CALIFORNIA BANKERS ASSOCIATION

CBA Bank Counsel Seminar
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Real Estate Lending Update

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Agenda

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- Civil Code 2924.13 (AB 130)
- California Finance Code 90002 (SB 825)
- California Civil Code Section 2954.85 (AB 493)
- California Civil Code Section 2954.8
- Default interest and the *Honchariw* case
- Brief overviews of (i) the new Small Business Data Collection Rule final rule, (ii) recent guidance on lending to illegal immigrants and Trump's EO, and (iii) AB 801



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California Civil Code Section 2924.13

The Zombie Mortgage Law

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AB 130: Scope

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- Effective June 30, 2025; added Civil Code § 2924.13.
- Applies to a "subordinate mortgage": a security instrument in residential real property that was subordinate to another security interest ***when recorded***.
- Applies to consumer and commercial loans secured by residential real property.

Six "Unlawful Practices" – 2924.13(b)

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1. **No written communication** regarding the loan for at least three years.
2. Failure to provide a **servicing-transfer notice** when required by law, investor, or guarantor requirements.
3. Failure to provide an **ownership-transfer notice** when required.
4. Foreclosure or threatened foreclosure after a form provided to borrower indicating debt was **written off or discharged (including IRS Form 1099)**
5. Foreclosure or threatened foreclosure "after the applicable statute of limitations expired"
6. Failure to provide **periodic account statements** when required.

The Foreclosure Gatekeeper – 2924.13(c)

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- Before a nonjudicial foreclosure may be conducted—or threatened—a certification under penalty of perjury must be recorded

- Certification must state either:
  - **No unlawful practice occurred**; or
  - **All instances of unlawful practices are listed**.

- Certification concerns "mortgage servicer," which expressly includes current and prior servicers.

Remedies In Nonjudicial Foreclosure Cases

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- **Pre-Sale: Mandatory Injunction**

  Civil Code § 2924.13(d): "Upon a borrower's petition to the court for relief before the foreclosure sale, ***the court shall enjoin a proposed foreclosure sale pursuant to a power of sale in a subordinate mortgage until a final determination on the petition has been made***"

- **Post-Sale: Set Aside Sale Nonjudicial Foreclosure Sale**

  Civil Code § 2924.13(g): Post-sale petition may seek to set aside a sale if the certification was never recorded, disclosed unlawful practices, or misrepresented compliance history.



Judicial Foreclosure

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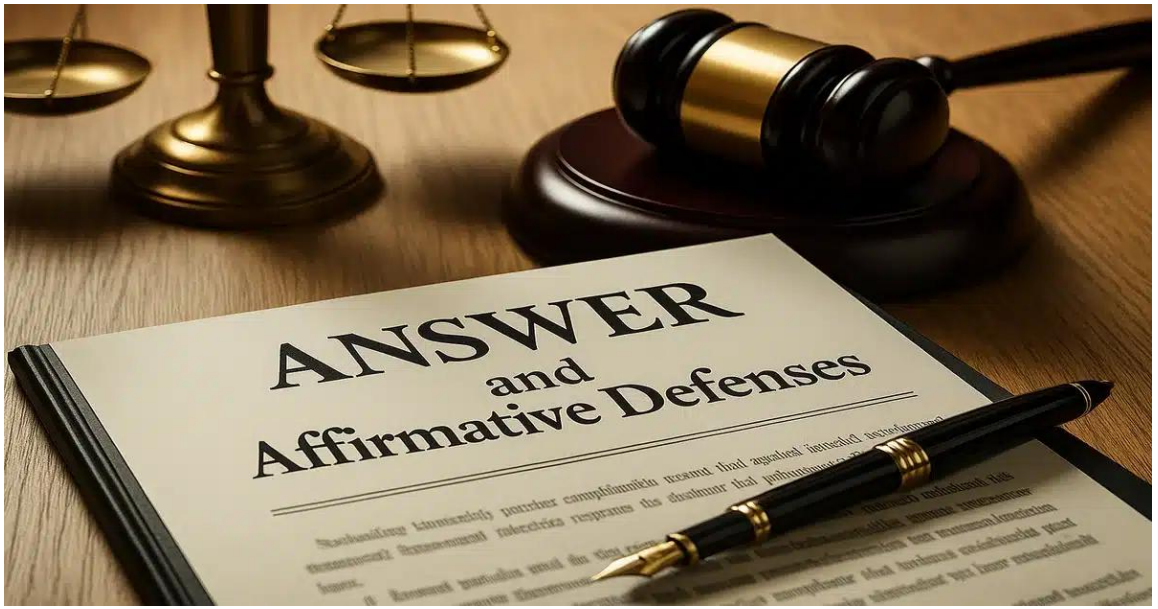
- Judicial foreclosure: unlawful practices become an ***affirmative defense***.



