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## Should Banks Be Permitted to Engage in Real Estate Brokerage and Management Services: How the Current Debate Demonstrates the Inadequacies of the Gramm-Leach-Bliley Act

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SHOULD BANKS BE PERMITTED TO ENGAGE IN  
REAL ESTATE BROKERAGE AND MANAGEMENT  
SERVICES?: HOW THE CURRENT DEBATE  
DEMONSTRATES THE INADEQUACIES OF THE  
GRAMM-LEACH-BLILEY ACT

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I. INTRODUCTION

Representing the most comprehensive reform of the financial services industry in nearly seventy years, President Clinton signed the Gramm-Leach-Bliley Financial Modernization Act of 1999 into law on November 12, 1999.<sup>1</sup> The Act included

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<sup>1</sup>Gramm-Leach-Bliley Financial Modernization Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338 (codified as amended in scattered sections of 12 U.S.C.).

provisions designed to facilitate affiliation among banks, securities firms and insurance companies,<sup>2</sup> as well as provisions requiring financial service companies to disclose the institutions' privacy policies with respect to nonpublic personal information.<sup>3</sup> To foster competition and innovation in the financial services industry, title I of the Act repealed sections 20 and 32 of the Glass-Steagall Act<sup>4</sup> and amended section 4 of the Bank Holding Company Act of 1956.<sup>5</sup> While the primary focus of title I was to break down the firewalls between banks, securities firms, and insurance companies by creating financial holding companies, the Act includes a provision that allows these newly created financial institutions to engage in any activity that is determined "to be financial in nature or incidental to such financial activity."<sup>6</sup> One of the first major efforts by regulators to expand the list of permissible activities under the Gramm-Leach-Bliley Act is to allow financial holding companies and financial subsidiaries of nationally chartered banks to engage in real estate brokerage and real estate management services.<sup>7</sup>

Part II of this Note will provide a brief history of the financial service regulations that preceded the Gramm-Leach-Bliley Act. Part III will discuss the legislative history of the Gramm-Leach-Bliley Act, provide a brief overview of the Act, and detail the provision which may allow financial holding companies to engage in real estate brokerage and management activities. Part IV of this Note will discuss the pending legislation on this issue, including the proposed rule requesting public comment and the current bills in the House and Senate against allowing banks to engage in the proposed activities. Part V will detail the arguments on both sides of the issue, primarily from the perspective of industry groups. Finally, Part VI of this Note will explain how the current proposal to permit banks to engage in real estate brokerage and management activities highlights the inadequacies of the Gramm-Leach-Bliley Act.

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<sup>2</sup>Gramm-Leach-Bliley Financial Modernization Act §§ 101- 161.

<sup>3</sup>*Id.* § 501- 527.

<sup>4</sup>Banking Act of 1933 (Glass-Steagall Act), Pub. L. No. 73-66, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.).

<sup>5</sup>12 U.S.C. § 1843 (2000).

<sup>6</sup>*Id.* § 1843(k)(1)(A).

<sup>7</sup>Bank Holding Companies and Change in Bank Control, 66 Fed. Reg. 307 (Jan. 3, 2001) (to be codified at 12 C.F.R. pt. 225). In addition to the proposed rule, the Federal Reserve Board and the Secretary of the Treasury have issued three other proposals to expand the list of permissible activities under the Gramm-Leach-Bliley Act. The first related to banks acting as "finders" (putting buyers and sellers together in transactions negotiated by the buyers and sellers themselves). The second involved safeguarding and transferring financial assets and facilitating financial transactions for third parties. The third concerned a determination of whether certain types of expanded data processing activities are complementary to financial activities. *Hearings, infra* note 80 (statement of Hon. Laurence H. Meyer, Member, Board of Governors of the Federal Reserve System). At the time of this writing, only the proposal regarding banks acting as "finders" has been finalized. Bank Holding Companies and Change in Bank Control, 12 C.F.R. § 225.86 (2001).

## II. A BRIEF HISTORY OF FINANCIAL SERVICE INDUSTRY REGULATION

A. *The National Bank Act of 1863*

The American financial service industry has historically been heavily regulated, with three laws bearing particular significance to the events that led to the enactment of the Gramm-Leach-Bliley Act. The first influential regulation was the National Bank Act of 1863.<sup>8</sup> Promulgated at the height of the Civil War, the National Bank Act of 1863 created the dual bank regulation system that is particular to America and is still prevalent today.<sup>9</sup> Under this dual system, banks may choose to be state-chartered banks or federally-chartered national banks.<sup>10</sup> One of the primary factors considered when deciding between a state or national charter is the difference between regulating bodies.<sup>11</sup> Nationally chartered banks fall under the regulatory aegis of the Office of the Comptroller of the Currency, a division of the Department of the Treasury.<sup>12</sup> State banks are primarily regulated by the regulating bodies in their respective states, and can be subjected to federal regulation by electing to become a member of the Federal Reserve System or by insuring deposits through the Federal Deposit Insurance Corporation.<sup>13</sup> Though the emergence of state wild card statutes<sup>14</sup> and federal preemption<sup>15</sup> has had a smoothing effect on the differences between federal and state banking charters, the dual banking system remains an integral part of the U.S. banking system.<sup>16</sup>

B. *The Glass-Steagall Act of 1933*

The next major law affecting the powers of U.S. banking institutions was the Glass-Steagall Act of 1933.<sup>17</sup> The Glass-Steagall Act was enacted during the Great Depression in response to the financial crisis that began with the stock market crash of 1929 and led to widespread bank failures, eroding the public confidence in the

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<sup>8</sup>National Bank Act of 1863, ch. 58, 12 Stat. 665, *repealed* by National Bank Act of 1864, ch. 106 § 62, 13 Stat. 99 (codified as amended in scattered sections of 12 U.S.C.)

<sup>9</sup>Henry N. Butler & Jonathan R. Macey, *The Myth of Competition in the Dual Banking System*, 73 CORNELL L. REV. 677, 681 (1988).

<sup>10</sup>National Bank Act of 1863 at 668.

<sup>11</sup>Butler, *supra* note 9, at 682.

<sup>12</sup>*Id.* at 677.

