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STATE OF NEVADA
FINANCIAL INSTITUTIONS DIVISION
DEPARTMENT OF BUSINESS AND INDUSTRY

GEORGE E. BURNS
Commissioner
STEVEN W. KONDRUP
Deputy Commissioner

March 26, 2010

Matthew D. Saltzman, Esq.
Kolesar & Latham, Chtd.
Well Fargo Financial Center
3320 West Sahara Avenue, Ste. 380
Las Vegas, Nevada 89102

RE: *Petition for Advisory Opinion Regarding NRS 662.015*

Dear Mr. Saltzman:

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 on behalf of your client Southwest USA Bank (hereafter the "Petitioner"). The request was made pursuant to Nevada Administrative Code (NAC) 232.040, *et seq.*

STATEMENT OF ISSUES

The Petitioner has made two requests. First, it requested a response on the proper procedure for accounting for real estate held following foreclosure, based upon a hypothetical scenario. A restatement of the proposed facts and responses to them are fully stated below.

Second, the Petitioner requests that the Division waive the requirements of Nevada Revised Statutes (NRS) 662.015 that a bank write off the real estate it holds pursuant to the collection of a debt.

ANALYSIS

A. *Petitioner's Accounting Questions Related to NRS 662.015.*

The Petitioner's questions concern the interpretation of NRS 662.015(3) which reads as follows:

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3. This section does not prohibit any bank from holding, developing or disposing of any real property it may acquire through the collection of debts due it. Any real property acquired through the collection of debts due it may not be held for longer than 10 years. It must be sold at private or public sale within 30 days thereafter. ***During the time that the bank holds the real property, the bank shall charge off the real property on a schedule of not less than 10 percent per year, or at a greater percentage per year as the Commissioner may require.***

The Petitioner presents a hypothetical scenario where a borrower defaults on a loan to a Bank secured by real property. The remaining balance on the loan is \$1 Million. The Bank forecloses. The property has a fair market value of \$400,000, which is the book value the bank accounts for the property under Other Real Estate Owned (OREO). Given these facts, Petitioner requests the answer to the following questions:

1. Must the required charge off occur within a calendar year or within twelve (12) months from the date the property was placed in OREO?

The Bank must make the charge off pursuant to NRS 662.015(3) after twelve months from the date the property was placed in OREO. The statute makes clear that the charge off should occur "during the time that the bank holds the real property..." Further, the fact that statute reads "10 percent per year," and not calendar year, indicates that the Legislature intended that the accounting should occur annually and not at the end of each calendar year.

2. Does the initial charge off of \$600,000 (the difference between the loan balance and the fair market value) at the time of acquisition constitute the first annual charge off of the OREO property?

No. Based upon the statutory requirement that this write off occur "during the time the bank ***holds*** the real property," the write off must occur after the foreclosure sale has taken place. NRS 662.015(3). This corresponds to the accounting requirement that loss on the loan and the gain of the real property asset are recorded separately in the Bank's financial statement.

3. Can the initial charge off of \$600,000 apply to the required 10% charge off for all future years until the OREO property is either sold or the charged-off amount is exhausted?

For the same reasons as stated above, the answer is no. Pursuant to Financial Accounting Standards (FAS) 144, the Bank is required to account for the property at acquisition at the fair market value, or \$400,000, minus the cost to sell the property. As the balance of the loan is not the determination in the value of the asset, it should not be considered a factor in the write off. The 10 percent write off is based upon the current appraised value of the real property "during the time" that the bank is holding it, and no other time. As will be more fully explained below, the

intent of the statute was to discourage a bank from holding real property excessively and avoid real estate speculation. By front loading the entire write off at the time of foreclosure, the intent of the statute would be lost.

However, if the current appraised fair market value of the real property should decline by an amount greater than 10 percent during any twelve month period it is held by the Bank, then no additional write off is required. The current appraised value is established at the time the real property is placed in OREO, in this case \$400,000, and each year thereafter by appraisal throughout the period in which the Bank holds the property. If property values continue to fall, banks can include the 10 percent in the actual decline in the property's value. Using the hypothetical as an example, if the following year after foreclosure the property's current appraised value in OREO was \$360,000, then no additional write off is required because the property already depreciated by \$40,000 (10 percent of \$400,000). If, however, the appraised value fell to only \$380,000, then the bank would be required to write off an additional \$20,000 to meet the 10 percent minimum \$40,000 total.

