December 11, 2000

TO: Board of Governors

FROM: Staff[1]

SUBJECT: Proposed addition of real estate brokerage and management to the list of activities permissible for financial holding companies

The attached memorandum recommends Board approval to seek public comment on a proposal to determine that real estate brokerage and real estate management are activities that are financial in nature or incidental to a financial activity and, consequently, permissible for financial holding companies ("FHCs"). The proposal would not authorize FHCs to engage in real estate investment or development.

The Gramm-Leach-Bliley Act permits a bank holding company that qualifies as a FHC to engage in any activity that has been determined by the Board to be financial in nature or incidental to a financial activity. The American Bankers Association has asked the Board to determine that real estate brokerage and management activities are financial in nature. Two additional trade associations, the Financial Services Roundtable and the New York Clearing House Association, have requested that the Board permit FHCs to engage in real estate brokerage activities. The National Association of Realtors has urged the Board not to permit FHCs to engage in real estate brokerage activities. Staff believes that the

---

[1] Legal Division (Messrs. Mattingly, Alvarez, and Van Der Weide); Division of Banking Supervision and Regulation (Mr. Martinson); Division of Research and Statistics (Mr. Ettin).

Board has a reasonable basis to seek public comment on whether FHCs should be permitted to act as real estate brokers and managers.

Staff believes that the Board should seek comment on a proposal to determine that real estate brokerage and real estate management are activities that are financial in nature or incidental to a financial activity for the following principal reasons: (i) some depository institutions (namely, thrifts and certain state banks) already engage in general real estate brokerage and management activities; (ii) bank trust departments have long been involved in brokering and managing real estate assets that are part of trust estates; (iii) bank holding companies and their subsidiaries engage in a wide variety of other real-estate related activities; (iv) real estate brokerage is a natural extension of the finder activities permissible for national banks and FHCs and of a bank holding company's authority to assist third parties in obtaining commercial real estate equity financing; (v) some real estate management services are functionally and operationally similar to various other payment, disbursement, and accounting activities that banks and bank holding companies currently engage in; (vi) allowing FHCs to engage in real estate brokerage and management may help FHCs to compete effectively with other financial service providers in the United States that offer such services -- one of the factors that the GLB Act requires the Board to consider when determining whether an activity is financial in nature; and (vii) permitting FHCs to engage in the agency activities of real estate brokerage and management would not raise any material safety and soundness issues.

Concurrently with the Board's proposal, Treasury intends to seek comment on a proposal to determine that real estate brokerage and management activities are financial in nature or incidental to a financial activity and, accordingly, are permissible for financial subsidiaries of national banks under the National Bank Act. Staff recommends that the Board issue the attached Federal

Register notice and proposed rule jointly with Treasury. The attached memorandum discusses the proposal in greater detail.

Attachments

December 11, 2000

TO: Board of Governors

FROM: Staff[2]

SUBJECT: Proposed addition of real estate brokerage and management activities to the list of activities permissible for financial holding companies

ACTION REQUESTED: Approval of a proposal to seek public comment on whether to determine that real estate brokerage and real estate management are activities that are financial in nature or incidental to a financial activity and, consequently, permissible for financial holding companies ("FHCs"). The proposal also would seek comment on whether these activities should be permissible for financial subsidiaries of national banks.

The proposal, which would not authorize FHCs or financial subsidiaries to engage in real estate investment or development beyond the extent of their current authority, is explained in the attached Federal Register notice.

BACKGROUND: The Gramm-Leach-Bliley Act ("GLB Act") permits a bank holding company that qualifies as a FHC to engage in any activity that has been determined by the Board to be financial in nature or incidental to a financial activity. The American Bankers Association ("ABA") and Fremont National Bank & Trust Company, Fremont, Nebraska, have asked the Board to determine that real estate brokerage and management activities are financial in nature. Two additional trade associations, the Financial Services Roundtable and the New York Clearing

---

[2] Legal Division (Messrs. Mattingly, Alvarez, and Van Der Weide); Division of Banking Supervision and Regulation (Mr. Martinson); Division of Research and Statistics (Mr. Ettin).

House Association, have requested that the Board permit FHCs to engage in real estate brokerage activities.[3] The National Association of Realtors ("NAR") has urged the Board not to permit FHCs to engage in real estate brokerage activities.