<sup>13</sup>*Id.*

<sup>14</sup>*Id.* at 705. Wild card statutes is the generic name given to statutes that “automatically grant state banks the same powers as national banks whenever a change occurs in the laws affecting national banks.” *Id.* A majority of states have adopted such statutes. *Id.*

<sup>15</sup>*Id.* at 694. Under the Supremacy Clause of the U.S. Constitution, federal laws will preempt state laws when there is a direct conflict. With respect to banks and other financial service providers, “the federal government has passed preemptive legislation in the important areas of reserve requirements, separation of commercial banking from investment banking, and the regulation of bank holding companies.” *Id.*

<sup>16</sup>Butler, *supra* note 9, at 678.

<sup>17</sup>Banking Act of 1933.

banking industry as a whole.<sup>18</sup> The enactment of the Glass-Steagall Act “was predicated on the assumption that the securities activities of commercial banks and their affiliates played a significant role in the stock market crash.”<sup>19</sup> The broad objectives of the Glass-Steagall Act were to restore confidence in the commercial banking system and to eliminate perceived inherent conflicts of interest by separating commercial banking activities from investment banking activities.<sup>20</sup> The results were the prohibition of Federal Reserve member banks from affiliating with organizations principally engaged in the investment banking business,<sup>21</sup> the prohibition of investment banks from participating in commercial banking,<sup>22</sup> and the prohibition of management interlocks between commercial banks and securities firms.<sup>23</sup>

### C. *The Bank Holding Company Act of 1956*

The regulatory scheme set forth by the Glass-Steagall Act appeared adequate until the early 1950’s when “banks circumvented section 20 [of the Glass-Steagall Act] by forming bank holding companies, which were allowed to control both commercial banking and investment banking subsidiaries.”<sup>24</sup> The Bank Holding Company Act of 1956,<sup>25</sup> however, closed this loophole by limiting ownership of nonbanking subsidiaries to subsidiaries that engaged in activities determined to be “so closely related to banking or managing or controlling banks as to be a proper incident thereto.”<sup>26</sup> Despite the restrictions of the Bank Holding Company Act, the bank holding company remains the most prevalent organizational structure for banks in the United States today.<sup>27</sup>

Through “Regulation Y,” the Federal Reserve Board has continually added to the list of activities determined to be “closely related to banking.”<sup>28</sup> An example of an activity added to the list of permissible activities under the Bank Holding Company Act is certain courier or high speed transportation services.<sup>29</sup> The Federal Reserve

<sup>18</sup>A.J. Herbert III, *Comment: Requiem on the Glass-Steagall Act: Tracing the Evolution and Current Status of Bank Involvement in Brokerage Activities*, 63 TUL. L. REV. 157, 161-62 (1988).

<sup>19</sup>*Id.* at 162.

<sup>20</sup>*Id.*

<sup>21</sup>12 U.S.C. § 377 (2000), *repealed by* Gramm-Leach-Bliley Act of 1999, Pub L. No. 106-102, 113 Stat. 1338.

<sup>22</sup>12 U.S.C. § 378 (2000).

<sup>23</sup>12 U.S.C. § 78 (2000), *repealed by* Gramm-Leach-Bliley Act of 1999, Pub L. No. 106-102, 113 Stat. 1338.

<sup>24</sup>Herbert, *supra* note 18, at 169-70.

<sup>25</sup>Bank Holding Company Act of 1956, Pub. L. No. 84-511, 70 Stat. 133 (codified as amended in scattered sections of 12 U.S.C.).

<sup>26</sup>12 U.S.C. § 1843(c)(8).

<sup>27</sup>Herbert, *supra* note 18, at 170.

<sup>28</sup>Bank Holding Companies and Change in Bank Control, 12 C.F.R. § 225.4 (2001).

<sup>29</sup>Nat’l Courier Ass’n v. Bd. of Governors of the Fed. Reserve Sys., 516 F.2d 1229, 1232 (D.C. Cir. 1975).

Board added these activities to the list in 1972.<sup>30</sup> In 1975, a courier association challenged the regulation allowing bank holding companies to engage in such activities, claiming, in part, that the activities were not “closely related to banking.”<sup>31</sup> The D.C. Court of Appeals set the standard for determining whether or not an activity is “closely related to banking” in *National Courier*. The Court stated that the Federal Reserve Board must “articulate the ways in which banking activities and the proposed activities are assertedly connected, and must determine, not arbitrarily or capriciously, that the connections are close.”<sup>32</sup> The court then enumerated a number of factors for the Federal Reserve Board to consider in determining whether a proposed activity is “closely related to banking.”<sup>33</sup>

While the “closely related to banking” standard would remain in effect until the Gramm-Leach-Bliley Act, the restrictions imposed by both the Glass-Steagall Act and the Bank Holding Company Act gradually decreased over time, “primarily from more permissive interpretations by the regulatory agencies, and . . . from deference to these interpretations by the courts,”<sup>34</sup> culminating in the enactment of the Gramm-Leach-Bliley Act.

### III. MODERNIZATION OF FINANCIAL SERVICES REGULATION – THE GRAMM-LEACH-BLILEY ACT

#### A. Background and Legislative History of the Gramm-Leach-Bliley Act

The Gramm-Leach-Bliley Act was the result of years of debate over regulation of the financial services industry. The Act “[did] not represent a dramatic departure from what was already happening in the marketplace with the acquiescence of federal and state regulators,”<sup>35</sup> but was merely a codification of the eroding divisions between banks, securities firms, and insurance companies. While industry groups had been calling for the repeal of the Glass-Steagall Act and the reformation of financial services regulation for years, the effort received a big push by the announcement of a proposed merger between industry giants Citicorp and Travelers Insurance.<sup>36</sup> While the merger was technically impermissible under the law,

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<sup>30</sup>Bank Holding Companies and Change in Bank Control, 12 C.F.R. § 225.86 (2001).

<sup>31</sup>*Nat'l Courier Ass'n*, 516 F.2d at 1232.

<sup>32</sup>*Id.* at 1237.

<sup>33</sup>*Id.* The court enumerated the following factors for the Federal Reserve Board to consider, which, if met, would support a finding that an activity is closely related to banking:

1. Banks generally have in fact provided the proposed services.
2. Banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed service.
3. Banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form. *Id.*

<sup>34</sup>Herbert, *supra* note 18, at 171.

