

The Uncertainty Regarding AB 273's "Insurance" Offset To Deficiency Awards

by

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On June 10, 2011, Nevada enacted Assembly Bill 273 ("AB 273") in law, which made a number of changes to Nevada's deficiency scheme. Among the changes it made was the addition of NRS 40.459(2), which provides as follows:

For the purposes of this section, the "amount of the indebtedness" does not include any amount received by, or payable to, the judgment creditor or beneficiary of the deed of trust pursuant to an insurance policy to compensate the judgment creditor or beneficiary for any losses incurred with respect to the property or the default on the debt.

A similar provision was enacted with respect to junior lienholders in NRS 40.4636(1). As explained in the legislative history, these provisions are meant to prevent a lender from obtaining a judgment against a borrower for a loss that is covered by insurance. Unfortunately, there are a number of issues that make these provisions' operation unclear.

First, most if not all insurance policies have provisions that allow the insurer to recover any loss payment by means of the express reservation of subrogation, lien, or reimbursement rights. For example, assume that a PMI insurer paid a creditor's claim for a loss after foreclosure. The PMI policy is very likely to give the insurer the right to subrogate to the creditor's position such that the insurer could seek a deficiency judgment in the same manner that the creditor could. It is unclear whether NRS 40.459(2) simply cuts off the insurer's contractual right to such recovery in these instances.

Second, it is unclear what exactly qualifies as an "insurance policy," which is not defined in the Nevada Revised Statutes. The legislative history specifically suggests that NRS 40.459(2) should apply to loss-share agreements between the FDIC and banks that have assumed a failed bank's assets from the FDIC. Indeed, debtors have already raised this issue in litigation where the loan at issue was transferred from the FDIC to the plaintiff-creditor. Yet, a loss-share agreement bears little resemblance to an "insurance policy," as that term is generally understood. Rather, the FDIC is operating in its statutorily mandated role as the *receiver of a failed bank*—as opposed to its distinct role as the *insurer of certain kinds of deposit accounts*—when it enters such agreements. Moreover, assuming banks in such instances are obligated to reasonably pursue recoveries, including deficiency judgments, and then credit the FDIC. Similarly, NRS 40.459(2) may also apply to the kind of mortgage insurance provided by federal entities like the Federal

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Housing Administration and Veteran's Administration, which is used to help low-income borrowers and veterans acquire credit to purchase residential homes. Accordingly, it is unclear whether NRS 40.459(2) applies in such instances and, if so, whether that application would run afoul of the federal preemption and contracts clause doctrines of the Nevada and U.S. Constitutions.

Third, it is unclear whether the "amount received by, or payable to, the judgment creditor or beneficiary of the deed of trust pursuant to an insurance policy" includes the attorney's fees and costs that a lender may be entitled under the insurance policy or loan instruments. Losses from the default of a debt generally include reimbursement for the attorney's fees and costs incurred by the lender, which is distinct from the amount of the debt payable to the lender.

While there are a couple writ petitions pending before the Nevada Supreme Court on AB 273's addition of NRS 40.459(1)(c) (the "consideration" provision), neither NRS 40.459(2) nor NRS 40.4636(1) is at issue in those cases. Thus, while the Court's opinions in these cases may shed light as to whether AB 273 operates retroactively from the statute's June 10, 2011 effective date, the Court is unlikely to shed light on the substantive issues noted above anytime soon.