

# Second Circuit Rules New York Interest-on-Escrow Law is Preempted by National Bank Act

Renewing Circuit Split and Adding Uncertainty to Federal Preemption of State Interest-on-Escrow Statutes

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A recent ruling by the US Court of Appeals for the Second Circuit adds uncertainty to the issue of federal preemption of state interest-on-escrow statutes.

## Case Background

On remand from the US Supreme Court, the Second Circuit issued a 2-1 decision in [Cantero v. Bank of America](#) this week, finding that New York's interest-on-escrow statute, which mandates that banks pay customers two percent interest on funds held in their mortgage escrow accounts, is preempted by the National Bank Act.

Tuesday's decision comes after the Supreme Court unanimously vacated the Second Circuit's earlier ruling in the same case that federal law preempts the New York interest-on-escrow statute on the basis that it purports to exercise control over a federally granted banking power, regardless of the magnitude of its effects.

The Supreme Court found that the lower court had failed to conduct a "practical" and "nuanced comparative analysis" of preemption-related precedent to assess the "nature and degree" of the interference with the banking power, and remanded for further proceedings.

## Second Circuit Doubles Down on Preemption

Applying the court's ruling in *Cantero* on remand, the Second Circuit found again that New York's interest-on-escrow statute is preempted by federal law. The court reviewed legal precedent in cases where state laws either

did or did not significantly interfere with the bank’s exercise of its federal powers and ultimately concluded that because New York’s interest-on-escrow law “affects a broad federal grant of power to set the terms of mortgage-escrow accounts and it impedes national banks’ ability to offer those accounts efficiently,” it is preempted by federal law.

The Second Circuit found that the New York statute interferes with a bank’s ability to efficiently make real estate loans to a degree similar to the interference created by a law regulating advertising that the court previously found to be preempted.

In finding that New York’s interest-on-escrow statute worked a significant interference with a federal banking power, the Second Circuit noted the Office of the Comptroller of the Currency’s (OCC) [proposed preemption determination](#) that would preempt state interest-on-escrow laws, and specifically targets New York’s statute. However, the opinion did not analyze the OCC’s proposed determination at length or expressly rely on it to support the ruling.

One judge filed a dissenting opinion, in which she argued that there was no evidence or reason to believe that the obligation to pay interest-on-escrow “will materially distort the bank’s incentives to offer mortgages, or prompt changes in other mortgage terms that might deter consumers.”

## What’s Next?

The Second Circuit’s ruling renews a circuit split regarding preemption of interest-on-escrow statutes that existed prior to the court’s decision in *Cantero*. The First and Ninth Circuits have both found that similar state interest-on-escrow statutes are not preempted under the *Cantero* standard.

The Second Circuit expressly disagreed with the First Circuit’s reasoning in *Conti v. Citizens Bank* for two reasons:

1. that *Conti* failed to give appropriate consideration to RESPA and TILA when assessing the scope of federal banking power despite their importance in federal preemption precedents, and
2. that *Conti* did not acknowledge the material impact that the state law would have on the bank’s operations.

Hinshaw will continue to monitor preemption decisions as disagreement mounts among the circuits, potentially setting the stage for a second round of review in the Supreme Court.

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