<sup>35</sup>Douglas P. Faucette, *The Impact of Convergence and the Gramm-Leach-Bliley Act on the Insurance Industry*, 8 GEO. MASON L. REV. 623, 647 (2000).

<sup>36</sup>See Yvette D. Kantrow & Liz Moyer, *Citi, Travelers: A Global Leader Takes Shape*, THE AM. BANKER, Apr. 7, 1998, at 1. On April 6, 1998 Citicorp and Travelers Insurance

“Citigroup [was] betting that regulators [would] allow it up to five years to divest impermissible activities, and that Congress [would] enact enabling legislation before the five-year period expire[d].”<sup>37</sup> Apparently confident that Congress would do just that, a number of large financial institutions announced mega-mergers in the wake of the Citigroup announcement. Within two weeks of the Citigroup announcement, Nationsbank and Bank of America announced a merger agreement, creating the largest bank in the United States. On that same day, Banc One Corporation and First Chicago NBD Bank announced plans to join, creating by far the largest midwest bank.<sup>38</sup> While the success of the latter mergers was not contingent upon the repeal of the Glass-Steagall Act as was the Citigroup deal, the announcements were a clear indication that the nation’s preeminent banks were posturing for the imminent changes to come.

An early version of the Gramm-Leach-Bliley Act was introduced in 1998 as H.R. 10 and it passed in the House by a single vote.<sup>39</sup> The bill then went to the Senate; however, after much debate and compromise in the Senate Banking Committee, the congressional session ended before the bill made it to the Senate floor for a vote.<sup>40</sup> The bill, however, would find new life when Congress reconvened the following year, when “[i]n January 1999, Representative James A. Leach (R-Iowa), Chairman of the House Banking and Financial Services Committee, reintroduced H.R. 10, which was based largely on the Senate compromise bill drafted the prior year.”<sup>41</sup> The House Banking Committee held hearings on the bill shortly thereafter, as did the House Commerce Committee headed by Chairman Thomas Bliley (R-Va). The bill was passed by the House of Representatives on July 1, 1999, by a vote of 343-86.<sup>42</sup>

Senator Phil Gramm (R-Tex), Chairman of the Senate Banking Committee, introduced a more streamlined financial modernization bill, also in early 1999.<sup>43</sup> While the vote was along partisan lines, the republican-controlled Senate passed this bill with a 54-44 vote on May 6, 1999.<sup>44</sup> A compromise bill was compiled in the fall of 1999, which passed both houses of Congress on November 4, 1999.<sup>45</sup> The

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announced a \$70 billion merger which would create the largest financial services company in the world, to be known as Citigroup, with nearly \$700 billion in assets. *Id.*

<sup>37</sup>William M. Isaac, *Challenge to Policymakers-and Dealmakers Too; As Lawmakers Fiddle, Market Forces Transforming the Financial Industry*, THE AM. BANKER, Apr. 24, 1998, at 7.

<sup>38</sup>*Id.*

<sup>39</sup>Douglas P. Faucette, *The Impact of Convergence and the Gramm-Leach-Bliley Act on the Insurance Industry*, 8 GEO. MASON L. REV. 623, 626 (2000).

<sup>40</sup>*Id.*

<sup>41</sup>*Id.* at 626-27.

<sup>42</sup>*Id.* at 627.

<sup>43</sup>*Id.* at 627.

<sup>44</sup>Faucette, *supra* note 39, at 628.

<sup>45</sup>*Id.* at 629.

Gramm-Leach-Bliley Act was signed into law by President Clinton on November 12, 1999.<sup>46</sup>

The Gramm-Leach-Bliley Act created a vehicle known as the “financial holding company,” which greatly expanded the scope of permissible activities for banks and other financial service providers.<sup>47</sup> According to the Act, a financial holding company is authorized to engage in the same activities as bank holding companies<sup>48</sup> (either directly or through nonbank subsidiaries), and is further permitted to engage in activities deemed to be “financial in nature or incidental to a financial activity.”<sup>49</sup> In order for a bank holding company to qualify as a financial holding company, it must make application to the Federal Reserve and meet the specific guidelines outlined by that agency.<sup>50</sup> Essentially the Act requires that each of the depository institutions controlled by the financial holding company is well-capitalized,<sup>51</sup> well-managed,<sup>52</sup> and must have received a Community Reinvestment Act rating of “satisfactory” or “outstanding.”<sup>53</sup> If a bank holding company does not meet of each of these specific criteria, it will not be granted financial holding company status.<sup>54</sup> Furthermore, if a financial holding company fails to remain in compliance with these requirements, it may be forced to divest itself of financial activities not available to bank holding companies.<sup>55</sup>

Although the Gramm-Leach-Bliley Act created the financial holding company structure, the traditional bank holding company structure still remains an option.<sup>56</sup> Therefore, bank holding companies that do not meet the specific requirements for financial holding company status (well-capitalized, well-managed, and in satisfactory compliance with the Community Reinvestment Act) can nonetheless continue to own bank and nonbank financial subsidiaries. The Act did not change the fact that any activities in which a bank holding company wishes to engage in

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<sup>46</sup>*Id.*

<sup>47</sup>12 U.S.C. § 1841(p) (2000).

<sup>48</sup>12 U.S.C. § 1843(j)(4)(C).

<sup>49</sup>12 U.S.C. § 1843(k)(1)(A).

<sup>50</sup>12 U.S.C. § 1843(l).

<sup>51</sup>12 U.S.C. § 1843(l)(A). The Federal Reserve considers a domestic bank, thrift or trust company to be well-capitalized where it has a total risk based capital ratio of not less than ten percent, a Tier 1 capital ratio of not less than six percent, and a leverage ratio of not less than five percent. Bank Holding Companies and Change in Bank Control, 12 C.F.R. § 225.2(r) (2001).

<sup>52</sup>12 U.S.C. § 1843(l)(B). The Federal Reserve considers a domestic bank, thrift or trust company to be well-managed if in its latest examination it received a composite rating of at least “satisfactory” and a management rating of at least “satisfactory.” 12 C.F.R. § 225.2(s)(1) (2001).

<sup>53</sup>12 C.F.R. § 225.82(d) (2001).

