

SENATE JUDICIARY COMMITTEE
Senator Thomas Umberg, Chair
2025-2026 Regular Session

AB 1278 (Harabedian)
Version: June 22, 2026
Hearing Date: June 30, 2026
Fiscal: Yes
Urgency: No
ID

SUBJECT

Mortgages: hazard insurance proceeds: interest

DIGEST

This bill permits a financial institution to disburse directly to a borrower the required two percent interest on any hazard insurance proceeds that the financial institution holds in a loss draft account pending property rebuilding or repair, as specified.

EXECUTIVE SUMMARY

When homes are damaged or destroyed by a disaster, the process of rebuilding is often a long and arduous one. When homeowners receive insurance payouts to cover the cost to rebuild, the funds are typically held in a loss draft account by their mortgage servicer and are disbursed as needed as construction progresses. During that time, which may be many months or years, the funds may or may not be accruing interest. In 2025, the Legislature enacted AB 493 (Harabedian, Ch. 103, Stats 2025) to require financial institutions that make loans on properties of one- to four-family residences to pay two percent simple annual interest on hazard insurance proceeds while they are held by the financial institution pending the property rebuilding or repair. It also prohibited the financial institution from charging any fee or charge related to the maintenance or disbursement of the insurance proceeds that would result in an interest rate of less than two percent. AB 493 required the financial institution to credit this interest to the borrower's loss draft account. This bill would permit the financial institution to also disburse the interest directly to the borrower through a check or electronic funds transfer, as specified.

AB 1278 is author-sponsored, and is supported by the California Credit Union League. The Committee has received no timely letters of opposition. AB 1278 previously passed the Senate Banking and Financial Institutions Committee by a vote of 7 to 0.

PROPOSED CHANGES TO THE LAW

Existing law:

- 1) Requires a financial institution that makes loans upon the security of real property to pay simple interest of at least two percent per annum on amounts received in advance for the payment of taxes and assessments, the payment of insurance, or for other purposes relating to such real property. Provides that the interest shall be credited to the borrower's account annually or upon termination of such account, whichever is earlier. (Civ. Code § 2954.8(a).)
 - a) Prohibits a financial institution from imposing any fee or charge in connection with the maintenance or disbursement of the funds described in (1), above, that will result in an interest rate of less than two percent per annum being paid on the funds received. (Civ. Code § 2954.8(b).)
 - b) Exempts from these requirements funds that are required by a state or federal regulatory authority to be placed by a financial institution other than a bank in a non-interest-bearing demand trust fund account of a bank. (Civ. Code § 2954.8(d).)
- 2) Requires a financial institution that makes loans upon security of real property containing one to four residences, or that purchases obligations secured by such property, and that holds hazard insurance proceeds in a loss draft account pending property rebuilding or repair, to pay two percent simple annual interest on those proceeds, and requires this interest to be credited to the loss draft account annually or upon termination of the account, whichever is earlier. (Civ. Code § 2954.85.)
- 3) Prohibits a financial institution subject to the requirement in (2), above, from imposing a fee or charge in connection with the maintenance or disbursement of insurance proceeds following property damage or loss that would result in an interest rate of less than two percent per annum being paid to the borrower. (Civ. Code § 2954.85(b).)
- 4) Specifies that the provisions in (2) and (3), above, do not apply to hazard insurance proceeds held in a loss draft account that are required by a state or federal regulatory authority to be placed in a financial institution other than a bank in a non-interest-bearing demand trust fund account of a bank. (Civ. Code § 2954.85(d).)
- 5) Permits a financial institution, notwithstanding any other law, to deposit hazard insurance proceeds in an interest-bearing account in a federally insured depository institution, federal home loan bank, federal reserve bank, or another similar government-sponsored enterprise. (Civ. Code § 2954.85(e).)

- 6) For funds held in a loss draft account as of the effective date of the provisions described in (2) through (5), above, requires interest to begin to accrue on the effective date of these provisions. (Civ. Code § 2954.85(f).)
- 7) Defines, for the purposes of (2) through (5), “financial institution” to mean a bank, savings and loan association, or credit union chartered under the law of the state or the United States, or any person or organization that makes loans upon the security of real property containing one- to four-family residences. (Civ. Code § 2954.85(c).)

This bill:

- 1) Specifies that the interest required by (2), above, may also be paid back directly to the borrower, annually or upon termination of the account.
- 2) Specifies that a payment made directly to the borrower shall be made by check, electronic funds transfer, including automated clearing house transfers, or another payment method agreed to by the borrower.
- 3) Requires the financial institution to cancel a check issued pursuant to (1), above, that is uncashed 90 calendar days after delivery at no cost to the borrower, and to credit the amount to the loss draft account.
- 4) Defines, for the purposes of its provisions, “check” to mean a draft, other than a documentary draft, payable on demand and drawn on a bank and which can be cancelled by the issuer. Specifies that “check” does not include a cashier’s check, money order, or other instrument that cannot be cancelled by the issuer.