The GLB Act directs the Board to consider a variety of factors when considering a request for a determination that an activity is financial in nature or incidental thereto, including the purposes of the Bank Holding Company Act ("BHC Act") and the GLB Act and whether approval of the activity is necessary or appropriate to allow FHCs to compete effectively with companies providing financial services in the United States.[4] Under the "closely related to banking" standard that existed before the passage of the GLB Act, the Board and the courts looked to whether banks generally (i) conduct the proposed activity, (ii) provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed services, or (iii) provide services that are so integrally related to the proposed services as to require their provision in a specialized form.[5] Staff believes that it is appropriate to consider these factors, in addition to those that are listed in the GLB Act, in determining whether an activity is financial in nature or incidental to a financial activity. The

---

[3] The New York Clearing House Association submitted its request on behalf of The Bank of New York Company, Inc.; Chase Manhattan Corporation; Citigroup, Inc.; J.P. Morgan, Inc.; Bankers Trust Company; Fleet Boston, Inc.; HSBC; Bank One Corporation; First Union Corporation; and Wells Fargo & Company.

[4] See 12 U.S.C. § 1843(k)(3). A complete list of the factors that the GLB Act requires the Board to take into account in considering whether an activity is financial in nature or incidental to a financial activity is provided in Appendix A.

[5] See National Courier Association v. Board of Governors of the Federal Reserve System, 516 F.2d 1229, 1237 (D.C. Cir. 1975).

GLB Act also requires that the Board consult with the Secretary of the Treasury ("Secretary") concerning any request, proposal, or application for a determination that an activity is financial in nature or incidental to a financial activity for purposes of the BHC Act.[6]

Concurrently with the Board's proposal, Treasury intends to seek comment on whether it should determine that real estate brokerage and management activities are financial in nature or incidental to a financial activity and, accordingly, are permissible for financial subsidiaries of national banks under the National Bank Act.[7] The GLB Act requires that the Secretary consult with the Board concerning any proposal for a determination that an activity is financial in nature or incidental to a financial activity under the National Bank Act.[8] Staff

---

[6] The Board may not determine that an activity is financial in nature or incidental to a financial activity if the Secretary informs the Board in writing that the Secretary believes that the activity is not financial in nature, incidental to a financial activity, or otherwise permissible under the BHC Act. The Secretary must notify the Board of his decision within 30 days of receiving notice from the Board of the proposal, although the Board may extend this 30-day period if it determines the extension is appropriate in the circumstances.

[7] Under the National Bank Act, as amended by the GLB Act, financial subsidiaries of national banks are authorized to engage in activities that (i) have been defined to be financial in nature or incidental to a financial activity pursuant to section 4(k)(4) of the BHC Act; or (ii) the Secretary determines to be financial in nature or incidental to a financial activity. 12 U.S.C. § 24a(b)(1)(A).

[8] The Secretary may not determine that an activity is financial in nature or incidental to a financial activity if the Board informs the Secretary in writing that the Board believes that the activity is not financial in nature, incidental to a financial activity, or otherwise permissible under the BHC Act. The Board must notify the Secretary of its decision within 30 days of receiving notice from the Secretary of the proposal, although the Secretary may extend this 30-day period if it determines the extension is appropriate in the circumstances.

recommends that the Board issue the attached draft Federal Register notice and proposed rule jointly with Treasury.

DISCUSSION AND ANALYSIS:

A. Real Estate Brokerage Services

Real estate brokerage is the business of bringing together parties interested in consummating a real estate purchase, sale, exchange, lease, or rental transaction and negotiating on behalf of such parties a contract relating to the transaction. The activity of real estate brokerage would include acting as agent for a party to a real estate transaction; listing and advertising real estate; locating buyers, sellers, lessors, and lessees interested in engaging in real estate transactions between themselves; conveying information between the parties to a potential real estate transaction; providing advice in connection with a real estate transaction; negotiating price and other terms on behalf of parties to a real estate transaction; and administering the closing to a real estate transaction. Real estate brokerage generally does not involve purchasing or selling real estate as principal. The business of real estate brokerage may only be conducted pursuant to state licensing laws and regulations.

Before the passage of the GLB Act, bank holding companies were permitted to engage only in activities that the Board determined were closely related to banking under section 4(c)(8) of the BHC Act. In 1972, the Board determined that real estate brokerage was not closely related to banking for purposes of the BHC Act.[9]

---

[9] 12 C.F.R. 225.126(c); Boatmen's Bancshares, Inc., 58 Federal Reserve Bulletin 427, 428 (1972). In 1987, as part of a proposal to authorize bank holding companies to engage in real estate investment (the "1987 Proposal"), the Board proposed permitting a bank holding company to provide real estate brokerage

Although the GLB Act does not explicitly authorize FHCs to act as real estate brokers, the statute permits FHCs to engage in any activity that the Board has determined to be financial in nature or incidental to a financial activity. The legislative history of the GLB Act makes clear that the "financial in nature" test is broader than the former "closely related to banking" test.[10] For the reasons discussed below, staff believes that the Board should seek comment on whether real estate brokerage activities are financial in nature or incidental to a financial activity within the meaning of section 4(k)(1)(A) of the BHC Act.

