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Should Banking Powers Expand into Real Estate Brokerage and Management?

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Summary

In late 2000, the Federal Reserve and the Treasury proposed to increase banking powers. They proposed allowing banking companies to engage in real estate brokerage and management, as activities that are financial in nature. The substantiative issues are (1) the respective nature of banking and of real estate activities and (2) the potential impact on consumers. Procedural questions involve the intent of Congress in the Gramm-Leach-Bliley Act, which delegated authority to the two agencies to issue new regulations. Treasury spending bills have forestalled any such regulations for four fiscal years, including FY2006. Most recently, the prohibition occurred via H.R. 3058, the 2006 Treasury Appropriations measure. The reintroduced Community Choice in Real Estate Act, H.R. 111/S. 98, 109th Congress, would permanently remove these real estate activities from consideration under the market-adaptive powers of the regulators. Conversely, H.R. 2660, the Fair Choice and Competition in Real Estate Act of 2005, would allow banking companies into the fields. 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), to engage in a variety of activities not previously allowed to banks or companies owning banks.[2] Under

[1] 113 Stat. 1338-1481.

[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
(continued...)

GLBA, the Federal Reserve (Fed) and the Treasury Department, which contains the Office of the Comptroller of the Currency (OCC), have authority to issue regulations expanding activities for FHCs and FSs, respectively.

In GLBA, Section 103 requires that the Fed find new activities for FHCs that are financial in nature, 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 repeats the standard for the OCC governing FSs. Congress crafted GLBA as a compromise to allow financial affiliations while avoiding a general mixing of "banking" with "commerce." It 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]

Proposed Brokerage and Management Regulation

In December 2000, the Fed and the Treasury released a proposal to allow banking companies into new real estate businesses, under Sections 103 and 121 of GLBA.[4] 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 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 the purchase or sale of property as an owner, and it 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.

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 half the states seem to allow these activities for the financial institutions that they charter and regulate; however, actual practice of bank realty powers appears very rare.[5] Conversely, real estate brokers and managers cannot offer essential banking services — accepting deposits and

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[2] (...continued)
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.

[5] Conference of State Bank Supervisors, "Real Estate Brokerage Chart," at website [http://www.csbs.org/government/legislative/realestate/re_chart.htm].

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 this 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 these activities are financial in nature and would lower the costs of realty transactions. Other supporters are the America's Community Bankers, Consumer Bankers Association, Independent Community Bankers of America, Realty Alliance, and Real Estate Services Providers Council.

The National Association of Realtors (NAR) opposes the proposal, arguing that no law, including GLBA, authorizes banking firms to provide real estate brokerage and property management, which it argues are nonfinancial in nature. From its perspective, the proposal would create anticompetitive and anticonsumer concentrations of power dominating the realty industry and increasing costs to consumers. Other opposing entities are 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.

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. (Found parties must negotiate terms, including prices, for themselves.)[6]

(4) Bankers already act as intermediaries in arranging commercial real estate equity financing (transfer of title, control, and risk arrangements for projects) and often finance the underlying 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, most visibly mortgages.

(6) Some savings associations and state-chartered banks already provide these kinds of real estate services. Twenty-seven states and the federal Office of Thrift Supervision appear to allow the activities at issue for deposit-based financial institutions, at least statutorily.

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[6] 12 CFR 225.86(d).

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. When bankers sponsored Real Estate Investment Trusts in the 1970s, most collapsed with large losses.

(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) One study states that the real estate industry is highly competitive and efficient, much more productive than financial services generally.[7] If so, bankers 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/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. Consumers, including buyers of these services, generally prefer more competitors in a field to fewer.[8]

(2) 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. The credit approval/underwriting process is the stage of real estate purchase that is usually the most delayed.

(3) Laws against forcing customers to obtain both nonlending services and loans from banking companies (which observers call "tying") would still restrain market power of companies providing banking and realty services jointly. Meanwhile, many real estate brokers seem to have close ties with favorite mortgage lenders, title companies, etc., making it easy for customers to deal with almost one-stop financial shopping.

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[7] A conclusion of a study by Leonard Zampano of the University of Alabama presented at the NAR Midyear Legislative Meetings and Trade Expo, Washington, DC, May 17, 2001.

[8] American Bankers Association, "Consumers Want More Real Estate Competition, New Survey Reveals," at website [http://www.aba.com/Press+Room/051501realestate.htm].

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, unbundled deals may be available from competition among multiple providers.