B. The Bank's Request for Waiver of NRS 662.015 Requirements.

Next, the Petitioner requests that it be exempt from the provisions of NRS 662.015(3) pursuant to NRS 662.015(1)(f) which permits a state chartered bank to act as a national bank would operate.

Exercise any authority and perform all acts that a national bank may exercise or perform, with the consent and written approval of the Commissioner. The Commissioner may, by regulation, waive or modify a requirement of Nevada law if the corresponding requirement for national banks is eliminated or modified.

This law was enacted as a "wild card" statute, with the intent that state banks would not be held to a competitive disadvantage to their national counterparts because state law was not able to keep up with national trends. During the hearing on this bill, one bank president testified that he had "found that it was very difficult for banks to operate with out-dated regulations." *Hearing on S.B. 343 before the Senate and Assembly Standing Committees on Commerce*, 1971 Legis. 56th Sess. 3 (March 16, 1971).

Here the Petitioner requests that the "write off" requirement be waived because this is an act which national banks are not required to do. In support of this assertion, it cites federal regulations and policy standards for accounting procedures for real property acquired through foreclosure. However, these accounting standards are utilized throughout the industry. The Petitioner and every other bank is accounting for its OREO under the very standards that it describes in its petition. The requirement contained in NRS 662.015(3) is merely a modification that 10 percent of OREO be subtracted from asset on an annual basis.

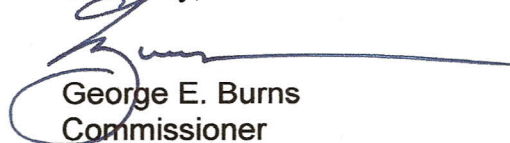
Moreover, the Petition requests that the Commissioner make change in Nevada law which can only be accomplished by regulation and only to address "the corresponding requirement for national banks is eliminated or modified." NRS 662.015(1)(f). The provision requiring a 10 percent write off was never part of the federal law, and as such, this request is not based upon any elimination or modification of an existing federal requirement. As the Petitioner emphatically states, "There is no statutory or regulatory requirement for a national bank to 'charge off' a certain percentage of OREO property on an annual basis as required by Nevada law." (Emphasis included). Indeed, federal law did not require a "write off" even when Nevada enacted the requirement. Consequently, because the change requested requires a change in existing Nevada law which is not the result of modification or elimination of a corresponding federal law, the request falls outside the scope of the NRS 662.015(3). Therefore, the only way this requirement can be lifted is through an act of the Legislature, which the Commissioner does not support.

The intent behind this law is to discourage and disincent banks from holding real property obtained through collection of debts due as an asset for an excessive period of time. The real estate holdings of banks are non-earning assets that in the case of OREO are supported by deposits which are not liquid and not readily available for withdrawal or lending. The law was enacted to ensure that banks engage in the fundamental business of banking; that is, taking deposits and making loans, and not real estate speculation. As the hypothetical demonstrates, in a dramatically declining market, the write off percentage is irrelevant, because values have dropped year-over-year more than the 10 percent established under NRS 662.015(3). However, in a relatively stable market or where values are increasing, the statute encourages banks to sell the property and make loans with the money rather than tie the money to the value of relatively illiquid real property.

This requirement is not solely a product of Nevada law. Other states have enacted similar legislation in order to address the same issues. Oregon requires disposition of OREO within 15 years and reduced in book value by five percent every year. ORS 708A.195 and 708A.590. Further, Alaska provides that a bank is only permitted to hold OREO for the time prescribed by the regulation and afterward is written off in its entirety and may not be carried as an asset. Alaska Stat. § 06.05.245.

Therefore, based upon the above, the Commissioner will not waive the write off requirement for OREO on banks or any other depository institution pursuant to NRS 662.015.

Sincerely,



George E. Burns
Commissioner