1. General "Financial in Nature or Incidental" Analysis

Some depository institutions already engage in real estate brokerage. Although the Office of the Comptroller of the Currency ("OCC") has not permitted national banks to provide general real estate brokerage services, several states currently permit their state-chartered banks to act as a general real estate broker.[11]

---

services in connection with real estate in which the bank holding company had an interest. See 52 Federal Register 543 (1987); see also 50 Federal Register 4519 (1985). The Board never adopted this proposed rule in final form.

[10] See H.R. Conf. Rep. No. 106-434, at 153 (1999) ("permitting banks to affiliate with firms engaged in financial activities represents a significant expansion from the current requirement that bank affiliates may only be engaged in activities that are closely related to banking").

[11] See, e.g., Iowa Code § 524.802 ("A state bank shall have . . . the power to . . . engage in the brokerage of insurance and real estate subject to the prior approval of the superintendent."); N.J. Admin. Code tit. 3, § 11-11.5(a)(4) (permitting a subsidiary of a New Jersey state-chartered bank to provide real estate brokerage services); 1979 Ky. AG LEXIS 224 ("A state bank, through its authorized trust department, and state trust companies may act as real estate brokers or salesmen in the general real estate business, regardless of whether it involves the institution's fiducial business or not.").

The Office of Thrift Supervision ("OTS") also has permitted the service corporation subsidiaries of federal savings associations to provide general real estate brokerage services.[12] In addition, national and state bank trust departments have long been involved as agent in the purchase and sale of real estate assets that are part of trust estates.

Although the Board has not allowed bank holding companies to provide real estate brokerage services, bank holding companies and their subsidiaries engage in a wide variety of other real-estate related activities, including (i) holding bank premises and acquiring real estate in a fiduciary capacity or in the ordinary course of collecting a debt previously contracted; (ii) making real estate investments that have as their primary purpose community development; (iii) providing real estate appraisal services; (iv) arranging commercial real estate equity financing; (v) real estate lending; (vi) real estate leasing; (vii) providing real estate settlement and escrow services; and (viii) providing real estate investment advisory services.[13] Since the passage of the GLB Act, FHCs also have been able to provide title insurance, private mortgage insurance, and any other type of insurance to the parties to a real estate transaction.[14] As a result, bank holding companies and their subsidiaries participate in most aspects of the typical real estate transaction other than brokerage.

---

[12] See 12 C.F.R. 559.4(e)(4) and OTS Letter, July 16, 1997 (1997 OTS LEXIS 3).

[13] See, e.g., 12 C.F.R. 225.22(d)(1) and (3) and 225.28(b)(2) and (12).

[14] See 12 U.S.C. § 1843(k)(4)(B).

In addition, banks and bank holding companies currently engage in a variety of activities that are functionally and operationally similar to real estate brokerage. Banking organizations have provided their customers with various agency transactional services, including securities brokerage services, private placement services, futures commission merchant services, agency transactional services relating to swaps and other derivative instruments, and insurance agency services.[15] Although these agency services are provided by banking organizations in connection with an underlying financial transaction (the purchase of securities, derivatives, or insurance), the agency services provided by a real estate broker are similar in nature to those provided by a securities, derivatives, or insurance broker.

Moreover, real estate brokerage services are a natural outgrowth from the finder activities permissible for national banks, some state banks, and FHCs. The OCC's regulations provide that "a national bank may act as a finder in bringing together a buyer and a seller" for a financial or nonfinancial transaction and further provide that permissible finder activities include "identifying potential parties, making inquiries as to interest, introducing or arranging meetings of interested parties, and otherwise bringing parties together for a transaction that the parties themselves negotiate and consummate."[16] Pursuant to the finder and financial counseling authorities, the OCC has permitted national banks to locate, analyze, and make recommendations regarding the purchase or sale of real estate; and to place real estate investment properties by contacting a limited number of qualified investors, identifying and engaging real estate brokers, advising investors

---

[15] See, e.g., 12 C.F.R. 225.28(b)(7) and 12 U.S.C. § 1843(k)(4)(B).

[16] 12 C.F.R. 7.1002.

regarding the terms of a real estate sale, and administering a real estate closing.[17] A proposed rule issued by the Board on July 31, 2000, would authorize FHCs to act as a finder.[18] Although the full range of real estate brokerage services would not fit within the scope of national bank or FHC finder activities,[19] many of the essential aspects of real estate brokerage are already permissible finder activities.

