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STATE OF NEVADA
FINANCIAL INSTITUTIONS DIVISION
DEPARTMENT OF BUSINESS AND INDUSTRY

GEORGE E. BURNS
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Deputy Commissioner

September 8, 2010

Francis Grady, Esq.
Grady & Associates
20950 Center Ridge Road, Ste. 100
Rocky River, OH 4416

RE: Petition for Advisory Opinion Regarding Legal Lending Limits

Dear Mr. Grady:

This letter constitutes the response by the Financial Institutions Division, State of Nevada Department of Business and Industry (hereafter the "Division") regarding your request for an advisory opinion dated May 28, 2010. The request was made pursuant to Nevada Administrative Code (NAC) 232.040, *et seq.*

STATEMENT OF ISSUES

Grady and Associates (hereafter "Petitioner") is requesting an advisory opinion on two issues:

1. Whether it is permissible to include the allowance for loan and lease losses (ALLL) when calculating the legal lending limits made pursuant to NRS 662.145.
2. Whether *ad hoc* overdraft payments resulting from the presentment of insufficient funds items on a checking account are considered "loans" for the purpose of determining compliance with NRS 662.145.

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ANALYSIS

1. Allowance of Loan and Lease Losses (ALLL) and other reserves are included as shareholders' equity when calculating the legal lending limit under NRS 662.145.

NRS 662.145 reads as follows:

NRS 662.145 Limits on amount of loans; exceptions.

1. Subject to the limitations set forth in NRS 662.155, the total outstanding loans of any bank to any person, company, corporation or firm may not at any time exceed 25 percent of the stockholders' or members' equity of the bank, actually paid in. The discount of bills of exchange drawn in good faith against actual existing values, as collateral security, and a discount or purchase of commercial or business paper, actually owned by the persons, must not be considered as money loaned.

2. Neither the limitation on loans by banks contained in this section nor any other similar limitations contained in any law of this state relating to banks or banking apply to any loan or loans made by any bank to the extent that they are secured or covered by guarantees or by commitments or agreements to take over or to purchase made by any Federal Reserve Bank or by the United States or any department, bureau, board, commission or establishment of the United States, including any corporation wholly owned, directly or indirectly, by the United States.

3. The Commissioner may establish limitations on loans made by a bank to its directors, officers or employees and may establish requirements for the reporting of these loans.

4. The Commissioner may adopt regulations necessary to carry out the provisions of this section.

Petitioner's first question is whether or not reserves such as Allowances for Loan and Lease Losses (ALLL) are considered part of "stockholders' equity" for purposes of calculating the loan limits of NRS 662.145. The ALLL is a cash reserve maintained by banks and other financial institutions based upon estimates of uncollectable balances. Petitioner's argument that "stockholders' equity" includes by definition such reserves is well taken. NRS 657.070 defines "stockholders' equity" as "the capital, surplus and retained earnings of a bank." The Division has defined "surplus" for purposes of NRS 662.145 to include "reserves for contingencies and other capital reserves, excluding accrued dividends on perpetual and limited life preferred stock." Nevada Administrative Code (NAC) 662.006(3).

The definition contained in NAC 662.006 was originally meant for the term "surplus" as was contained in NRS 662.145. However, in 1997 the term "surplus" was removed from the statute. While the deletion of a term in statute is generally interpreted as a substantial change in the law, *McKay v. Board of Sup'rs of Carson City*, 102 Nev. 644, 650, 730 P.2d 438, 442 (1986) (citation omitted); *Hardy & Hardy v. Wills*, 114 Nev. 585, 589, 958 P.2d 78, 80 (1998), a review from the

legislative history indicates that no substantial change was intended. The terms capital and surplus were replaced by "stockholders' equity" to conform to "more common corporate concepts" and to create parity with corporate law generally. Hearing on A.B. 360 before the Assembly Committee on Commerce, 1997 Legis., 69th Sess. 16-17 (May 14, 1997).

Petitioner points out that the Nevada Attorney General issued an opinion stating that reserves could not be used in calculating "capital" and "surplus" under the previous version of NRS 662.145. Nev. Atty. Gen. Op. 90-9 (1990). However, this opinion was superseded by the enactment of NAC 662.006 in 1992. "A properly adopted substantive rule establishes a standard of conduct which has the force of law." *State ex rel. Tax Comm'n v. Safeway*, 99 Nev. 626, 668 P.2d 291 (1983).

Consequently, the bank may use reserves such as ALLL in its calculation of stockholders' equity when determining its loan limits pursuant to NRS 662.145. As the term "surplus" was retained by the Legislature in the definition of "shareholders' equity," no substantial change in the law was intended and none shall be created here.

2. The bank's payment of overdrafts on checking accounts is an extension of credit and a loan and subject to the legal lending limit under NRS 662.145.

The term "loan" for the purposes of NRS 662.145 is described in NAC 662.008 and reads as follows:

NAC 662.008 Limits on amount of loans: "Total outstanding loans" interpreted. (NRS 658.105, 662.145, 662.155) For the purpose of determining "total outstanding loans," as used in NRS 662.145:

1. If a loan is secured by a cash deposit, which is under the direct control of the bank making the loan, the amount of the loan does not include the amount of the cash deposit.

2. Any loans subject to the requirements of subsection 1 of NRS 662.145 and subsection 1 of NRS 662.155 must be combined if:

(a) The proceeds of the loan directly benefit another borrower with loans that are outstanding at the same bank; or

(b) A common enterprise exists between the borrowers.

3. For the purposes of this section:

(a) A "common enterprise" exists if the source of repayment for a loan is the same for each borrower or a loan is made to borrowers related through common control.

(b) "Common control" exists if:

(1) One or more persons directly or indirectly own, control or have power to vote 25 percent or more of a class of voting securities of another person;

(2) One or more persons act in concert to control, in any manner, the election of a majority of the directors, trustees or other persons exercising similar functions of another person; or

(3) Any other circumstances exist which indicate that one or more persons acting in concert directly or indirectly exercises a controlling influence over the management of policies of another person.

Clearly, NAC 662.008(1) includes in the definition of "loan" the general transaction of paying a check from an overdrawn account and then collecting the money from the account when funds are deposited.

Although, Petitioner asked this question without reference to any particular bank or business, deposit contracts will generally provide that where overdrafts are covered by the bank, the bank is extending credit at a cost to the account holder. This conduct clearly falls within the definition of "loan" which is "a grant of something for temporary use." Black's Law Dictionary (8th ed. 2004). Similarly, courts have viewed this process as the extension of a loan which must be repaid. See, *National Bank of Andover v. Kansas Bankers Sur. Co.*, 225 P.3d 707, 724 (Kan., 2010), *quoting*, *Lincoln Nat'l Bk. & Trust v. Peoples Trust Bk.*, 177 Ind.App. 312, 379 N.E.2d 527 (1978).


Therefore, the bank's payments of overdrafts to checking accounts are loans and subject to the limitation stated in NRS 662.145.

CONCLUSION

Based on the foregoing, allowance for loan and lease losses and other reserves are considered "stockholders' equity" for the purpose of calculating the loan limit pursuant to NRS 662.145. Additionally, the bank's payment of overdrafts to a checking account is considered "loans" under that calculation as well.

Sincerely,

STATE OF NEVADA
DEPARTMENT OF BUSINESS & INDUSTRY
FINANCIAL INSTITUTIONS DIVISION



GEORGE E. BURNS
Commissioner