Date of Hearing: January 12, 2026

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Avelino Valencia, Chair
AB 1278 (Harabedian) – As Amended January 5, 2026

SUBJECT: Mortgages: hazard insurance proceeds: interest

SUMMARY: Starting January 1, 2026, financial institutions are required to pay 2% simple interest to the borrower for insurance proceeds following property damage or loss held in escrow. This requirement applies to loans executed before January 1, 2026 to specified properties impacted by the January 2025 Los Angeles-area wildfires. This law will broaden the methods by which a borrower may be paid the interest accrued. Specifically, **this bill**: Permits an applicable financial institution to pay interest from hazard insurance proceeds directly to a borrower with a check.

EXISTING LAW:

1) Requires financial institutions that make mortgage loans to pay at least 2% interest on amounts received in advance for payment of taxes and assessments on the property, insurance, or other purposes related to the property. Civil Code Section 2954.8.

To prepare for the anticipated large volume of insurance payouts to be held in escrow during post-wildfire property reconstruction, the Legislature enacted an urgency measure during the 2025 legislative year. Specifically, the law that took effect on Jan 1, 2026:

2) Requires a financial institution that makes loans upon the security of real property containing only a one- to four-family residence or purchases obligations secured by property and holds hazard insurance proceeds in a loss draft account pending property rebuilding or repair to pay at least 2% simple interest per annum. Civil Code Section 2954.85(a).

   a) Interest is required to be paid annually or upon termination of the account, whichever is earlier. *Id*.

   b) Interest is to be credited to the loss draft account. *Id.*

FISCAL EFFECT: **None.**

COMMENTS:

Statement from the Author

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.

Background

California has faced an alarming increase in destructive wildfires. Most of the largest and devastating fires have taken place within the last decade, culminating in a particularly severe

outbreak in recent years. This period has witnessed some of the worst wildfires in the state's recorded history.

More recently, January 2025 wildfires, often referred to as firestorms due to the intense hurricane-force winds that helped the fires quickly spread, destroyed more than 16,000 structures and has led to widespread hardship for victims and the surrounding communities. According to the most recently available data from the Department of Insurance, a total of 39,171 residential insurance claims were filed with over $20.8 billion paid as of November 2025.[1]

Escrow Accounts and Insurance Payouts

An escrow account for insurance claims is a temporary financial account used to hold insurance payout funds, ensuring they are properly used for property repairs. This is commonly required in homeowners insurance claims, especially when the property has a mortgage. Instead of paying the homeowner directly, the insurer deposits the funds into an escrow account managed by the mortgage lender or a third-party administrator.

While the terms of each policy is different, the following is a general description of the steps involved in the escrow process. After the claim is approved, funds are placed in escrow rather than given directly to the homeowner. The lender then releases payments in stages as repairs progress, ensuring the work is completed properly and contractors are paid. Once the final repairs are inspected and verified, the remaining balance is released to the homeowner or contractor. This prevents misuse of funds and ensures the property is restored.

Escrow accounts protect lenders by ensuring their collateral (the home) is properly repaired. However, if a property does not have a mortgage or if the claim is small, insurers typically pay the homeowner directly without requiring escrow.

This Bill

Section 2954.84(a) of the Civil Code pertains to specific circumstances– specifically financial institutions that 1) make loans of real property 2) containing a one- to four- family residence located in California or that purchase obligations secured by property and 3) that holds hazard insurance proceeds in a loss draft account during property rebuilding or repair. Under these conditions, the financial institution is required to pay interest of no less than 2% simple interest per annum, to be paid on the sooner of annually or upon termination. The accrual date for applicable accounts is January 1, 2026. This bill will allow financial institutions to pay borrowers interest as required from this code section in a manner other than crediting the loss draft account.

Stakeholders seeking this change claim that sending borrowers a check for interest is a method that has historically been used exclusively for interest payments on other property related advanced payments such as over payment of tax assessments. However, section 2954.84(a) borrowers are categorically unique in that they are physically displaced from their home, which is most borrowers' mailing address. Following a natural disaster, while it is encouraged by some service providers to obtain a Post Office box (P.O. box) and have one's mail forwarded, is an uncommon practice and depending on the location it can be cost prohibitive. Additionally, these

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[1] https://www.insurance.ca.gov/01-consumers/180-climate-change/Wildfire-Claims-Tracker.cfm

particular borrowers are likely to be in a financial position where the 2% payment can be very helpful for living expenses, as usually, property is not the only thing these borrowers are rebuilding.