Real estate brokerage is also a natural extension of a bank holding company's authority to assist third parties in obtaining commercial real estate equity financing.[20] In this regard, the Board has allowed bank holding companies to act as an intermediary for the financing of commercial or industrial income-producing real estate by arranging for the transfer of the title, control, and risk of

---

[17] See OCC Interpretive Letter No. 238 [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,402 (Feb. 9, 1982). The OCC also has allowed national banks to participate in the structuring and negotiation of certain real estate exchange transactions. See OCC Interpretive Letter No. 880 [1999-2000 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,373 (Dec. 16, 1999).

[18] 65 Federal Register 47,696 (2000).

[19] Real estate brokerage would not fit within the finder activities permitted to national banks because real estate brokerage essentially involves the real estate broker in negotiation of the real estate transaction -- a role specifically forbidden to national bank finders. See 12 C.F.R. 7.1002(b). Real estate brokerage would not fit within the finder activities proposed to be authorized for FHCs because the Board's proposed finder rule prohibits a finder from becoming involved in negotiation and specifically excludes any activity that would require the FHC to register or obtain a license as a real estate agent or broker. See 65 Federal Register 47,700 (2000).

[20] 12 C.F.R. 225.28(b)(2)(ii). The OCC similarly has authorized national banks to arrange for the placement of equity interests in commercial and investment real estate. See OCC Interpretive Letter No. 271 [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,435 (Sept. 21, 1983).

such a real estate project to one or more investors. Bank holding companies may only arrange commercial real estate equity financing with respect to real estate projects that are not sponsored by or invested in by the holding company. Although these arranging activities are restricted to commercial real estate and do not include the full panoply of services provided by a real estate broker, the arranging activities do include an important subset of the services provided by the typical real estate broker.

In determining whether an activity is financial in nature or incidental to a financial activity, the GLB Act specifically instructs the Board to consider whether the activity is necessary or appropriate to allow a FHC to compete effectively with other financial services companies operating in the United States.[21] Before the passage of the GLB Act, in determining whether an activity was "closely related to banking," the law directed the Board to consider whether banks generally engaged in the activity, but did not explicitly authorize the Board to consider whether other financial service providers engaged in the relevant activity.[22] This change in law represents a significant expansion of the Board's capacity to consider the competitive realities of the U.S. financial marketplace in determining the permissibility of activities for FHCs.

As the financial marketplace continues to evolve, it appears that many financial companies are adding real estate brokerage to their menu of services. In this regard, the ABA has provided evidence that several diversified financial companies provide real estate brokerage services in addition to their more

---

[21] 12 U.S.C. § 1843(k)(3)(D)(i).

[22] See National Courier Association v. Board of Governors of the Federal Reserve System, 516 F.2d 1229, 1237 (D.C. Cir. 1975).

traditional banking, securities, and insurance services.[23] The ABA also has asserted that buyers and sellers of real estate are increasingly looking to a single company to provide all of their real estate-related needs. Purchasers of real estate seem especially interested in obtaining real estate brokerage and mortgage finance from a single provider. On this basis, a finding that FHCs may engage in real estate brokerage activities would permit FHCs to compete effectively with other financial service providers in the United States. The proposal would seek comment on the extent to which U.S. financial services companies provide real estate brokerage services.

In determining whether real estate brokerage activities are financial in nature or incidental to a financial activity, the GLB Act also directs the Board to consider the underlying purposes of the BHC Act.[24] One of the primary purposes of the BHC Act is to prevent companies that own banks from engaging in commercial activities that would result in unfair competition or conflicts of interest or would impair the safety and soundness of the companies' subsidiary banks. Existing federal and state laws should operate to mitigate the potential adverse effects of combining banking and real estate brokerage. The antitying rules would help prevent the subsidiary banks of a FHC from using any market power possessed by the banks to monopolize or compete unfairly in the real estate

---

[23] For example, General Motors Acceptance Corporation operates a thrift, makes mortgage loans, and provides real estate brokerage services; Prudential Insurance Company provides insurance and securities products and real estate brokerage services; Cendant Corporation provides insurance, mortgage loans, and real estate brokerage services; and Long & Foster provides mortgage loans, insurance products, and real estate brokerage services.

