Order Code RS21104
Updated February 21, 2003

CRS Report for Congress
Received through the CRS Web

# Should Banking Powers Expand into Real Estate Brokerage and Management?

William D. Jackson
Specialist in Financial Institutions
Government and Finance Division

## Summary

In late 2000, the Federal Reserve and the Treasury proposed to use their authority to increase banking powers. The regulators proposed allowing banking companies to engage in real estate brokerage and management, as activities that are financial in nature. Their proposal has been controversial, pitting real estate companies against banks. The substantiative issues are two: those that question the respective nature of banking and of real estate activities; and those that question what the impact on consumers will be. Procedural questions involve the intent of the 106th Congress in the Gramm-Leach-Bliley Act, which delegated authority to the two agencies to issue new regulations of this kind. Members have reintroduced the Community Choice in Real Estate Act, as H.R. 111/S. 98, to remove these real estate activities from consideration under the market-adaptive powers of the regulators. The House, via an amendment introduced by Representative Northup to the Treasury-Postal appropriations measure, H.R. 5120 of the 107th Congress, had voted to block issuance of the proposed rule in fiscal year 2003. That amendment was carried forward into the appropriations package passed early in the 108th Congress, H.J. Res. 2. As a result, the Treasury Department is forbidden to act upon its regulation until October 2003, when fiscal year 2004 begins. Consequently, the Federal Reserve cannot issue it either. This report will be updated as events warrant.

## Framework of Legislation and Regulation

The Gramm-Leach-Bliley Act (GLBA, P.L. 106-102)[1] was landmark legislation that allowed banking, securities, and insurance companies to operate in affiliation with each other under the umbrella organizational form of financial holding companies (FHCs.) GLBA also permitted FHCs, like financial subsidiaries of banks (FSs) newly authorized by the law, to engage in a variety of financial activities not previously allowed to banks

[1] 113 *Stat.* 1338–1481.

or companies owning banks, while continuing some prohibitions.[2] Also, GLBA invested the authority in regulators to amend and add allowable activities for FHCs and FSs to adapt to future changes in financial markets. The Federal Reserve (Fed) and the Treasury Department, through its Office of the Comptroller of the Currency (OCC), have authority to issue regulations expanding activities for FHCs and FSs, respectively.

Statutory standards in GLBA for regulatory expansion of lines of business available to FHCs and to banks through FSs are somewhat elastic. Section 103 of the Act requires that the Fed find that new activities for FHCs are financial in nature, or incidental to a financial activity, or, in a less stringent test, both "complementary" to a financial activity and not posing a substantial risk to safety and soundness. Section 121 defines the same standard for FSs. New activities must meet one or more of these tests, as determined by regulation, to be considered appropriate. GLBA allows the regulators of FHCs and FSs to propose new permissible activities according to these criteria.

Congress crafted GLBA in this way as a compromise to allow financial affiliations while avoiding a general mixing of "banking" with "commerce." For example, the law specifically excluded bank FSs from underwriting insurance, and from real estate investment and development, except as may already have been authorized by other law.[3]

In December 2000, the Fed and the Treasury released a proposal to would allow banking companies into new real estate businesses, under Sections 103 and 121 of GLBA.[4] It has proven controversial and remains unissued.

## Proposed Brokerage and Management Regulation

Their proposal would allow FHCs and FSs to enter real estate brokerage and property management, if these activities could be considered financial in nature or incidental to a financial activity. The language of the draft regulation does not address the less exacting "complementary" test. "Brokerage" includes acting as an intermediary between parties to a real estate transaction, listing and advertising real estate, soliciting sales, negotiating terms, and handling closings. It does not involve purchase or sale of property as an owner, and requires state licensing and regulation. "Property management" includes soliciting tenants, negotiating leases, servicing rents, maintaining security deposits, making operating payments, and overseeing upkeep. Managers thus need not be owners, and banking firms could not become owners of real estate through this proposal.

---

[2] FHCs hold controlling stock interests in separately incorporated or chartered businesses, such as banks, mortgage companies, stockbrokers and dealers, etc. The Federal Reserve supervises all FHCs, which are not federally insured. FSs are businesses that banks themselves own. The bank regulators supervise FSs, which, while not necessarily federally insured, are owned directly by insured banks. These structural differences are important because GLBA allows more latitude for uninsured FHCs to operate in nontraditional lines of business. FHCs are considered less likely than banks and bank subsidiaries to cause difficulties for the federal support mechanisms for banks, especially deposit insurance funds, should they encounter losses.

[3] 113 *Stat.* 1373, 12 U.S.C. 24a.

[4] Board of Governors of the Federal Reserve System and Department of the Treasury, "Bank Holding Companies and Change in Bank Control," *Federal Register*, vol. 66, no. 2, Jan. 3, 2001, pp. 307-314.

