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From Europe to California: Aligning Global Audits With the New U.S. Banking Landscape

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OCC Preemption Decision and Final Rule Regarding Mortgage Escrow Account State Laws

May 26, 2026

By Mercedes Kelley Tunstall
Partner | Financial Regulation

By Daniel Meade
Partner | Financial Regulation

On May 15, 2026, the Office of the Comptroller of the Currency (OCC) **issued a preemption decision** addressing state laws that govern how mortgage escrow accounts are managed, as well as a final rule establishing a national bank's escrow powers (the **Escrow Powers Rule**). After more than a decade of preferring to allow preemption concerns to be battled out in court, the OCC has recently begun issuing preemption determinations again.

In the **announcement of the preemption decision and related rule**, the OCC lauded the Second Circuit for its application of the methodology detailed in the Supreme Court's decision in *Bank of America v. Cantero* (which we wrote about **here**). The Court's May 5, 2026 **decision** in the remand of the *Cantero* case found that the relevant New York state law governing the payment of interest on mortgage escrow accounts was effectively preempted because the law: 1) affects the national banking power to offer mortgages; 2) targets banks and limits their broad powers in a manner similar to the Supreme Court decisions that preempted state laws including *Fidelity Federal Savings and Loan v. de la Cuesta* and *Barnett Bank v. Nelson*; and 3) interferes with banks' ability to make real-estate loans in a degree that is "similarly severe to the interference created by the preempted advertising law" in the Supreme Court's decision in *Franklin National Bank of Franklin Square v. New York.* Now that the OCC has rendered its preemption decisions, cases like *Cantero* may no longer show up in court. Although with **Chevron deference gone**, there could still be some room for litigants to challenge preemption.

The preemption decision addresses state laws like the one involved in *Cantero* that require interest to be paid on mortgage escrow account balances. To this end, the OCC identified laws in twelve states that require interest to be paid on escrow account balances and declared those laws preempted under both the National Banking Act (preempting these laws for national banks), as well as the Home Owner's Loan Act (preempting these laws for federal savings associations). The twelve states are California, Connecticut, Maine, Maryland, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Utah, Vermont, and Wisconsin. The laws of Guam and the U.S. Virgin Islands are also preempted.

Specifically, the OCC found that these state laws were contrary to the flexibility granted by Federal law to national banks, which sufficiently interferes with the bank's business judgment. As stated, "[t]he OCC's regulations have long made clear that national banks have broad discretion to determine the pricing of their products and services based on consideration of relevant factors, including costs, which supports their ability to effectively and efficiently exercise their Federally authorized powers." Further, "[r]equiring compliance with State interest-on-escrow laws would undermine this discretion and could cause national banks to, among other things, attempt to recoup or offset costs in other ways that are not as well aligned with their sound banking judgment or safe and sound banking principles and that may even increase mortgage pricing."

Meanwhile, the new Escrow Powers Rule provides clarity on how the OCC will evaluate whether a state law involving mortgage escrow accounts interferes with national bank powers. Escrow accounts are defined in the rule (which is an update to **12 CFR 34** and **12 CFR 160**) as accounts "established in connection with a loan or extension of credit secured by a lien on interest in real estate in which the borrower places funds for the purpose of assuring payment of taxes, insurance premiums, or other charges with respect to the property." By its terms, this means that the preemption analysis extends beyond escrow accounts tied to residential mortgages and applies also to escrow accounts tied to other kinds of mortgages. Specifically, the rule establishes that banks may make "business decisions" in their discretion to establish the terms and conditions of escrow accounts, including investment of the escrowed funds, fees charged and the payment of interest on the balances.

The OCC's two-step approach by finalizing the Escrow Powers Rule and then issuing the preemption decision appears to strengthen the OCC's preemption position on preemption. By making clear that escrow accounts are clearly part of

the business of banking applicable to national banks (and federal thrifts), it arguably helps solidify the preemption determination. Of some interest, the National Credit Union Administration (NCUA) appears ready to follow the OCC's preemption determination. On May 18, the NCUA **filed** an interim final rule for review with the Office of Management and Budget's Office of Information and Regulatory Affairs, putting federal credit unions on similar footing.

The European Securities and Markets Authority (ESMA) Reports on Investment Managers' Compliance and Audit Functions

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By Alix Prentice
Partner | Financial Regulation

In 2025, the European Securities and Markets Authority (ESMA) performed a Common Supervisory Action (CSA) exercise on the establishment of effective compliance and internal audit functions in the investment management sector. On 11 May 2026, ESMA published **its Final Report** on "2025 CSA on compliance and internal audit functions of fund managers" summarising its key findings and including a list of good and poor practices identified by regulators during the exercise.

While overall compliance levels are assessed to be satisfactory, a number of areas for improvement have been identified. Noting that the assessment guidelines prioritised UCITS and alternative investment funds (AIFs) with a retail investor base, ESMA's views and conclusions focus on:

- ensuring that recordkeeping is appropriate and up to date;
- the importance of ensuring that compliance and internal audit are properly resourced and backed by the right organisational arrangements—ESMA highlights the fact that responsibility for ensuring that these functions operate compliantly lies with management, even when they are performed by third parties;
- giving the compliance function the necessary authority within the organisation, including a clearly defined escalation process in case of disagreement with operational units;
- verifying the independence of these functions;
- the importance of the compliance function receiving full and timely information in order to be able to monitor operational units;
- the risk that methodologies and tools provided by parent companies can potentially lead to an underestimation of local risk—i.e., risk must be looked at in context.