[24] 12 U.S.C. § 1843(k)(3)(A).

brokerage business. The antitying rules would prevent a subsidiary bank of a FHC engaged in real estate brokerage from extending credit, furnishing any service, or varying the consideration for any loan or service on the condition that the customer obtain real estate brokerage services from the bank or any affiliate of the bank.[25]

Sections 23A and 23B of the Federal Reserve Act would limit the amount of credit or other support that a subsidiary bank of a FHC could provide to a real estate brokerage affiliate.[26] In addition, section 23B would require mortgage loans by a bank to a customer who obtains real estate brokerage services from a bank affiliate to be on market terms.[27] Furthermore, federal and state consumer protection laws, including the Real Estate Settlement Procedures Act,[28] would help protect customers of banks and affiliated real estate brokers. Notwithstanding these protections, the proposal would solicit comment on the potential adverse effects that may result from permitting FHCs to broker real estate and whether special restrictions are necessary to mitigate those adverse effects.[29]

---

[25] 12 U.S.C. § 1972(b)(1).

[26] 12 U.S.C. §§ 371c and 371c-1.

[27] 12 U.S.C. § 371c-1(a)(2)(D). Although section 23A also could be read to cover mortgage loans by a bank to a customer who uses part of the loan proceeds to pay the brokerage commission of a real estate brokerage affiliate of the bank, the current draft of Regulation W would clarify that such arrangements are not covered transactions under section 23A.

[28] 12 U.S.C. § 2601 et seq.

[29] Under section 114 of the GLB Act, the Board has authority to impose restrictions or requirements on transactions or relationships between a depository institution subsidiary of a bank holding company and any affiliate of such depository institution, if the Board finds that such action would be (i) consistent with the purposes of applicable Federal law and (ii) appropriate, among other

Permitting FHCs to engage in real estate brokerage does not appear to raise any safety and soundness issues. The proposed rule would ensure that the authorized real estate brokerage services are agency services only and that the FHC takes no principal risk in connection with real estate transactions that it brokers. As a consequence, FHCs engaging in real estate brokerage would not be subject to either the liquidity risk or market risk associated with real estate investment and development. Real estate brokerage involves operational and legal risks, but these risks appear similar in nature and extent to those posed by other agency activities conducted by FHCs.

2. Real Estate Brokerage as a Statutorily Listed Financial Activity

The ABA has argued that real estate is a financial asset and that, accordingly, the Board should find real estate brokerage to be part of the statutorily listed financial activity of "[l]ending, exchanging, transferring, investing for others or safeguarding financial assets other than money or securities."[30] According to the ABA, real estate is a financial asset because (i) the home is the largest asset for many individuals; (ii) real estate serves as the underpinning for hundreds of billions of dollars of mortgage-backed securities; and (iii) real estate serves as a means of wealth creation by increasing in value over time and providing tax benefits.

---

things, to avoid adverse effects such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. GLB Act § 114(b).

[30] 12 U.S.C. § 1843(k)(5)(B)(i). The GLB Act requires the Board to define this activity and two other listed activities as "financial in nature" and to determine "the extent to which such activities are financial in nature or incidental to a financial activity." 12 U.S.C. § 1843(k)(5)(A). See Appendix B for a complete list of the activities that the Board must so define.

Staff is not convinced that real estate should be deemed a financial asset because it is a comparatively large asset on most individuals' personal balance sheet or because it often is used as collateral for financial instruments. Airplanes, boats, and automobiles are large assets that are often used as collateral for financial instruments (loans and leases in particular), yet these assets are generally considered to be nonfinancial. Staff recognizes, however, that real estate does have certain important attributes of a financial asset; namely, that individuals often purchase real estate, at least in part, for investment purposes and with a view toward the financial benefits of the transaction.

These financial attributes of real estate may, however, not be enough to justify treating real estate as a financial asset. Although real estate often is purchased, in part, for investment purposes, the same can be said of many nonfinancial assets such as fine art, rare stamps, and antique cars. Moreover, whereas loans, securities, and most other financial assets are held for investment purposes only, most purchasers and renters of real estate also use the property as a residence or in the operation of a business. Finally, financial assets are generally thought to include money, loans, securities, and other intangible, contractual rights to a payment stream. Real estate, on the other hand, is a tangible, physical asset that is not used as a currency for payment transactions. Because real estate possesses some of the characteristics of a financial asset, the proposal would seek comment on whether real estate should be considered a financial asset.

The ABA also has argued that the purchase, sale, or lease of real estate is a financial transaction and that, accordingly, the Board should find that real estate brokerage is part of the listed financial activity of "[a]rranging,

effecting, or facilitating financial transactions for the account of third parties."[31] The ABA contends that the purchase, sale, or lease of real estate is a financial transaction because it is the most important, complex, and financially difficult transaction that most individuals undertake. Staff is not convinced that the importance, complexity, or size of a transaction should affect a determination as to whether the transaction is financial in nature. On the other hand, real estate transactions often are entered into, at least in part, for investment purposes. To that extent, real estate transactions do have some aspects of a financial transaction. Accordingly, the proposal would seek comment on whether a real estate purchase, sale, or lease transaction should be considered a financial transaction.

