
**SENATE COMMITTEE ON
BANKING AND FINANCIAL INSTITUTIONS**
Senator Timothy Grayson, Chair
2025 - 2026 Regular

Bill No: AB 1278 **Hearing Date:** June 17, 2026
Author: Harabedian
Version: January 14, 2026 Amended
Urgency: No **Fiscal:** Yes
Consultant: Michael Burdick

Subject: Mortgages: hazard insurance proceeds: interest

SUMMARY

This bill specifies the allowable payment methods by which a financial institution can satisfy its obligation to pay interest on funds held in a loss draft account, as specified.

EXISTING LAW

Requires a financial institution that makes loans upon the security of real property containing only a one- to four-family residence and located in this state or purchases obligations secured by the property and that holds hazard insurance proceeds in a loss draft account pending property rebuilding or repair shall pay interest on those funds at a rate of at least 2 percent simple interest per annum. Requires the interest to be credited to the loss draft account annually or upon termination of the account, whichever is earlier. (Civil Code Section 2954.85)

THIS BILL

- 1) Allows the interest on hazard insurance proceeds to be paid with a check, as specified, drawn by a financial institution payable at or through a bank directly to the borrower.
- 2) Provides that a check that is uncashed 90 calendar days after delivery be cancelled at no cost to the borrower and the amount credited to the loss draft account.

COMMENTS

1) *Purpose*

According to the author:

Beginning January 1, 2026, existing law requires financial institutions to pay borrowers 2% simple interest on post-loss insurance proceeds held in escrow following property damage or loss for certain properties impacted by the January 2025 Los Angeles-area wildfires. AB 1278 expands the methods by which borrowers may receive that accrued interest by authorizing financial institutions to pay interest directly to homeowners by check, ensuring disaster survivors can fully access the funds owed to them during the rebuilding process.

2) *Background*

Last year, the author of this bill authored AB 493 (Harabedian, Chapter 103, Statutes of 2025), which was one of many bills introduced in response to the wildfires in Los Angeles in January 2025. AB 493 requires that mortgage servicers pay at least 2% interest on funds held by the mortgage servicer that were paid by an insurer related to property damage caused by the fires.

When a home with an outstanding mortgage is damaged or destroyed, the insurance company typically pays out the claim to the lender, not directly to the homeowner who is the borrower on the mortgage loan. This practice is compelled by property insurance contracts that often contain a mortgagee, loss payee, or lenders loss payable clause, which are designed to protect a mortgage lender in the event that the property securing the mortgage is damaged, known as an insured loss event. Navigating through an insured loss event requires actions of the borrower/property owner, the insurer, and the mortgage servicer.¹

The mortgage servicer plays a key role, along with the insurance company, in working with a borrower when the borrower's property experiences an insured loss event. Mortgage servicers are expected to ensure the proof of loss claim is filed timely with the insurer and to monitor the disbursement of insurance loss proceeds. Mortgage servicers undertake a variety of activities in this process, including the following:

- Determining if the property can be legally rebuilt.
- Obtaining complete details on the damage to the property and determining the needed repairs.
- Discussing with the borrower any plans for repairing the property.
- Immediately issuing the borrower a check for any amount designated for contents (for example personal property) or living expenses.
- Depositing insurance funds retained by the servicer pending disbursement for repair or reconstruction.
- Reviewing and approving the final plans for repair, including obtaining the necessary bids to repair the property.
- Monitoring and inspecting repairs as completed to verify the repairs comply with the final repair plan.
- Disbursing funds for repairs, often based on periodic inspections of the progress of the repair work.²

¹ A mortgage servicer is an entity that interacts with borrowers after a loan has been originated and the borrower begins to repay the loan. A mortgage servicer collects payments from the borrower and manages any associated escrow account.

² These activities were taken from the Fannie Mae servicing guide, which provides the duties and expectations for mortgage servicers who are servicing loans purchased by Fannie Mae, a government-sponsored enterprise that supports liquidity within the mortgage financing system. <https://servicing-guide.fanniemae.com/svc/b-5-01/insured-loss-events>

The process for repairing or rebuilding a damaged home, particularly in an area affected by a widespread disaster, is often time-consuming and cumbersome. While the insurance proceeds usually arrive within weeks or a few months, the process for clearing debris, rebuilding damaged infrastructure, finding contractors, developing plans, and constructing the repair or rebuild of the home often takes more than a year, sometimes stretching over several years. During this time, the insurance proceeds are placed in a bank account by the mortgage servicer.

This bill allows the interest that accrues on hazard insurance proceeds to be paid to the borrower with a check, rather than requiring the interest be credited to the loss draft account. This change provides more flexibility to mortgage servicers in how they comply with the required payment of interest. If desired by the Committee, the bill could be further amended to add electronic payment options.

3) *Amendments*

Committee staff recommends the following amendment to allow interest payments to be made by automated clearing house or electronic funds transfer.

2954.85. (a) (1) A financial institution that makes loans upon the security of real property containing only a one- to four-family residence and located in this state or purchases obligations secured by the property and that holds hazard insurance proceeds in a loss draft account pending property rebuilding or repair shall pay interest on those funds at a rate of at least 2 percent simple interest per annum. That interest shall be credited to the loss draft account, or paid ~~with a check drawn by a financial institution payable at or through a bank~~ directly to the borrower, annually or upon termination of the account, whichever is earlier.

(2) A payment made directly to the borrower under paragraph (1) shall be made by check, electronic funds transfer, including ACH transfer, or another payment method agreed to by the borrower.

LIST OF REGISTERED SUPPORT/OPPOSITION

Support

California Association of Realtors

Opposition

None received