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Compliance Alert

AB 130 AND THE NEW "ZOMBIE MORTGAGE"
COMPLIANCE MANDATE

Effective July 1, 2025, California's Assembly Bill 130 (AB 130) brings major implications for mortgage servicers and lenders in California, particularly those handling second mortgages and HELOCs. Specifically, AB 130 adds Section 2924.13 to the California Civil Code, to address concerns about so-called "zombie mortgages" or dormant second liens that have long gone quiet, only to resurface and trigger foreclosure.

Notably, the law applies retroactively and introduces a set of compliance requirements that financial institutions should familiarize themselves with and update their servicing policies and practices accordingly. As a preliminary matter, before foreclosing or "threatening" to foreclose on a second lien, AB 130 requires that the financial institution (or the mortgage servicer, trustee, or authorized agent acting on behalf of the financial institution) certify, under penalty of perjury, that it has complied with specific servicing obligations.

Violations of the servicing obligations imposed by AB 130 include failing to send billing statements, missing required transfer disclosures, or making statements that could mislead a borrower about the status of the loan. Another example of unlawful conduct under AB 130 includes situations where a mortgage servicer has not provided the borrower with any written communication regarding the loan for at least three years. If the financial institution has engaged in any of the unlawful practices specified in AB 130, it could preclude the financial institution from successfully foreclosing on a second mortgage lien. Moreover, proceeding to foreclose on a second lien in violation of AB 130 could result in significant exposure for the financial institution, including injunctive relief enjoining a nonjudicial foreclosure sale, providing an affirmative defense to the borrower in a judicial foreclosure sale, and allowing a judicial officer to impose other equitable remedies such as striking the arrears claims, barring foreclosure, or setting aside a nonjudicial foreclosure sale.

Based on the significant consequences of failing to comply with AB 130, financial institutions should take a close look at their second lien portfolios, especially accounts that are dormant or were acquired from other servicers. Financial institutions should also ensure that all files are complete, communication logs are clear, and periodic statements were sent as required. Reengaging with borrowers may also help safeguard enforcement rights, particularly where accounts have been inactive. However, such communications should be carefully reviewed to ensure compliance with applicable laws.

Furthermore, loans that were transferred or service released to the financial institution should be reviewed carefully. Before foreclosing on any second lien that was previously serviced by another institution, it is important to confirm that all required borrower

notices were delivered and that the loan file and documentation support the servicing history. If the file is incomplete or unclear, that could affect enforcement rights and create potential liability for the financial institution.

For loans that are already in default, or close to it, financial institutions will need to make sure the certification process is followed properly. If there is any uncertainty about past servicing conduct, financial institutions may need to consider pausing foreclosure efforts to ensure full compliance with AB 130.

To summarize, AB 130 changes how second-lien holders are expected to manage and enforce dormant debt. Financial institutions will need to be more deliberate, more transparent, and more thorough in how they service and maintain loan records and communicate with borrowers in order to protect their rights and limit their liability going forward. It is also worth noting that the law may be subject to legal challenge, and its current form could evolve depending on how courts interpret or respond to its provisions.

If your team could use support reviewing your portfolio, revising borrower communications, or navigating AB 130's certification process, we are here to help. As always, preparation on the front end can prevent bigger issues down the road.