3. Arguments of the NAR

As noted, the NAR has asked the Board to refrain from permitting FHCs to provide real estate brokerage services. The NAR makes four principal contentions in support of its position. First, the NAR notes that the GLB Act does not specifically authorize FHCs to engage in real estate brokerage activities. Although this contention is true, the GLB Act also authorizes the Board to supplement the statutory activities list with additional activities that the Board determines, in consultation with the Treasury, to be financial in nature or incidental to a financial activity. The NAR points out that the GLB Act specifically prohibits financial subsidiaries of national banks from engaging in real estate investment and development activities, but this prohibition by its terms does not apply to FHCs or to real estate brokerage activities.

Second, the NAR suggests that it would be inappropriate for the Board now to permit FHCs to provide real estate brokerage services because the

---

[31] 12 U.S.C. § 1843(k)(5)(B)(iii).

Board prohibited bank holding companies from acting as a real estate broker in 1972. As noted above, the Board's 1972 decision on real estate brokerage was made pursuant to the former "closely related to banking" standard; the GLB Act now authorizes the Board to approve any activity that is "financial in nature" or "incidental to a financial activity." The plain meaning of and legislative history behind the "financial" and "incidental to financial" standards suggest that Congress intended the new standards to be broader than the old "closely related to banking" test. Furthermore, the financial services environment has changed significantly in the past 30 years, and what may have been an inappropriate activity for bank holding companies in the early 1970s may be appropriate for the diversified FHCs of the early 21st century.

Third, the NAR claims that real estate brokerage is a commercial activity and not a financial activity. Finally, the NAR argues that the Board should delay finding real estate brokerage to be a permissible activity for FHCs until such time as FHCs gain experience in conducting the various other new activities authorized by the GLB Act.

The proposal would seek comment on whether real estate brokerage is an activity that is financial in nature or incidental to a financial activity. In doing so, the proposal specifically would seek comment on the arguments advanced by the NAR and would provide the NAR with an opportunity to supplement its arguments.

B. Real Estate Management Services

Real estate management is the business of providing for others the service of day-to-day management of real estate. Day-to-day management of real estate would include procuring tenants; negotiating leases; maintaining security deposits; billing and collecting rent payments; providing periodic accountings for such payments; making principal, interest, insurance, tax, and utilities payments;

and generally overseeing inspection, maintenance, and upkeep of real property. Real estate management generally does not involve purchasing, selling, or owning real estate as principal. Although some states do not subject real estate managers to special licensing laws or regulations, real estate managers in other states are subject to the same state licensing laws and regulations that apply to real estate brokers.

The Board first proposed allowing bank holding companies to provide property management services in 1971.[32] For a variety of reasons, however, including the substantial volume of negative public comment received on the proposal, the Board determined in 1972 that property management was not closely related to banking for purposes of the BHC Act.[33] For the reasons discussed below, staff believes that the Board should seek comment on whether real estate management activities are financial in nature or incidental to a financial activity within the meaning of section 4(k)(1)(A) of the BHC Act.

1. General "Financial in Nature or Incidental" Analysis

Neither the OCC nor state banking departments, to our knowledge, have permitted banks to provide general real estate management services.[34] Thrift holding companies (including non-unitary thrift holding companies) and thrift

---

[32] See 36 Federal Register 18,427 (1971).

[33] 12 C.F.R. 225.126(g); 58 Federal Reserve Bulletin 652 (1972). As part of the 1987 Proposal, the Board proposed authorizing a bank holding company to provide real estate management services in connection with real estate in which the bank holding company had an interest. See 52 Federal Register 543 (1987); see also 50 Federal Register 4519 (1985). As noted above, the Board never finalized this proposed rule.

[34] See, e.g., OCC Interpretive Letter No. 238, supra.

service corporation subsidiaries, however, have been permitted to maintain and manage real estate.[35] In addition, as noted above, banking organizations have long been engaged in a variety of real estate-related activities. Moreover, some (though not all) real estate management activities appear to be functionally and operationally similar to various other activities that banks and bank holding companies currently engage in. For example, collecting rental payments; maintaining security deposits; making principal, interest, taxes, and insurance payments; and providing periodic accountings are functionally similar to collecting loan or lease payments, disbursing escrow payments, and performing related accountings. In addition, banks and bank holding companies have a long history of managing real estate assets that are part of trust estates, that are used by the banking organization in its own operations, or that are acquired as a result of foreclosure.[36]

As noted above, in determining whether an activity is financial in nature or incidental to a financial activity, the GLB Act instructs the Board to consider whether the activity is necessary or appropriate to allow a FHC to compete effectively with other financial services companies operating in the United States. The ABA has contended that competitive considerations support a Board determination to allow FHCs to provide real estate management services. The proposal would solicit comment on the extent to which financial services

---

[35] See 12 C.F.R. 559.4(e)(3), 584.2-1(b)(8).