<sup>54</sup>12 U.S.C. § 1843(l)(c).

<sup>55</sup>12 U.S.C. § 1843(m).

<sup>56</sup>*See generally* 12 U.S.C. § 1843(c)(8).



must be “closely related to banking.”<sup>57</sup> There is, however, one caveat. The Gramm-Leach-Bliley Act amended the Bank Holding Company Act so that bank holding companies could only engage in activities that had been determined by the Federal Reserve Board to be “closely related to banking” as of November 11, 1999, the day before Gramm-Leach-Bliley’s enactment.<sup>58</sup> This essentially froze bank holding companies in time, requiring any institution wishing to engage in activities not permitted prior to the Act to qualify as a financial holding company. Thus, while the bank holding company structure may continue to be a viable option for institutions with no intention of expanding present product offerings beyond what was previously allowed, or for institutions that are unable to meet the heightened requirements for financial holding company status, the financial holding company will likely be the vehicle for continued evolution of the financial services industry, with bank holding companies decreasing significantly in number, possibly towards extinction.

### *B. The Emergence of a New Standard*

The Gramm-Leach-Bliley Act enumerated a number of activities that are permissible for financial holding companies and financial subsidiaries of national banks.<sup>59</sup> In order to adapt to changes in the financial marketplace, the Gramm-Leach-Bliley Act amended the Bank Holding Company Act to include a provision that allows the Federal Reserve Board to determine permissible activities for financial holding companies.<sup>60</sup> Prior to the enactment of the Gramm-Leach-Bliley Act and the creation of the financial holding company, the Federal Reserve Board was required to find that a proposed activity was “closely related to banking” if it was to be a permissible activity for bank holding companies.<sup>61</sup> Under the Gramm-Leach-Bliley Act, however, the Board must only determine that the proposed activity is “financial in nature or incidental to such financial activity; or is complementary to

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<sup>57</sup>*Id.*

<sup>58</sup>*Id.*

<sup>59</sup>The Gramm-Leach-Bliley Act states that the following activities shall be considered to be financial in nature:

- (A) Lending, exchanging, transferring, investing for others, or safeguarding money or securities.
- (B) Insuring, guaranteeing, or indemnifying against loss harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of the foregoing, in any State.
- (C) Providing financial, investment, or economic advisory services, including advising an investment company. . .
- (D) Issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly.
- (E) Underwriting, dealing in, or making a market in securities.
- (F) Engaging in any activity that the Board has determined, by order or regulation that is in effect on November 12, 1999, to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

12 U.S.C. § 1843(k)(4)(A)-(F) (2000).

<sup>60</sup>*Id.*

<sup>61</sup>12 U.S.C. § 1843(c)(8).

a financial activity and does not propose a substantial risk to the safety or soundness of depository institutions or the financial system generally.”<sup>62</sup> This provision of the Act has spurred a renewed effort to allow financial holding companies and financial subsidiaries of national banks to engage in real estate brokerage and management services.

The banking industry has tried unsuccessfully to gain permission to engage in real estate brokerage and management services in the past. In 1972, the Federal Reserve Board determined that real estate brokerage was “not closely related to banking” for purposes of the Bank Holding Company Act.<sup>63</sup> In 1987, however, the Board solicited public comment on a proposal to allow bank holding companies to engage in real estate investment activities.<sup>64</sup> The proposal included a provision that would have allowed banks to engage in “activities that are incidental to the ownership of real property, such as property management, maintenance and brokerage activities conducted in connection with real estate in which the bank had an interest,”<sup>65</sup> though it did not propose to allow bank holding companies to engage generally in such activities. The proposal, however, was never adopted in its final form.<sup>66</sup> The issue is now being revisited by the Federal Reserve Board and the Secretary of the Treasury, because “[t]he [a]gencies believe that the [Gramm-Leach-Bliley] Act’s ‘financial in nature or incidental’ standard represents a significant expansion of the ‘closely related to banking’ standard that the Board previously applied in determining the permissibility of activities for bank holding companies.”<sup>67</sup>

#### IV. PENDING LEGISLATION

##### *A. Joint Proposal of the Federal Reserve Board and the Secretary of the Treasury*

As previously noted, the Gramm-Leach-Bliley Act provides a means by which the list of permissible activities in which a financial holding company may engage could be expanded beyond the list enumerated in the Act itself.<sup>68</sup> The Act requires coordination between the Federal Reserve Board and the Secretary of the Treasury wherein each agency must notify the other of any “request, proposal or application . . . for a determination of whether an activity is financial in nature or incidental to a financial activity.”<sup>69</sup> The agency that did not receive the initial request then has

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<sup>62</sup>12 U.S.C. § 1843(k)(1)(A),(B).

<sup>63</sup>Bank Holding Companies and Change in Bank Control, 12 C.F.R. § 225.126(c)(2001). The Federal Reserve Board has determined that the following activities are not closely related to banking as to be a proper incident thereto: insurance premium funding; underwriting life insurance not sold in connection with a credit transaction; real estate brokerage; land development; real estate syndication; management consulting; and property management. 12 C.F.R. § 225.126 (2001).

<sup>64</sup>Bank Holding Companies and Change in Bank Control, 52 Fed. Reg. 543 (1987).

<sup>65</sup>*Id.*

<sup>66</sup>*Id.*

<sup>67</sup>Bank Holding Companies and Change in Bank Control, 66 Fed. Reg. 307, 308.

<sup>68</sup>*See generally* 12 U.S.C. § 1843(k).