Equitable Relief for Court for Borrower

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Court may grant borrowers equitable relief, including:

1. striking all or a portion of arrears
2. barring foreclosure, or
3. allowing foreclosure only after future compliance and a corrected arrearage claim.



Retroactivity: The Central Fight

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- **Backward-Looking Certification**
- The Attorney General: Retroactive
- Prospective as of June 30, 2025?

Why is Compliance Difficult?

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- Requires certification of prior-servicer compliance, often across many years.
- Historical records may be incomplete.
- Certification under penalty of perjury increases risk and reluctance to certify based on incomplete records
- Foreclosure cannot be threatened before compliance.
- Documentation gaps can become enforceability barriers.

California Mortgage Ass'n v. Bonta

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- Plaintiffs argue in the lawsuit that Civil Code 2924.13 violates:
  - Contract Clause
  - Equal Protection Clause
  - Due Process
  - Supremacy Clause (Preemption)

California Mortgage Ass'n v. Bonta

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- On June 3, 2026, Judge Dale A. Drozd dismissed case based on sovereign immunity because Attorney General Bonta lacked a sufficiently direct enforcement connection

- Plaintiffs filed a Rule 59/60 motion to vacate and seek leave to add the DFPI Commissioner; the hearing is set for October 19, 2026.

- Appeal pending in the Ninth Circuit.

2026 Cases

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- *Sewell v. Franklin Credit Mgmt. Corp*. (June 25, 2026): § 2924.13 did not create a retroactive basis to unwind a 2024 foreclosure based on conduct that was not unlawful when it occurred.

- *Estrada v. Real Time Resolutions* (April 20, 2026): § 2924.13(d)'s injunction language did not create a mandatory entitlement to a lis pendens or transform allegations into a real-property claim.



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California Finance Code 90002

SB 825: Expanded DFPI UDAAP Enforcement

SB 825: What Changed

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- Effective January 1, 2026.

- The CCFPL already prohibits covered persons and service providers from engaging in unfair, deceptive, or abusive acts or practices (UDAAP).

- Before SB 825, Entities acting under the authority of a license "of any state agency" and certain categories of DFPI licensees were largely shielded from DFPI action. (Cal. Fin. Code §§ 90002(a), (b).)

- After SB 825: These entities will now be subject to DFPI regulation and investigation if those entities engage in unfair, deceptive, or abusive conduct, thereby causing overlapping regulatory oversight, duplicative investigations, and increased compliance costs

- SB 825 expands DFPI's ability to police UDAAP

Who Is—and Is Not—Affected

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- Impacted:
  - Escrow agents
  - CFL licensees
  - broker-dealers/investment advisers
  - CRMLA licensees
  - California-chartered institutions
  - licensees of other state agencies

- EXEMPT: National Banks, out-of-state banks, and credit unions

Why SB 825 Matters

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- Increased UDAAP actions
- Available enforcement remedies: administrative or civil proceedings, restitution, rescission, injunctive relief and civil penalties
- "Unfair" and "deceptive" standards draw from California UCL concepts
- "Abusive" drawn from Dodd-Frank: conduct that "materially interferes with the ability of a consumer to understand" a product's terms or that takes "unreasonable advantage" of a consumer's lack of understanding, inability to protect themselves, or reasonable reliance. (12 U.S.C. § 5531(d).)

AB 130/SB 825: The Combined Risk

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- AB 130 creates substantive foreclosure restrictions and a sworn certification tied to servicing history.