[36] See, e.g., OCC Interpretive Letter No. 238, supra; OCC Interpretive Letter No. 355 [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,525 (Dec. 10, 1985); Bancorp Hawaii, Inc., 71 Federal Reserve Bulletin 168, 168 n.2 (1985); United Missouri Bancshares, Inc., 64 Federal Reserve Bulletin 415, 417 (1978).

companies provide real estate management services in the United States and on whether permitting FHCs to provide real estate management services would help ensure competitive equity between FHCs and other financial firms.

As noted above, the GLB Act also directs the Board to consider the underlying purposes of the BHC Act in determining whether activities are financial in nature or incidental thereto. As also noted above, one of the primary purposes of the BHC Act was to prevent companies that own banks from engaging in commercial activities that would result in unfair competition or conflicts of interest or that would impair the safety and soundness of the company's subsidiary banks. The same laws that would operate to mitigate potential adverse effects in the real estate brokerage context also would help to alleviate potential adverse effects in the provision of real estate management services. Nevertheless, the proposal would solicit comment on the potential adverse effects of allowing FHCs to act as a real estate manager and whether special restrictions are necessary to mitigate those adverse effects.

Permitting FHCs to engage in real estate management activities does not appear to raise any material safety and soundness issues. The proposed rule would ensure that the authorized real estate management services are agency services only and that the FHC takes no principal risk in connection with real estate that it manages. Staff recognizes, however, that engaging in property management may increase the operational, legal, and reputational risks faced by a FHC. Accordingly, the proposal would seek comment on the nature and extent of these risks.

2. Real Estate Management as a Statutorily Listed Financial Activity

The ABA has argued that the Board should find that real estate management is part of the listed financial activity of "[l]ending, exchanging, transferring, investing for others or safeguarding financial assets other than money

or securities."[37] If the Board were to conclude that real estate is a financial asset, this argument would have some textual appeal. Real estate management could be viewed, in part, as a form of safeguarding real estate. The proposal would seek comment on whether real estate management should be considered a form of safeguarding financial assets.

The ABA also has argued that the Board should find that real estate management services are part of the listed financial activity of "[a]rranging, effecting, or facilitating financial transactions for the account of third parties."[38] Part of the role of a property manager does involve the facilitation of financial transactions: for example, maintenance of security deposits, collection of rent payments, and distribution of principal, interest, insurance, tax, and utility payments. Property management also, however, appears to have components that go beyond the facilitation of financial transactions. The proposal would seek comment on whether real estate management should be considered a form of arranging, effecting, or facilitating financial transactions.

C. Proposed Rule

1. Real Estate Brokerage

The proposed rule, which is discussed in greater detail in the attached draft Federal Register notice, authorizes FHCs to provide real estate brokerage services and provides examples of the sorts of activities that staff considers to be included within real estate brokerage. The proposal would seek comment on

---

[37] 12 U.S.C. § 1843(k)(5)(B)(i).

[38] 12 U.S.C. § 1843(k)(5)(B)(iii).

whether any final rule should provide further guidance regarding the scope of activities that are included within real estate brokerage.

Importantly, the proposed rule also contains restrictions designed to ensure that a FHC, when acting as a real estate broker, serves only as an intermediary between buyers and sellers (or lessees and lessors) and does not otherwise become impermissibly involved in the underlying real estate transaction. In particular, the proposal makes clear that it does not authorize a FHC to (i) invest in or develop real estate; or (ii) take title to, acquire, or hold an ownership interest in any real estate that is the subject of the company's real estate brokerage services.

Staff understands that many real estate brokers offer employee relocation services to their corporate clients. Certain fundamental employee relocation services -- assisting a client's transferred employees to sell their existing homes, buy homes in their destination locations, and obtain mortgage financing for their new home purchases -- appear to be forms of real estate brokerage or currently permissible financial activities.

Other employee relocation activities seem less obviously a part of real estate brokerage or otherwise financial in nature. For example, a real estate broker providing employee relocation services often commits to purchase any home owned by one of its client's transferred employees at a fixed price if the broker fails to sell the home within a certain time period. Staff believes that such services may be incidental to real estate brokerage if the homes purchased by the broker are sold within a short time period, the broker's total holdings of unsold real estate do not exceed some threshold amount, and the broker only purchases unsold real estate in connection with providing bona fide employee relocation services to customers (not for the purpose of speculating on the price of real estate). Staff also understands that employee relocation services often include assisting transferred

employees to move household goods to their destination locations and assisting the spouses of transferred employees to find employment in their destination locations.