Thus, while the assessment represents an overall clean bill of health, it is also an indication of an ongoing need to revisit documentation, the granularity of the approach, independence, information flow and local ownership.

Banking Agencies Propose Revisions to CAMELS Rating System

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By Daniel Meade
Partner | Financial Regulation

This week, the Federal Financial Institutions Examination Council (the "FFIEC") released a **notice of proposed rulemaking** (the "NPR") to revise the Uniform Financial Institutions Rating System (more commonly referred to as CAMELS, for each of its components: Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to risk). Comments on the NPR are due August 17, 2026.

The NPR would retain the basic framework of the existing CAMELS rating system, with modifications aimed at focusing the component and composite ratings on factors that "materially affect an institution's financial condition and risk profile" and at "improv[ing] [the] transparency" of the ratings "by more clearly articulating expectations for financial institutions." In particular, the proposed revisions would decrease the prominence of the Management component in CAMELS ratings, both by reducing the emphasis on the Management component in the composite rating and as a consideration that is currently woven into the other non-Management components.

The FFIEC's proposed overhaul of the CAMELS framework is consistent with the federal banking agencies focus on material financial risks, as opposed to process. Most notably, the proposal would eliminate the long-standing instruction that the "Management" component receive "special consideration" in determining a bank's composite CAMELS rating. The agencies acknowledge what the industry has argued for years: that Management ratings have become disproportionately influential, particularly in recent years.

Under the revised framework, a Management downgrade to a "3" or worse generally would require risk management weaknesses that actually result in "material financial risk" to the institution. That is a substantially narrower formulation than many institutions believe exists in practice today.

The agencies also propose to narrow the Management component itself by removing several evaluation factors, including management succession planning, responsiveness to supervisory recommendations, and willingness to serve community banking needs.

Likewise, specialty review findings — including compliance-related findings — would only meaningfully influence CAMELS ratings where they impact overall financial condition, create material financial risk, or reflect significant legal noncompliance.

For banks, the proposal could represent a meaningful recalibration of supervisory leverage. In practice, a Management "3" can have enormous consequences well beyond examination optics because CAMELS ratings directly affect "well managed" status under multiple banking rules (e.g., financial holding company status).

As noted in the **FDIC's summary** of the proposal the revisions being proposed would:

- Remove "Special Consideration" Given to the Management Component Rating when Assigning the Composite Rating;
- Update the Definition and Evaluation Factors for the Management Component Rating;
- Change the Treatment of Specialty Review Findings;
- Revise Composite Rating Definitions;
- Clarify Language on Risk Management;
- Clarify Evaluation Factors;
- Improve Consistency, Structure, and Approach to Ratings Definitions; and
- Modernize and Conform CAMELS Framework Language.

The NPR also continues the broader regulatory retreat from "reputation risk" as a supervisory concept. Consistent with recent OCC, FDIC, Federal Reserve, and NCUA actions, all references to reputation risk would be removed from the CAMELS framework.

The agencies also modernize the framework by updating terminology to reflect current expected credit losses ("CECL") accounting standards and expanding discussion of interest-rate risk, net interest income sensitivity, contingent liabilities, and funding costs.

FDIC Chairman Travis Hill, who serves as the current Vice-chair of the FFIEC stated that "[t]he proposal is intended to modify how the overall composite and individual component ratings are described to shift the emphasis away from a bank's process for managing risks and towards factors and risks that materially impact a bank's financial condition." Similarly, FRB Vice Chair of Supervision Michelle Bowman, who serves as the current Chair of the FFIEC stated in the **FFIEC's news release** that "[t]he revised CAMELS framework marks a decisive shift toward transparency, quantitative factors, and predictability of supervisory oversight."

Even with revised definitions, examiners will still exercise substantial judgment in determining whether a weakness creates "material financial risk."

As noted above, the comment period runs through August 17, 2026.

[1] (The FFIEC is made up of the Federal Reserve Board ("FRB"), including the Consumer Financial Protection Bureau ("CFPB"), the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC"), the National Credit Union Administration ("NCUA"), and a state liaison.

Rohit Chopra Named Head of New California Consumer Protection Agency

May 26, 2026

By Mercedes Kelley Tunstall
Partner | Financial Regulation

California Governor Gavin Newsom **announced** that he has named former Consumer Financial Protection Bureau (CFPB) Director Rohit Chopra as the Secretary of the state's new Business and Consumer Services Agency (BCSA). The appointment will be effective upon the agency's launch on July 1, 2026.

The BCSA is the umbrella agency overseeing not only the state agency that has a mission closest to the CFPB, the Department of Financial Protection & Innovation (DFPI), but also the agencies that govern cannabis control, alcohol control, licensing for various consumer-related businesses, civil rights, homelessness, real estate and the horse racing industry. While the CFPB lingers in twilight during the current administration, the industry and consumer protection advocates alike have been expecting state agencies to step into the breach and cover the gaps in consumer protection.

To date, the relevant state agencies, including the DFPI, have stepped up their enforcement activities, but due to budgetary and personnel constraints, the lack of CFPB activity is often keenly felt. Nevertheless, with Chopra at the helm, we may expect to see California continuing to lead the charge to fill in the gap in federal enforcement.