COMMENTS

1. Author’s statement

In support of this measure, the author states:

AB 1278 makes technical clarifications to AB 493 from last year, which ensured homeowners receive interest on post-loss insurance payouts. Providing homeowners with every possible resource is critical to supporting recovery after a disaster, and AB 1278 makes it easier for banks to deliver post-loss insurance payouts to survivors.

2. California law and the requirement to pay interest on insurance proceeds held in escrow

When a homeowner with an outstanding mortgage is rebuilding with insurance proceeds, the insurance proceeds are typically disbursed not directly to the borrower,

but instead to the company servicing their mortgage (the mortgage servicer). This is because the mortgage lender has a financial interest in the homeowner's property as the security for the loan that the mortgage lender provided. Thus, the lender has an interest in protecting the property and ensuring that the reconstruction or repairs are completed appropriately. When the mortgage servicer receives the insurance proceeds, it will typically hold the proceeds in an escrow account, and will disburse the funds as needed through the construction process.

During that time, which may be many months or years, the funds may or may not be accruing interest. California law requires financial institutions that make or purchase mortgage loans on property with four or fewer residential units to provide interest on various funds that it receives in advance. (Civ. Code § 2954.8.) This provision, Civil Code section 2954.8, applies to funds received for the advance payment of taxes and assessments on the property, insurance, or for other purposes related to the property, and requires that the interest rate paid to the borrower on such amounts be a simple annual interest rate of at least two percent. In addition, a financial institution is prohibited from imposing any fee or charge in connection with the maintenance or disbursement of funds that the institution holds for disbursement and the required interest that would result in the interest rate on the held funds being less than the required two percent. (Civ. Code § 2954.8(b).)

3. AB 493 required financial institutions to pay two percent interest on insurance hazard proceeds held by the institution for the borrower

While Civil Code section 2954.8 mentions insurance in its provisions, a question has arisen regarding whether it required that insurance proceeds from a property loss accrue interest. To correct this, last year the Legislature passed AB 493 (Harabedian, Ch. 103, Stats. 2025). AB 493 required a financial institution that provides loans for one- to four-family residences or purchases obligations secured by such properties to provide two percent annual interest on any hazard insurance proceeds that the financial institution holds in a loss draft account for the borrower during the rebuilding or repair process. AB 493 also prohibited a financial institution in that case from charging any fee or other charge that would result in an interest rate less than two percent. It exempted any hazard insurance proceeds that are required by a state or federal regulatory authority to be placed in a financial institution other than a bank in a non-interest-bearing demand trust fund account.

4. AB 1278 permits the financial institution to disburse this interest directly to the borrower

Yet AB 493 required that the financial institution credit the interest to the loss draft account annually or upon termination of the account, and did not permit the financial institution to disburse the interest directly to the borrower. AB 1278 aims to correct this by permitting the financial institution to disburse the interest directly to the borrower

by check, electronic funds transfer (such as an ACH transfer), or another payment method agreed to by the borrower. AB 1278 specifies that a “check” for disbursing interest does not include a cashier’s check, money order, or other instrument that cannot be canceled by the issuer. If the financial institution issues a check and the borrower does not cash it within 90 days, AB 1278 would require the financial institution to cancel the check and instead deposit the interest funds into the borrower’s loss draft account.

SUPPORT

California Credit Union League

OPPOSITION

None received

RELATED LEGISLATION

Pending Legislation: None known.

Prior Legislation:

AB 493 (Harabedian, Ch. 103, Stats. 2025) required mortgage lenders that make loans secured by property containing one- to four-family residences pay two percent interest on any insurance proceeds following property damage or loss that is held by the mortgage lender, as specified. Required the financial institution to credit this interest to the loss draft account for the borrower. *See Comment 3.*

AB 238 (Harabedian, Ch. 128, Stats. 2025) authorized a borrower experiencing financial hardship due to the wildfire disasters in Los Angeles County in January 2025 to request forbearance on their residential mortgage loan, and required a mortgage servicer to offer mortgage payment forbearance of up to an initial 90 days, up to 12 months.

SB 455 (McGuire, Ch. 873, Stats. 2023) required that, when a mortgage on a property located within the geographic area of a declared state of emergency or local emergency is transferred to a new mortgage servicer, the transferor mortgage servicer provide the new mortgage servicer with any written records between the borrower and the mortgage servicer relating to the borrower’s use of insurance proceeds to repair or replace property damaged or destroyed by the disaster, and required the new mortgage servicer to honor any previous written agreements between the borrower and the previous mortgage servicer.

PRIOR VOTES:

Senate Banking and Financial Institutions Committee (Ayes 7, Noes 0)

Assembly Floor (Ayes 70, Noes 0)

Assembly Appropriations Committee (Ayes 15, Noes 0)

Assembly Banking and Finance Committee (Ayes 8, Noes 0)
