

First Circuit Rules Rhode Island Interest-on-Escrow Law is Not Preempted by National Bank Act

3 min read

Nov 24, 2025

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A recent ruling by the US Court of Appeals for the First Circuit could signal heightened exposure for lenders and servicers to state escrow-on-interest statutes, along with greater litigation risk.

Case Background

In [Conti v. Citizens Bank](#), the First Circuit vacated the dismissal of a class action suit in the Rhode Island federal court, where the district court concluded that the National Bank Act preempted Rhode Island's interest-on-escrow statute. However, following the district court's dismissal of Conti's case, the Supreme Court decision in [Cantero v. Bank of America](#) was announced.

Applying *Cantero*, the First Circuit did not follow the more traditional and automatic, categorical approach to preemption. Instead, the court undertook a more nuanced analysis that looks at the nature and degree of interference that *Cantero* now requires.

Conti financed the purchase of a house in Rhode Island with a mortgage loan from Citizens Bank, and the mortgage required him to make advance payments for property taxes and homeowners' insurance into an escrow account maintained by Citizens Bank. Citizens Bank did not pay Conti any interest or earnings on the escrow account, in accordance with the mortgage agreement.

Conti sued Citizens Bank for breach of contract and unjust enrichment, claiming that Citizens' failure to pay interest on the escrow account violated [Rhode Island law](#), which requires banks operating in Rhode Island to pay interest on borrower funds deposited into mortgage-escrow accounts. Citizens Bank moved to dismiss the case on the basis that the National Bank Act preempted any state law that required a bank to pay interest on a mortgage escrow account. The district court agreed and dismissed the case, but the First Circuit vacated the dismissal order, applying the preemption test established in *Cantero*.

First Circuit Refuses to Apply Categorical Preemption

The National Bank Act, [12 U.S.C. § 25b](#), preempts a state consumer financial law if it discriminates against national banks or “prevents or significantly interferes” with the exercise of national bank powers. Following the Supreme Court’s decision in *Cantero*, the First Circuit refused categorical preemption—under which a state law is preempted if it simply touches terms of a bank product—in favor of undertaking an assessment of the nature and degree of interference that is intended to be more practical and driven by precedent addressing similar factual situations.

The court reviewed legal precedent in cases where federal law explicitly authorizes an activity that a state law prohibits, or where federal law grants unfettered discretion that a state law limits. In such cases, the court reasoned that preemption is likely to apply. But where the state law is banking-specific and does not squarely conflict with federal law, the court considered the likely practical effects of applying the state law and whether the outcome would be consistent with the federal scheme.

In Conti’s case, the First Circuit found no clear conflict with federal law and held that Citizens Bank had not developed a showing that the practical effects of applying the state law would result in significant practical interference.

The court also noted the fact that Congress mandated compliance with interest-on-escrow requirements for certain mortgages under the Truth in Lending Act suggests that such laws can coexist with the federal framework. Importantly, the First Circuit rejected two common arguments in favor of preemption:

1. First, that congressional silence implies banks have unfettered discretion free from state rules; and
2. Second, that the “patchwork” of state requirements itself triggers preemption.

What’s Next?

The First Circuit’s refusal to preempt Rhode Island’s interest-on-escrow statute under the National Bank Act portends a shift in how federal courts will address the interplay between federal and state consumer finance laws. Hinshaw will continue to monitor preemption decisions that rely on the new framework established in *Cantero* and *Conti*.

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