<sup>69</sup>12 U.S.C. § 1843(k)(2)(A)(i).

thirty days to notify the other agency, in writing, of its belief that the activity is not financial in nature or incidental to a financial activity.<sup>70</sup>

If neither agency objects to a request, the agencies may then initiate a public rulemaking to find the activity permissible under the Act.<sup>71</sup> The Act enumerates the factors which the agencies are to consider when making a determination of whether an activity is financial in nature or incidental to a financial activity, which are:

- (A) the purposes of [the Bank Holding Company Act] and the Gramm-Leach-Bliley Act;
- (B) changes or reasonably expected changes in the marketplace in which financial holding companies compete;
- (C) changes or reasonably expected changes in the technology for delivering financial services, and;
- (D) whether such activity is necessary and appropriate to allow a financial holding company and the affiliates of a financial holding company to-- (i) compete effectively with any company seeking to provide financial services in the United States.<sup>72</sup>

Shortly after the enactment of the Gramm-Leach-Bliley Act, the American Bankers Association<sup>73</sup> and Fremont National Bank & Trust Company<sup>74</sup> revisited the possibility of allowing banks to offer real estate brokerage and management services by petitioning the Federal Reserve Board and the Secretary of the Treasury to determine that the activities are financial in nature under the expanded standard set forth in the Act.<sup>75</sup> Two additional trade associations, the Financial Services Roundtable<sup>76</sup> and the New York Clearing House Association<sup>77</sup> also requested that the

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<sup>70</sup>12 U.S.C. § 1843(k)(2).

<sup>71</sup>*Id.*

<sup>72</sup>*Id.* § 1843(k)(3).

<sup>73</sup>The American Bankers Association is based in Washington, D.C. and represents banks on issues of national importance. The ABA was founded in 1875 and represents all categories of banking institutions including community, regional and national banks and holding companies, savings banks and institutions, and trust companies. See ABA, *About ABA available at* [www.aba.com/About+ABA/default/html](http://www.aba.com/About+ABA/default/html) (last visited Feb. 13, 2002).

<sup>74</sup>Fremont National Bank and Trust Company is located in Fremont, Nebraska. The company was founded in 1871, and currently has 135 employees and four banking locations. See Fremont National Bank and Trust Co., at [www.fremontnational.com/general/index/html](http://www.fremontnational.com/general/index/html) (last visited Feb. 13, 2002).

<sup>75</sup>Bank Holding Companies and Change in Bank Control, 66 Fed. Reg. 307.

<sup>76</sup>The Financial Services Roundtable is a national association that represents 100 of the largest diversified financial service companies, including sixty-four commercial banking and thrift organizations, twelve insurance companies, seven securities or investment companies and four other types of financial service companies. *Hearings, infra* note 80 (statement of Richard J. Parsons, Executive Vice President, Bank of America Corporation, on behalf of The Financial Services Roundtable).

Board deem real estate brokerage a permissible activity for financial holding companies.<sup>78</sup>

Pursuant to the Act, the Federal Reserve Board and the Secretary of the Treasury consulted with each other and, in January 2001, issued a joint proposed rule and a request for public comment to determine that real estate brokerage and real estate management are activities that are financial in nature or incidental to a financial activity.<sup>79</sup> The agencies requested public comment to the proposed rule with an initial public comment period of sixty days, ending March 2, 2001.<sup>80</sup> Due to an overwhelming number of public comments and at the request of several members of Congress, the public comment period was extended for an additional sixty days, expiring May 2, 2001.<sup>81</sup> A substantial number of the public comments were the result of a letter writing campaign against the proposed rule initiated by the National Association of REALTORS®.<sup>82</sup>

If the rule is adopted as proposed, it will amend section 225.86 of Regulation Y<sup>83</sup> to include real estate brokerage and management services with certain limitations as permissible activities of financial holding companies.<sup>84</sup> As part of the proposed rule, the Federal Reserve Board and the Secretary of the Treasury defined both real estate brokerage and real estate management. The rule defined real estate brokerage as “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.”<sup>85</sup> The rule then enumerated a number of specific activities that would fall under the panoply of real estate

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<sup>77</sup>“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.” Bank Holding Companies and Change in Bank Control, 66 Fed. Reg. 307, 307 n.2.

<sup>78</sup>*Id.* at 307.

<sup>79</sup>*Id.*

<sup>80</sup>*Id.*

<sup>81</sup>*Proposal by the Board of Governors of the Federal Reserve System and the Secretary of the Treasury to Permit Financial Holding Companies and Subsidiaries of National Banks to Offer Real Estate Brokerage and Management Services: Hearing Before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit*, 107th Cong. (2001). [hereinafter *Hearings*] (opening statement of Hon. Spencer Bachus, Chairman, House Subcommittee on Financial Institutions and Consumer Credit).

<sup>82</sup>James R. Peterson, *Sizing Up Real Estate Brokerage; First Test of Key GLB Provision Turns Into a Dustup*, ABA BANKING JOURNAL, October, 2001, at 46 (2001).

<sup>83</sup>12 C.F.R. § 225.86.

<sup>84</sup>Bank Holding Companies and Change in Bank Control, 66 Fed. Reg. 307, 313. While allowing real estate brokerage and management, the amendment would prohibit financial holding companies from investing in or developing real estate as principal and from taking title to, acquiring, or holding any ownership interest in the real estate. Regarding real estate management services, the financial holding companies would be further prohibited from directly or indirectly maintaining or repairing the real estate. *Id.*

<sup>85</sup>*Id.* at 308.

brokerage, but distinguished real estate brokerage from activities that involve the purchasing or selling of real estate as a principal.<sup>86</sup>

The proposed rule defined real estate management as “the business of providing for others day-to-day management of real estate.”<sup>87</sup> Again, the rule enumerated a number of specific activities considered to be real estate management activities, including: procuring tenants, negotiating leases, billing and collecting rent payments, and maintenance of real property.<sup>88</sup> In the past, the Federal Reserve Board has explicitly determined that real estate brokerage and management services were not closely related to banking for purposes of the Bank Holding Company Act.<sup>89</sup> The question now becomes whether these activities, though not closely related to banking, are financial activities or incidentally related to financial activities for purposes of the Gramm-Leach-Bliley Act.

#### *B. The Community Choice in Real Estate Act*

Both houses of Congress have recently proposed legislation in response to the rule proposed by the Federal Reserve Board and the Secretary of the Treasury. On December 6, 2001, Representative Ken Calvert (R-Cal) introduced H.R. 3424 “to amend [Section 4 of] the Bank Holding Company Act of 1956 and [Section 5136A(b) of] the Revised Statutes of the United States to prohibit financial holding companies and national banks from engaging, directly or indirectly, in real estate brokerage or real estate management activities.”<sup>90</sup> On December 18, 2001, Senator Wayne Allard (R-CO) introduced the mirror image of H.R. 3424 in the Senate.<sup>91</sup> These acts are commonly known as the “Community Choice in Real Estate Act,”<sup>92</sup> and if passed would moot the Board’s current proposal. While both bills appear to have bipartisan support, neither bill appears to have the initial support of the Chairmen of the respective committees, Representative Spencer Bachus<sup>93</sup> and

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<sup>86</sup>*Id.*

<sup>87</sup>*Id.* at 311.

