,

upon transfer, state laws will effectively rewrite the terms of failed FSAs' loans—and thereby diminish their value—will discourage non-FSAs like Chase from entering into similar P&As. A reduced ability to resolve failed or failing FSAs through P&As will, in turn, mean fewer alternatives for efficiently dealing with financial crises, resulting risk exposures that will put additional strain on the federal Deposit Insurance Fund and, potentially, reduced confidence in the U.S. financial system.

CONCLUSION

For the foregoing reasons, this Court should reverse the district court's erroneous and harmful decision.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing brief was filed electronically on August 12, 2019 and will therefore be served electronically on all counsel of record.

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitations of Federal Rule of Appellate Procedure 29(a)(5) because, excluding the parts of the document exempted by Fed. R. App. P. 32(f), this brief contains 6,778 words. This brief 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 brief has been prepared in a proportionally spaced typeface in 14-point Times New Roman font.

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