- SB 825 expands DFPI's ability to police UDAAP

- A servicing practice can therefore generate multiple layers of exposure: borrower injunction/remedies, foreclosure defenses, UCL theories and regulatory scrutiny.
- The compliance question is no longer only "Did we satisfy the foreclosure statute?" but also "Could the process be characterized as unfair, deceptive or abusive?"



AB 493
&
California Civil Code Section 2954.85

Hazard Insurance Proceeds Held in Escrow



Background

- Assembly Bill 493 was introduced in 2025
- Legislative bill analysis
  - Referenced *Gray v. Quicken Loans, Inc*., 61 Cal. App. 5th 524 (March 2, 2021) regarding Civil Code Section 2954.8
  - Referenced 2025 Los Angeles wildfires
- On August 29, 2025, Governor Newsom signed California Assembly Bill 493 (AB 493) into law and it became effective immediately
- Amends the Cal. Civil Code to include new Section 2954.85



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Background (cont.)

- Civil Code 2954.85 requires:
  - Mortgage lenders that make loans secured by property containing 1- to 4-family residences
  - To pay interest on any insurance proceeds following property damage or loss that is held by the mortgage lender



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Covered Lenders

- Civil Code 2954.85 applies to financial institutions
- "Financial institution" is defined as:
  - A bank, savings and loan association or credit union chartered under the laws of California or United States, or any other person or organization making loans upon the security of real property containing only a 1- to 4- family residence



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Covered Loans

- Civil Code Section 2954.85 applies to loans made upon the security of real property containing only a one- to four family residence and which is located in California ("Covered Loans")
- Also applies to those that purchase Covered Loans
- The requirements apply regardless of the nature or purpose of the Covered Loan (such as a consumer loan or commercial loan)



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New Requirements

- Requires financial institutions that hold hazard insurance proceeds related to a Covered Loan in a loss draft account pending property rebuilding or repair, to apply interest on those funds at a rate of at least:
  - **2% simple interest per annum**



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New Requirements (*cont.*)

- The interest must be credited to the loss draft account annually or upon termination of the account (whichever is earlier)

- If a loss draft account was opened prior to the effective date of AB 493, then interest must begin to accrue under the new law as of the effective date of the bill (that is, August 29, 2025)

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New Requirements (*cont.*)

- Financial institutions are prohibited from imposing a fee or charge in connection with the maintenance or disbursement of hazard insurance proceeds if:
  - It would result in an interest rate of less than 2% percent per annum being paid on the hazard insurance proceeds. Section 2954.85(b).



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Exception

- Requirements 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 by a non-bank financial institution in a non-interest bearing demand trust fund account of a bank



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What is a Lost Draft Account Under AB 493?

- Section 2954.85 does not define the term “loss draft account”
- “Loss draft” is a term used in the insurance industry that refers to insurance claim payments
- So, it seems a “loss draft account” would refer to a bank account holding insurance claim proceeds (a type of “escrow” account)



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New AB 1278 to Amend Section 2954.85

- AB 1278 was signed into law on September 30, 2026
- Becomes effective January 1, 2027



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New AB 1278 to Amend Section 2954.85

- Changes effective January 1, 2027:
  - Adds that in addition to paying the interest to the draft account, alternatively interest can be "*paid directly to the borrower*"
  - If paid directly to the borrower, the payment "*shall be made by check, electronic funds transfer, including automated clearing house transfers, or another payment method agreed to by the borrower*."
    - A "check" means a draft payable on demand and drawn on a bank and which can be canceled by the issuer
    - Does not include a cashier's check, money order, or other instrument that cannot be canceled by the issuer
  - If the check is uncashed 90 calendar days after delivery, then it must be canceled (at no cost to the borrower) and the amount credited to the loss draft account



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Litigation Update
on
California Civil Code Section 2954.8(a)

Interest on Mortgage Escrow Accounts

Overview of Section 2954.8

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- Every financial institution that makes loans secured by real property containing only a one- to four-family residence located in California, and that maintains an impound account, is required to pay interest to the borrower. Section 2954.8(a).

- "Financial institution" includes a bank, savings association, credit union and any other person or organization making one- to four-family residential loans. Section 2954.8(c).