<sup>88</sup>*Id.*

<sup>89</sup>12 C.F.R. § 225.126(c),(g).

<sup>90</sup>Community Choice in Real Estate Act, H.R. 3424, 107th Cong. (2001). Section 4 of the Bank Holding Company Act (12 U.S.C. § 1843) pertains to financial holding companies while § 5136A(b) of the Revised Statutes of the United States pertains to financial subsidiaries of nationally chartered banks. The two statutes are substantially similar in enumerating the permissible activities.

<sup>91</sup>Community Choice in Real Estate Act, S. 1839, 107th Cong. (2001).

<sup>92</sup>Community Choice in Real Estate Act, H.R. 3424, 107th Cong. (2001) and Community Choice in Real Estate Act, S. 1839, 107th Cong. (2001).

<sup>93</sup>Chairman of the U.S. House of Representatives Subcommittee on Financial Institutions and Consumer Credit.

Senator Paul Sarbanes.<sup>94</sup> At the time of this writing, both bills have been referred to the respective committees, but no other action has taken place.<sup>95</sup>

## V. TWO SIDES TO EVERY STORY

### A. Arguments in Favor of Permitting Real Estate Brokerage and Management Activities

The Gramm-Leach-Bliley Act “neither specifically authorizes nor specifically forbids financial holding companies or financial subsidiaries of national banks to engage in real estate brokerage and management activities.”<sup>96</sup> The Act does, however, prohibit financial subsidiaries from engaging in real estate investment and development.<sup>97</sup> According to Laurence Meyer of the Federal Reserve Board, “[t]he existence of this limited real estate provision in the [Gramm-Leach-Bliley] Act suggests that the Congress thought about real estate activities in connection with the [A]ct and determined to leave unresolved the question of whether financial holding companies or financial subsidiaries should be permitted to act as real estate brokers or managers.”<sup>98</sup>

The most ardent supporters for the inclusion of real estate brokerage and management services among the list of permissible activities for financial holding companies are members of the banking industry, represented in part by the Financial Services Roundtable<sup>99</sup> and the American Bankers Association.<sup>100</sup> These trade groups have advanced a number of reasons why real estate brokerage and real estate management services should be determined as financial in nature or incidental to a financial activity and therefore, permissible under the Gramm-Leach-Bliley Act.<sup>101</sup> First, a number of depository institutions already engage in real estate brokerage.<sup>102</sup> According to Neil Milner, President and Chief Executive Officer of The Conference of State Bank Supervisors, “[twenty-five] states and the District of Columbia allow their state-chartered banks to conduct real estate brokerage. In a number of states this activity has been allowed for ten to twenty years. In one state . . . the activity has been allowable for over one hundred years.”<sup>103</sup> Proponents of the dual banking

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<sup>94</sup>Chairman of the U.S. Senate Committee on Banking, Housing and Urban Affairs.

<sup>95</sup>Bank Holding Companies and Change in Bank Control, <http://rs9.loc.gov/cgi-bin/bdquery/z?d107:s.01839>: (last visited Feb. 19, 2002); <http://rs9.loc.gov/cgi-bin/bdquery/z?d107:h.r.03424>: (last visited Feb. 19, 2002).

<sup>96</sup>*Hearings*, *supra* note 81 (statement of Laurence H. Meyer, Member, Board of Governors of the Federal Reserve System).

<sup>97</sup>*Id.*

<sup>98</sup>*Id.*

<sup>99</sup>*See supra* note 76, and accompanying text.

<sup>100</sup>*See supra* note 73, and accompanying text.

<sup>101</sup>66 Fed. Reg. 307, 313.

<sup>102</sup>*Hearings*, *supra* note 81 (statement of Neil Milner, President and CEO, The Conference of State Bank Supervisors).

<sup>103</sup>*Id.*

system note that “[t]he ability for state banks to test new products, services, powers and structures on a state-by-state basis, prior to issuing a broad grant of authority to institutions nationwide, has identified best practices for the delivery of financial services that has then been available to federally chartered institutions.”<sup>104</sup> Thus, proponents of the proposed rule assert that a number of state-chartered banks have effectively engaged in real estate brokerage and management services for years, and now it is both necessary and appropriate for nationally chartered banks to engage in the activities as well.<sup>105</sup> In addition to state-chartered banks, the Office of Thrift Supervision has also allowed service corporation subsidiaries of federal savings associations to provide general real estate brokerage services.<sup>106</sup>

The proposed rule also notes that “banks and bank holding companies currently engage in a variety of activities that are functionally and operationally similar to real estate brokerage.”<sup>107</sup> These activities include: securities brokerage services, private placement services, agency transactional services, and insurance agency services.<sup>108</sup> Proponents argue that real estate brokerage services are simply an additional form of agency services and are essentially no different from the permissible agency services already offered by banks and bank holding companies.<sup>109</sup>

In addition to state-chartered banks and nationally-chartered thrifts, many of the other institutions against which financial holding companies currently compete are able to offer real estate brokerage services.<sup>110</sup> The proposed rule provides several examples of diversified financial companies that are not subject to the Bank Holding Company Act that provide real estate brokerage services as well as more traditional financial services.<sup>111</sup> These companies include General Motors Acceptance Corporation, Prudential Insurance Company, Cendant Corporation, and Long & Foster.<sup>112</sup> Conversely, real estate brokerages are increasingly offering many of the services traditionally reserved for financial service companies, including, most notably, mortgage lending and insurance services.<sup>113</sup> According to the testimony of Richard J. Parsons on behalf of the Financial Services Roundtable, nine of the ten leading real estate brokers cited by *Realtor* magazine compete with financial holding

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<sup>104</sup>*Id.*

<sup>105</sup>*Id.*

<sup>106</sup>*See* Subordinate Organizations, 12 C.F.R. § 559.4(e)(4) (2001).

<sup>107</sup>Bank Holding Companies and Change in Bank Control, 66 Fed. Reg. 307, 309.