The Fed and the OCC historically disallowed real estate brokerage and property management activities for their regulated institutions. The Office of Thrift Supervision (also within the Treasury) does allow subsidiaries of federal savings associations to provide real estate brokerage and property management services. About 25 states seem to allow these activities for the financial institutions that they charter and regulate, however, actual practice of them appears very rare.[5] Conversely, real estate brokers and managers cannot offer essential banking services–accepting deposits and making commercial loans–and are not seeking to become bank-like. They do not want to form financial holding companies or obtain bank charters, and especially seek to avoid becoming regulated by the Fed or other banking agency.

Bankers (American Bankers Association, Financial Services Roundtable, and New York Clearing House Association) requested the new authority. In their view, it would allow financial institutions to offer a fuller range of financial service, using many skills that banks already have. They argue that real estate brokerage and property management are financial in nature and that the proposed changes would be beneficial to customers, because costs of realty transactions might fall.

The National Association of Realtors (NAR) opposes the proposal, arguing that the law does not authorize banking firms to provide real estate brokerage and property management services, which it argues are primarily nonfinancial in nature. From its perspective, the proposal would create anti-competitive and anti-consumer concentrations of power dominating the realty industry and might increase costs to consumers.

Arguments for and against the substance of the proposed regulation are of two kinds: those concerning the respective nature of banking and of real estate activities, and those concerning the potential impacts on consumers. Questions concerning the intent, and the application, of GLBA to what may or may not be "commercial" activities, and their effects on banking/securities/corporation practices, also persist.

## Arguments Concerning the Nature of the Industries

### Favoring the Proposal.

(1) Banks, FHCs, and FSs already engage in a variety of other real estate activities: financing, appraising, leasing, settling, escrowing, and investment advising.

(2) Agency services that FHCs and FSs provide in securities and insurance are similar to those of real estate brokers and property managers.

(3) FHCs may act as "finders," bringing together buyers and sellers of non-real-estate assets generally. (Once brought together, the parties must negotiate terms, including prices, for themselves.)[6]

---

[5] The Conference of State Bank Supervisors' listing of real estate brokerage authorities and prohibitions for state-chartered banks may be accessed on Web Site [http://www.csbs.org/government/legislative/realestate/re_chart.htm]

[6] 12 *CFR* 225.86(d).

(4) Bankers already act as intermediaries in arranging commercial real estate equity financing (transfer of title, control, and risk arrangements for projects).

(5) Several diversified financial companies provide realty services beyond their more traditional banking, securities, and insurance services. Some realty-based companies offer bank-like services.

(6) Some depository financial institutions–savings associations and state-chartered banks–already provide these kinds of real estate services.

### Opposing the Proposal.

(1) GLBA specifically prohibits FSs from engaging in real estate development and investment. Thus, its intent may have been to restrain new realty powers of bankers.

(2) Real estate brokerage and property management are commercial activities. Their necessary hands-on sales skills are far different from lending.

(3) Real estate brokerage and property management involve negotiation of realty transactions. That role has been forbidden to FHC s as "finders." FHC finders may not engage in any activity requiring registration or licensing as a realty agent or broker.

(4) At least one study states that the real estate industry is highly competitive and efficient, much more productive in these ways than financial services generally.[7] To the extent this is true, banking companies would presumably bring almost no net benefit to real estate brokerage and property management.

(5) Entry of deep-pocket banking companies, which benefit from federal assistance including deposit insurance, might drive out brokers and property managers, which typically operate on a much smaller scale.

(6) Competition for lending could decline if buyers believe that one-stop realty transacting and financing would ease credit approval. Mortgage lenders not involved with the brokerage part of realty transactions might lose business.

## Arguments Concerning Customers (Consumers and Businesses)

### Favoring the Proposal.

(1) Customers could benefit from lower costs and greater convenience if one organization provided most realty services bundled together. Transaction details (paperwork) often overwhelm buyers and sellers of property.

---

[7] This finding is a conclusion of a study by Leonard Zampano of the University of Alabama presented during a residential forum at the NAR Midyear Legislative Meetings and Trade Expo, Washington, D.C., May 17, 2001.

(2) Laws against forcing customers to obtain both non-lending services and loans from banking companies (which is called"tying") would still restrain market power of companies providing banking and realty services jointly.

(3) Clients of banks involved might not have to face the delays and complications of start-from-scratch checking of creditworthiness, which their bankers already know.

### Opposing the Proposal.

(1) Customers might believe that obtaining realty brokerage or property management services from bankers would ease credit approval for their financing. Better deals may be available from competition among multiple providers in unbundled form.

(2) Customer service could suffer with fewer specialized providers. Bank credit standards might not be appropriate for realty transactions requiring flexibility, especially when, as now, tightening credit quality concerns ("credit crunches") cut back bank lending.