Overview of Section 2954.8

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- The interest rate on impound accounts must be at least 2% simple interest per annum.
- The interest must be credited to the borrower's account annually or upon termination of the account, whichever is earlier.
- A financial institution is prohibited from imposing fees or charges for maintaining an impound account that would result in a net interest rate of less than 2% per annum.

Overview of Section 2954.8

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- The provisions of Section 2954.8 do not apply to the following:
  - Loans executed prior to January 1, 1980; or
  - Moneys which 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. Section 2954.8(d)(2).

Cantero v. Bank of Am., N.A. 175 F.4th 201 (2d 2026)

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- In *Cantero v. Bank of America* (2024), the U.S. Supreme Court rejected a categorical preemption test but did not decide whether state escrow-interest laws are preempted.

- Remanded to conduct a "nuanced comparative analysis" under the Dodd-Frank Act and *Barnett Bank of Marion County, N.A. v. Nelson* to see if the state law actually prevents or significantly interferes with a national bank's powers

- On remand, the Second Circuit (2-1) ruled that New York's 2% escrow interest law is preempted for national banks because it significantly interferes with mortgage-lending powers.

- May 22, 2026 – Petition for Certiorari filed.

Kivett v. Flagstar Bank, 154 F.4th 640

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- Flagstar did not pay interest on escrow accounts before 2017, asserting National Bank Act (NBA) preemption.

- District Court: Granted summary judgment under *Lusnak v. Bank of America*, 883 F.3d 1185 (9th Cir. 2018), holding that California's escrow-interest requirement is not preempted by the NBA.

- Ninth Circuit (2018) - held California's interest-on-escrow law not preempted by the National Bank Act.
-
- The Supreme Court vacated and remanded the Ninth Circuit's affirmance for reconsideration in light of Cantero.

Kivett v. Flagstar Bank, 154 F.4th 640

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- Ninth Circuit - The Supreme Court's decision in Cantero did not decide whether interest-on-escrow laws are preempted. That decision is not clearly irreconcilable with *Lusnak's* reasoning or result, so the panel lacks authority to overrule *Lusnak*.

- A petition for Certiorari was filed on June 1, 2026.

Default Interest Provisions for Commercial Loans in Light of the *Honchariw* Case



Background

- California Civil Code Section 1671 provides that liquidated damages provisions in non-consumer contracts are generally valid unless the amount assessed is unreasonable under the circumstances when the contract was made

- Seems to indicate that default interest rate provisions are enforceable if they represent a reasonable approximation of the actual cost to the lender of carrying the defaulted loan, and are not punitive

Background

- Courts have previously upheld default interest provisions for commercial loans when default interest was assessed on the entire balance of a matured commercial loan
  - Such as in *East West Bank v. Altadena Lincoln Crossing, LLC*, 598 B.R. 633 (Bankr. C.D. Cal. 2019)



Honchariw v. FJM Private Mortgage Fund, LLC, 299 Cal. Rptr. 3d 819 (Ct. App. 2022)

- Facts
  - A $5.6 million commercial loan was made to the borrowers with an interest rate of 8.5% per annum, secured by real property
  - When the borrowers failed to make the monthly payment of $39,667, the lender assessed the following pursuant to the late payment provision set forth in the loan documents:
    - A one-time **10% late fee** against the overdue payment; and
    - A **default interest charge of 9.99%** per annum against the total unpaid principal balance of the loan

Honchariw

- California appellate court held:
  - The default interest rate assessed on the entire unpaid principal balance of a commercial loan (that was not matured) was an unlawful liquidated damages award under Section 1671

Honchariw

- On December 9, 2022, Buchalter (representing the CBA as *amicus curiae*) submitted a letter to the California Supreme Court in support of review of the *Honchariw* case, or (in the alternative) to make the case "unpublished"

- On December 21, 2022, the California Supreme Court denied a petition to review the California appellate court's decision, which made the appellate court's decision final

Honchariw

- Options to consider:
  - Lower default interest rates
    - Challenge is that not all defaults are the same (such as monetary v. monetary defaults)
    - Also, the outstanding balance on the loan will impact whether the default rate results in a reasonable approximation of the actual cost to the lender
  - Some lenders have imposed set fees for certain types of defaults
  - Others?