<sup>108</sup>*Id.*

<sup>109</sup>*Id.*

<sup>110</sup>Bank Holding Companies and Change in Bank Control, Fed. Reg. 307, 310.

<sup>111</sup>*Id.* at 310 n.23.

<sup>112</sup>*Id.* In addition to providing real estate brokerage services, the companies engage in the following activities traditionally considered financial activities: General Motors Acceptance Corporation operates a thrift and makes mortgage loans; Prudential Insurance Company provides insurance and securities products; Cendant Corporation provides insurance products and mortgage loans; and Long & Foster provides mortgage loans and insurance products. *Id.*

<sup>113</sup>*Hearings, supra* note 81 (statement of Richard J. Parsons, Executive Vice President, Bank of America Corporation, on behalf of The Financial Services Roundtable).

companies by offering mortgage loans or insurance.<sup>114</sup> Furthermore, fifty-six percent of residential real estate brokerage firms with more than fifty agents currently offer mortgage lending services.<sup>115</sup> Mr. Parsons further asserts, “the only financial institutions that uniformly cannot engage in real estate brokerage are financial holding companies and national banks.”<sup>116</sup> Proponents, therefore, view the proposed initiative to be an attempt to level the competitive playing field, and deem approval of the regulation as “both necessary and appropriate to allow financial holding companies to compete effectively with real estate brokerage companies, as well as with federal thrifts, credit unions, and state banks.”<sup>117</sup>

Advocates of the proposed regulation also note that the enhanced competition will benefit consumers.<sup>118</sup> Currently, financial holding companies and their subsidiaries engage in virtually every other aspect of real estate transactions, including mortgage loans, performing real estate appraisals, providing escrow services and various insurance products related to real estate transactions, including title insurance, private mortgage insurance, and homeowner’s insurance.<sup>119</sup> Allowing financial holding companies to offer real estate brokerage and management services would enable such institutions to provide convenient “one-stop shopping” for consumers and the increased competition would ostensibly result in lower transaction costs for consumers as well.<sup>120</sup>

*B. Counter-Arguments of the National Association of REALTORS® and Others*

By far, the most vociferous opposition to the proposed regulation comes from the National Association of REALTORS® (hereinafter “NAR”), an organization that represents more than 760,000 real estate professionals practicing in all areas of residential and commercial real estate.<sup>121</sup> The organization has referred to the proposed rule as “The Big Grab”<sup>122</sup> and spearheaded a massive letter-writing campaign against the proposed rule during the public comment period.<sup>123</sup>

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<sup>114</sup>*Id.*

<sup>115</sup>*Id.*

<sup>116</sup>*Id.*

<sup>117</sup>*Id.*

<sup>118</sup>*Hearings, supra* note 81 (statement of Richard J. Parsons, Executive Vice President, Bank of America Corporation, on behalf of The Financial Services Roundtable).

<sup>119</sup>*Id.* (statement of Laurence H. Meyer, Member, Board of Governors of the Federal Reserve System).

<sup>120</sup>*Id.* (statement of Richard J. Parsons, Executive Vice President, Bank of America Corporation, on behalf of The Financial Services Roundtable).

<sup>121</sup>*Id.* (statement of Richard A. Mendenhall, President, National Association of REALTORS®).

<sup>122</sup>*See* Realtor, [www.realtor.org/GAPublic.nsf](http://www.realtor.org/GAPublic.nsf) (last visited Jan. 9, 2002).

<sup>123</sup>According to the American Bankers Association, the request for public comment “drew an astonishing 46,000 letters of comment, mostly from irate realtors.” James R. Peterson, *Sizing Up Real Estate Brokerage; First Test of Key GLB Provision Turns Into a Dustup*, A.B.A. BANKING J., Oct., 2001, at 46.



The main contention of those opposed to the rule is the belief that real estate brokerage and management services are clearly commercial in nature, and permitting banks to engage in such activities would violate the very cornerstone of financial service industry regulation - the need to separate banking from commerce.<sup>124</sup> The NAR contends, “[r]eal estate brokerage involves the marketing and sale of tangible property, the very essence of commerce.”<sup>125</sup> The organization notes that under the Bank Holding Company Act of 1956, real estate brokerage and management services were always deemed commercial activities and therefore, an impermissible ground for bank holding companies.<sup>126</sup> The NAR feels that if real estate brokerage and management functions are deemed financial activities, there will be no demarcation between finance and commerce. This belief was echoed by Representative Spencer Bachus, Chairman of the House Subcommittee on Financial Institutions, when he said “I believe that the wholesale entry of banks into the real estate business – while not in and of itself undermining safety and soundness – may serve to erode the long-standing separation between banking and commerce that Congress most recently reaffirmed in the Gramm-Leach-Bliley Act.”<sup>127</sup>

A second contention by the rule’s opponents concerns the timing of the request by the banking industry trade groups, which came approximately one year after the enactment of the Gramm-Leach-Bliley Act.<sup>128</sup> The Act requires the Federal Reserve Board and the Secretary of the Treasury to consider, *inter alia*, changes or reasonably expected changes in both the marketplace and in technology when determining whether an activity is financial in nature or incidental to a financial activity.<sup>129</sup> The NAR states that “[n]o reasonable observer would suggest that there has been any significant change in the relevant technology, or in the business of real estate brokerage or management, since enactment of the [Gramm-Leach-Bliley] Act in late 1999.”<sup>130</sup> In fact, the NAR asserts neither the marketplace nor technology has changed since debate on the Act began in earnest in the mid-1990’s.<sup>131</sup> This, according to the NAR, coupled with the fact that real estate brokerage and management services are conspicuously absent from the enumerated list of activities automatically deemed financial in nature or incidental to a financial activity at the

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This was confirmed by a representative of the Federal Reserve Board, who testified that “the vast majority of the comments have been submitted by individual real estate agents opposed to the proposal.” *Hearings, supra* note 81 (statement of Laurence H. Meyer, Member, Board of Governors of the Federal Reserve System).

<sup>124</sup>*Hearings, supra* note 81 (opening statement of Richard A. Mendenhall, President, National Association of REALTORS®).