(3) Low and moderate-income households lacking bank relationships might not benefit from bundled realty services designed for bank clients of greater resources.

## Developments and Legislation

***2001.*** The original proposal remained open for comment until May 1, 2001. The House Subcommittee on Financial Institutions and Consumer Credit held a hearing on May 2, 2001, in which many Members voiced disapproval of it. The NAR also raised conflict of interest questions. Two members of the seven-person Board of Governors of the Fed come from the banking industry. The NAR questioned whether they can be impartial in voting on the controversial regulation. On December 6, 2001, Representative Calvert introduced H.R. 3424, the Community Choice in Real Estate Act. It would have prohibited banking companies from engaging in real estate brokerage or real estate management activities. Supporters believed the regulatory proposal went around the congressional intent of GLBA, by redefining real estate activities as financial activities, thus mixing banking with commerce, and would be anticompetitive as well. Senator Allard introduced the Senate version, S. 1839, on December 18. H.R. 3424 gathered more than half the House as cosponsors, while S. 1839 attracted 14 cosponsors.

***2002.*** In view of the controversy over the proposal and other priorities such preventing the financial funding of terrorism, the Treasury and the Fed announced they would not be ruling on it until 2003. Despite deferral of the proposal, Congress continued to examine it. The Subcommittee on Commercial and Administrative Law of the House Judiciary Committee held an "Oversight Hearing on Proposed Federal Reserve/Treasury Department Real Estate Brokerage and Management Rule," May 16. The Subcommittee on Financial Institutions of the Senate Banking Committee held its hearing on "Bank and Financial Holding Company Engagement in Real Estate Brokerage and Property Management," May 23. On July 24, the Subcommittee on Financial Institutions and Consumer Credit of the House Financial Service Committee held its second hearing on the proposal in the current Congress, explicitly focusing on H.R. 3424.

On July 9, 2002, the House Appropriations Committee approved an amendment to the Treasury Appropriations bill, H.R. 5120, prohibiting the Treasury Department from issuing the controversial rule: " The Committee includes a new provision that prohibits funds in the bill from being used to issue regulations relating to the determination that real estate brokerage is an activity that is financial in nature or incidental to a financial activity. " Since the(non-appropriated) Fed and the (appropriated) Treasury must jointly issue any regulation(s) allowing realty powers for banking companies; if Treasury cannot, then the business mix is nonexistent. The House retained this amendment, offered by Representative Northup, on July 24, when it passed H.R. 5120. It did not appear in the Senate's counterpart measure.

***2003.*** On January 7, 2003, Representative Calvert and Senator Allard reintroduced the Community Choice in Real Estate Act, now numbered H.R. 111 and S. 98, to prohibit FHCs and national banks from engaging, directly or indirectly, in real estate brokerage or real estate management activities. Both measures are identical to their predecessors. The House bill already has 176 cosponsors, while its Senate counterpart has nine, including Senate Banking Committee Chairman Shelby.

The NAR claims chances for the measure(s) could be better in the current Congress in light of recent accounting scandals and allegations that prominent FHCs have violated financial and operation safeguards against mixing separate banking company activities. Supporters of the legislation include the Building Owners and Managers Association, Consumers Union, Institute of Real Estate Management, International Council of Shopping Centers, National Affordable Housing Management Association, and National Association of Homebuilders. In opposition, the American Bankers Association, America's Community Bankers, the Consumer Bankers Association, the Independent Community Bankers of America, and the Financial Services Roundtable have renewed their support for the original proposal, on grounds that since banks and credit unions in several states along with federal savings institutions nationwide can already engage in real estate brokerage, the issues are of fairness and of properly carrying out GLBA.

Early legislative activity in the 108th Congress included passing the basic federal spending package, H.J.Res.2. This mammoth measure is the Consolidated Appropriations Resolution FY2003. It provides funding for: Agriculture, Commerce-Justice-State, District of Columbia, Energy and water development, Foreign operations, Interior, Labor-HHS-Education, Legislative branch, Transportation, Treasury-Postal Service, and VA-HUD. Among its myriad provisions as signed by the President is the prohibition amendment, disallowing any funds for Treasury Department issuance of the bankers' real estate regulation in fiscal 2003. Thus, the earliest that Treasury and the Federal Reserve could issue the regulation is October 2003. Some believe that the new Treasury team wishes to issue it when allowed, perhaps more than a year after that date.[8]

---

[8] Adam Wasch, "Omnibus Package Includes Obstacle to Banks Becoming Real Estate Brokers," Daily Report for Executives, Feb. 13, 2003, p. A-32; and, Wasch, "Real Estate Brokerage Rule on Hold Until Congress Moves, Fed's Olson Says," *Ibid.*, Feb. 20, 2003, p. A-17.