(2) Customer service could suffer with fewer specialized providers. Bank credit standards might not be appropriate for realty transactions requiring flexibility, especially when 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. On December 6, 2001, Representative Calvert introduced H.R. 3424, the Community Choice in Real Estate Act, which would have prohibited banking companies from engaging in real estate brokerage or real estate management activities. Supporters believed the regulatory proposal circumvented the congressional intent of GLBA, redefining real estate activities as financial activities, thus mixing banking with commerce. They also believed the proposal would be anticompetitive. Senator Allard introduced the Senate version, S. 1839, on December 18.

2002. Congress continued to examine the unissued proposal. The House Subcommittee on Commercial and Administrative Law held the Oversight Hearing on Proposed Federal Reserve/Treasury Department Real Estate Brokerage and Management Rule on May 16. The Senate Subcommittee on Financial Institutions held its hearing, Bank and Financial Holding Company Engagement in Real Estate Brokerage and Property Management, on May 23. On July 24, the House Subcommittee on Financial Institutions and Consumer Credit held a hearing 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 (appropriated) Treasury and the (nonappropriated) Fed must jointly issue any regulation allowing realty powers for banking companies; if Treasury cannot, then the Fed cannot either. The House retained Representative Northup's amendment on July 24, when it passed H.R. 5120.

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 were identical to their predecessors.

The 108th Congress passed the basic federal spending package, P.L. 108-7, early in 2003. It retained the prohibition amendment, disallowing any funds for Treasury

Department issuance of the bankers' real estate regulation in FY2003. Thus, an appropriations law again precluded the Treasury, hence the Fed, from issuing it.

2004. Representative Northup reintroduced the amendment that the House retained in 2002. On July 24, the Appropriations Committee voted to approve the Transportation Appropriations bill H.R. 2989, including that amendment as its Section 634. The measure prohibited FY2004 funds from being used to implement the proposed rule. The House approved that measure on December 8, 2003.[9] Senate approval on January 22, 2004, resulted in P.L. 108-199, continuing the no-spending language.

For the next fiscal year (FY2005), no-spending language reappeared as Section 523 of H.R. 5025, the Transportation, Treasury, and Independent Agencies Appropriations Act. Its ban on Treasury regulatory issuance via a spending cutoff was in the original measure, which cleared the subcommittee on July 15, 2004. Stronger, permanent, prohibitory language was included in Section 217 of the counterpart S. 2806, which, if Congress had approved it, would have had the force of law to prevent the proposed activity in the future. Following conference approval, the FY2005 omnibus spending measure, P.L. 108-447, adopted the House version.[10] The final version of the Treasury appropriations language thus included the third one-year moratorium, which lasts until the end of FY2005.

2005. Representative Allard reintroduced the Community Choice in Real Estate Act, again numbered H.R. 111. On January 24, Senator Allard reintroduced its companion bill, again numbered S. 98. Conversely, Representative Oxley introduced H.R. 2660, the Fair Choice and Competition in Real Estate Act of 2005, on May 26. It would amend the Bank Holding Company Act of 1956 (the foundation for GLBA) to allow real estate brokerage activities and real estate management activities as financial activities for financial holding companies and financial subsidiaries of national banks.[11] The House Committee on Financial Services held a hearing, Protecting Consumers and Promoting Competition in Real Estate, on June 15.[12] In the first of two reports on real estate brokerage, Government Accountability Office found that state-chartered bank activity (where permitted) apparently had little effect on competition or consumers.[13]

In the FY2006 appropriations process for H.R. 3058, covering the Treasury, conferees adopted House language prohibiting the Treasury from finalizing the contentious rule in FY2006 (Section 718). Conferees rejected stronger language in the Senate version of the measure (Section 723) that might have permanently prevented a decision on the issue, therefore issuance of any permissive regulation. President Bush signed this measure into law (P.L. 109-115) on November 30, 2005.

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[9] Division F, Title II, Section 538. *Congressional Record*, Nov. 25, 2003, p. H12415.

[10] Division H, Section 519, *Congressional Record*, Nov. 20, 2004, p. H10358.

[11] Karen L. Werner, "Reps. Oxley, Frank Introduce Measure To Allow Real Estate Brokerage for Banks," *Daily Report for Executives*, May 31, 2005 , p. A-11.

[12] See web site [http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=395].

[13] *Real Estate Brokerage Activity, Factors that May Affect Competition*, GAO-05-947, p. 22-23.