Honchariw

- Other issues to consider:
  - Representing that a default rate that may be assessed when it may be "unlawful" under Civil Code Section 1671 per *Honchariw*
    - Could be argued as violation of California's Unfair Competition Law in California Business & Professions Code Section 17200 *et seq*.
    - Similar argument was asserted in *Cohen & Assocs. Invs., LLC v. Luther Burbank Sav.*, 2023 Cal. Super. LEXIS 99490 (Dec. 1, 2023)
    - The court rejected the argument since *Honchariw* had not been formally decided when the lender assessed the default rate
  - LaserPro docs can be supplemented



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Honchariw

- What the case means for lenders with regard to **existing** loans?
  - Lenders should realize that charging default interest on the entire balance of an unmatured commercial loan may potentially run afoul of Section 1671 as interpreted in the *Honchariw* case
  - Lender is bound by what the loan docs (as may be modified) provide with regard to default rates and fees
  - Consult with legal counsel as needed

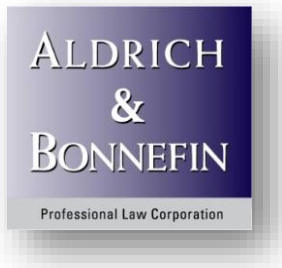
Additional Updates



Section 1071/SBLDC Rule Update

- Section 1071/Small Business Lending Data Collection (SBLDC) Rule was amended in May 2026 (91 FR 23530)
  - Extended the compliance deadlines for all covered lenders to January 1, 2028
  - Changed thresholds to qualify as a covered lender and a small business under the SBLDC Rule (*next slide*)
  - Changed the scope and type of data that lenders must collect under the SBLDC Rule





SBLDC Rule Updates

- New threshold under the SBLDC Rule
  - A “covered financial institution” now means a financial institution that originated at least 1,000 “covered credit transactions” for “small businesses” in each of the two preceding calendar years
  - The new final rule lowered the SBLC gross annual revenue threshold to qualify as a “small business” from $5 million to $1 million or less during the proceeding fiscal year





Lending to Non-Work Authorized Illegal Aliens

- On May 19, 2026, President Trump issued Executive Order (EO) 14406 titled "*Restoring Integrity to America's Financial System*"
  - Meant to "… *address the credit risks posed by extending financial services to* ***non-work authorized illegal aliens***"
- EO 14406 directed the CFPB, FRB, OCC and NCUA to issue clarifying statements/guidance

Lending to Non-Work Authorized Illegal Aliens

- On June 8, 2026 the CFPB issued "Statement on Ability To Repay and Immigration Status"
  - Provides guidance on a non-work authorized borrower's ability to repay under Reg Z
  - When determining repayment ability, permitted to consider the individual's immigration status and ability to earn income in the U.S. (when relying on income derived from U.S.-based employment)
    - An obligation to consider such information arises if documentation in the application (or other records) indicates the consumer's repayment ability will change on account of their immigration status
  - A creditor's awareness of immigration status may implicate a creditor's reasonable expectations about whether U.S. income will remain available for repayment
  - Indications that an individual may not be lawfully present may come from various sources, including direct inquiry or the consumer's reliance on atypical identification methods
  - Considering whether information regarding an applicant's immigration status indicates a reasonably expected change in future income is a matter of sound compliance practice

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Lending to Non-Work Authorized Illegal Aliens

- "Interagency Guidance on Lending to Individuals Not Legally Authorized to Work in the United States"
  - Issued by the FDIC, OCC and the NCUA (FRB has so far refrained from issuing guidance)
  - Outlines credit risk and underwriting considerations when lending to non-work authorized aliens, and refers to the CFPB's statement
  - Notes that lending to non-work authorized borrowers may present an elevated credit risk because a borrower's ability to generate income, maintain employment, and remain financially stable may be uncertain



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California AB 801

- California Fair Lending Examination Act
- Signed into law on September 30, 2026, effective January 1, 2027
- Requires the DFPI commissioner to, at least once every 4 years, examine banks and credit unions
  - For compliance with any nondiscrimination law applicable to mortgage lending
- Requires the DFPI commissioner to provide a written statement of the findings of that examination, and take appropriate steps to ensure correction of any violations
- More guidance may be issued by the DFPI

We're adjourned!



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