Preemption

In its the 2024 holding, the Supreme Court unanimously held "in applying the significant-interference test under *Barnett Bank*, 116 S.Ct. 1103… to the issue of whether the National Bank Act preempts a state law must make a practical assessment of the nature and degree of the interference caused by the state law; if the state law prevents or significantly interferes with the national bank's exercise of its powers, the law is preempted, but if the state law does not prevent or significantly interfere with the national bank's exercise of its powers, the law is not preempted".[2]

The Court's decision provides a clear framework for determining the question of federal preemption of state laws regulating banks in relation to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which ruled out field preemption.

> "Instead, Dodd-Frank provides that the National Bank Act preempts a state law "only if" the state law (i) discriminates against national banks as compared to state banks; or (ii) "prevents or significantly interferes with the exercise by the national bank of its powers," as determined "in accordance with the legal standard for preemption"[3]

Because section 2954.84 does not apply to a financial institution based on its charter, potential questions of preemption can only be raised on the "prevents or significantly interferes" preemption standard. Furthermore, there is no clear demarcation of where a state law significantly interferes with a national bank's ability to exercise its powers, and thus prior decisions must be taken into account. For example, in the Barnett case, a dispute arose because a national bank wanted to sell insurance in a small Florida town, but the state prohibited most banks from selling insurance. The Court held the Florida law preempted because it significantly interfered with the national bank's ability to sell insurance—a federally authorized power. The Court reasoned that "normally Congress would not want states to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted."[4] However, in *National Bank v. Commonwealth*, the Court determined that a Kentucky tax law was not preempted. The Kentucky law at issue there taxed the shareholders of all banks on their shares of bank stock.

> "The Court explained that national banks are "exempted from State legislation, so far as that legislation may interfere with, or impair their efficiency in performing the functions" that federal law authorizes them to perform. But national banks are not "wholly withdrawn from the operation of State legislation"; rather, they remain subject to state law governing "their daily

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[2] *Cantero v. Bank of America, N. A.* (2024) 144 S.Ct. 1290
[3] *Id.* citing *Barnett Bank of Marion Cty., N. A. v. Nelson,* 517 U.S. 25, 116 S.Ct. 1103
[4] *Barnett Bank of Marion Cty., N. A. v. Nelson,* 517 U.S. 25, 116 S.Ct. 1103

> course of business" such as generally applicable state contract, property, and debt-collection laws."[5]

As applied to section 2954.84(a) in its current form, any issues of preemption would hinder on whether or not a mandate to credit a loss draft account that the financial institution is already managing prevents or significantly interferes with the financial institution's ability to exercise its powers. This seems unlikely considering that to make payment any other way would be creating an extra step for the financial institution.

Similarly, this Committee has provided amendments. And a preemption analysis is likely to produce similar results. Based on the recommended amendments of this Committee, and issues of preemption would hinder on whether or not to the mandate to cancel a check that remained uncashed for 90 days and crediting a borrowers loss draft account for accrued simple interest prevents or significantly interferes with a financial institution's ability to exercise its powers. Considering the fact that check cancellation and crediting accounts are basic functions of financial institutions, such a mandate is unlikely to be preempted under the *Barnette* analysis.

AMENDMENTS FOR CONSIDERATION

Because a borrower subject to Section 2954.84(4) is highly likely to be temporarily displaced from their primary mailing address, the Committee should consider the following amendments:

1) Amend Cal. Civ. Code Section 2954.85(a) to become (a)(1), delete "otherwise" and add "with a check drawn by a financial institution payable at or through a bank"

   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 ~~otherwise~~ with a check drawn by a financial institution payable at or through a bank paid directly to the borrower annually or upon termination of the account, whichever is earlier.

2) Add (2). "A check issued pursuant to this subsection that is uncashed 90 calendar days after delivery shall be cancelled at no cost to the borrower and the amount credited to the loss draft account."

3) Add (3) to read: "For purposes of this subdivision, "check" means a draft, other than a documentary draft, payable on demand and drawn on a bank which can be canceled by the issuer. "Check" shall not include a cashier's check, money order, or other instruments that cannot be cancelled by the issuer."

REGISTERED SUPPORT / OPPOSITION:

Support

None received.
Verified 1/8/2026

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[5] *National Bank v. Commonwealth,* 9 Wall. 353, 76 U.S. 353, 361-362 (1870)

Opposition

None received.
Verified 1/8/2026

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