The proposal would request information on the kinds of employee relocation services that real estate brokers currently provide. The proposal also would solicit comment on whether to permit FHCs (i) to provide employee relocation services as part of real estate brokerage or otherwise; (ii) to purchase residential real estate in connection with providing employee relocation services and, if so, what conditions or limits should apply to such real estate purchases; and (iii) to assist transferred employees to move their household goods and to assist the spouses of transferred employees to find employment in connection with providing employee relocation services.

2. Real Estate Management

The proposed rule authorizes FHCs to provide real estate management services and provides examples of the sorts of activities that staff considers to be included within real estate management.

The ABA has suggested that the Board's definition of real estate management should include any activities that may be defined as 'real estate management' under state law. Staff is generally is reluctant to delegate to state legislatures any determinations regarding the scope of permissible activities for federally regulated banking organizations. Nevertheless, the proposal specifically would seek comment on whether real estate management activities should be defined explicitly to include any activities that are defined as "real estate management" under state law. The proposal also would seek comment more generally on whether any final rule should contain further guidance regarding the scope of activities that are included within real estate management.

The proposed rule contains restrictions designed to ensure that a FHC, when providing real estate management services, acts only in an agency capacity

as an intermediary between the owners and users of real estate. In particular, the proposal makes clear that real estate management does not include (i) investing in or developing real estate; or (ii) taking title to, acquiring, or holding an ownership interest in any real estate that the FHC manages.

The proposed rule also prevents a FHC that provides real estate management services from itself repairing or maintaining the managed real estate. Staff has doubts as to whether repair and maintenance of real estate are activities that are financial in nature or incidental to a financial activity. The proposed rule allows a FHC, however, to arrange for a third party to provide these services. The proposal would request comment on whether FHCs should be limited in their authority to engage in any other aspects of real estate management.

The proposal also would seek comment on whether the Board should draw any distinctions between the management of single-family housing, multi-family housing, office buildings, institutional buildings (hotels, hospitals, etc.), commercial and industrial properties, and farms. In addition, the proposal would solicit comment on whether real estate management should include management of the air rights above and the oil and mineral rights beneath particular parcels of land. Staff is concerned that certain forms of real estate management may more closely resemble day-to-day operation of a commercial enterprise than serving as the intermediary between the owners and users of real estate.

CONCLUSION: For the reasons discussed above, staff recommends that the Board request public comment on the attached draft rule for a 45-day period.

As noted above, the Board and Treasury intend to issue the proposed rule jointly. Board staff has provided the attached draft Federal Register notice and proposed rule to Treasury and has begun the consultative process required by the GLB Act. Although Treasury staff has not yet presented the proposal to the

Secretary, Treasury staff has indicated informally that they believe the Secretary will not object to the proposal.

In light of these facts, Board staff also requests the authority to make minor and technical changes to the draft proposed rule and Federal Register notice in consultation with Treasury prior to publication.

Attachments

APPENDIX A

The GLB Act requires the Board to consider the following factors in determining whether an activity is financial in nature or incidental to a financial activity:

(1) The purposes of the BHC Act and the GLB Act;

(2) Changes or reasonably expected changes in the marketplace in which FHCs compete;

(3) Changes or reasonably expected changes in the technology for delivering financial services; and

(4) Whether the activity is necessary or appropriate to allow FHCs or their affiliates to—

(A) Compete effectively with any company providing financial services in the United States;

(B) Efficiently deliver financial information and services through the use of technological means, including any application necessary to protect the security or efficacy of systems for the transmission of data or financial transactions; and

(C) Offer customers any available or emerging technological means for using financial services or for the document imaging of data.

These factors are not exclusive and the Board may consider other factors or information that it deems relevant.

APPENDIX B

The GLB Act requires the Board, by regulation or order, to define the following activities as financial in nature, and the extent to which such activities are financial in nature or incidental to a financial activity:

(1) Lending, exchanging, transferring, investing for others, or safeguarding financial assets other than money or securities;

(2) Providing any device or other instrumentality for transferring money or other financial assets; and

(3) Arranging, effecting, or facilitating financial transactions for the account of third parties.

The draft Federal Register notice is currently being revised and should be available later in the week.

Note: As of December 27, 2000, the final Federal Register notice is avaliable at http://www.federalreserve.gov/boarddocs/press/boardacts/2000/20001227/.