<sup>125</sup>*Id.*

<sup>126</sup>*Id.*

<sup>127</sup>*Id.* (opening statement of Rep. Spencer Bachus, Chairman, House Financial Services Subcommittee on Financial Institutions).

<sup>128</sup>*See generally* Bank Holding Companies and Change in Bank Control, 66 Fed. Reg. 307.

<sup>129</sup>12 U.S.C. § 1843(k)(3).

<sup>130</sup>*Hearings, supra* note 81 (opening statement of Richard A. Mendenhall, President, National Association of REALTORS®).

<sup>131</sup>*Id.*

time of enactment, demonstrates that Congress deemed these activities to be commercial, not financial.<sup>132</sup>

The NAR also attacks the argument that the proposed rule will be beneficial to consumers. The NAR notes that “[t]he real estate brokerage industry is already characterized by fierce competition, market efficiencies, and ease of entry so that there is nothing gained by consumers by permitting [financial holding companies’] entrance.”<sup>133</sup> In fact, the NAR argues that the proposed rule would actually have adverse effects on consumers because financial holding companies and national banks possess advantages that their nonbank competitors do not possess.<sup>134</sup> These advantages include the protection provided by federal deposit insurance, which reduces the cost of funds for insured depository institutions, and the special access to credit from the Federal Reserve and Federal Home Loan Banks, where banks can borrow at below market rates that are not available to other businesses.<sup>135</sup> Opponents of the rule assert that these advantages would provide a substantial competitive edge over nonbank real estate brokers, and while this might result in a short-term decrease in real estate commissions and other transaction costs, the stifling of competition and limitation of consumer choices would ultimately be at the expense of the consumer.<sup>136</sup>

#### VI. THE PROPOSED RULE HIGHLIGHTS THE INADEQUACIES OF THE GRAMM-LEACH-BLILEY ACT

##### *A. The Language Employed is Too Broad to Accomplish the Goals of the Act*

The debate over whether financial holding companies and financial subsidiaries of national banks should be permitted to engage in real estate brokerage and management services is certainly heated, with both sides asserting strong arguments. Regardless of the outcome, however, the debate has demonstrated some of the inadequacies in the Gramm-Leach-Bliley Act regarding the addition of permitted activities.<sup>137</sup> The first major criticism of the Act is that the language employed by Congress is far too broad to accomplish Congress’s goal of expanding the powers of financial holding companies while maintaining the separation of banking and commerce. The problem of over-inclusive language was noted by Laurence Meyer of the Federal Reserve Board, who said that Congress “wrote a very nuanced bill with a lot of flexibility. On the one hand, [Congress] considered and rejected a broad mixing of banking and commerce. But . . . provide[d] opportunities for mixing banking and commerce.”<sup>138</sup> In theory, the provision would simply expand the limits

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<sup>132</sup>*Id.*

<sup>133</sup>*Id.*

<sup>134</sup>*Hearings, supra* note 81 (opening statement of Richard A. Mendenhall, President, National Association of REALTORS®).

<sup>135</sup>*Id.*

<sup>136</sup>*Id.*

<sup>137</sup>12 U.S.C. § 1843(k).

<sup>138</sup>*Hearings, supra* note 81 (testimony of Laurence H. Meyer, Member, Board of Governors of the Federal Reserve System).

of the “closely related to banking” standard, but the practical reality is that the language employed by Congress provides no real limit to the types of activities that may be permissible under the Act. In addition to allowing financial holding companies to engage in activities that are financial in nature, the Act permits those institutions to engage in activities “incidental to such financial activity”<sup>139</sup> or any activity that is “complementary to a financial activity.”<sup>140</sup> Webster’s Dictionary defines “incidental” as “occurring by chance; of secondary importance; arising out of something else,”<sup>141</sup> while “complementary” is defined as “serving to complete.”<sup>142</sup> Thus, the plain language of the statute would allow financial holding companies not only to engage in financial activities, but also in non-financial activities that simply arise out of financial activities or serve to complete financial activities. While Congress has stated that its intention was to expand the scope of financial holding companies,<sup>143</sup> Congress also reaffirmed its intention to uphold the separation between finance and commerce.<sup>144</sup> While in the modern economy it is difficult to determine a bright line between financial and commercial activities, the demarcation between those commercial activities that are considered incidental or complementary to financial activities and those that are not is a far more arduous task.

Several members of the House Subcommittee on Financial Institutions felt that if the proposed activities are permitted under the Act, it would cause a slippery slope, resulting in the total mixing of banking and commerce.<sup>145</sup> As Robert Nielsen of the National Association of Home Builders noted, “[i]f this proposal is allowed to go forward, it would be difficult to predict what activities would not fall under [financial activities].”<sup>146</sup> On numerous occasions throughout the debate, for example, engaging in real estate brokerage and management activities has been analogized to engaging in the sale of automobiles.<sup>147</sup> An automobile is clearly a tangible asset, as is a piece of real estate, but the purchase of both types of assets generally involves some level of financing. Some commentators conjectured that if the current proposal is accepted, an argument could be made for permitting the sale of automobiles.<sup>148</sup> While this proposition may appear far-fetched at first, it may actually be a logical result of the Act as currently written. Once an activity is identified as a financial

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<sup>139</sup>12 U.S.C. § 1843(k)(1)(A).

<sup>140</sup>12 U.S.C. § 1843(k)(1)(B).

<sup>141</sup>WEBSTER’S DICTIONARY OF THE ENGLISH LANGUAGE 489 (1989).

<sup>142</sup>WEBSTER’S DICTIONARY OF THE ENGLISH LANGUAGE 200 (1989).

<sup>143</sup>*Hearings, supra* note 81 (statement of Rep. Michael Oxley).

<sup>144</sup>*Id.* (opening statement of Rep. Spencer Bachus, Chairman, House Financial Services Subcommittee on Financial Institutions).

<sup>145</sup>*Id.* (testimony of Rep. Bob Riley).

<sup>146</sup>*Id.* (statement of Robert Nielsen, on behalf of the National Association of Home Builders).

<sup>147</sup>*See generally Hearings, supra* note 81.

<sup>148</sup>*Hearings, supra* note 81 (testimony of Rep. Bob Riley). Rep. Riley further asserted, “I promise you, there is more financial activity in an automobile dealership than there is in any real estate brokerage company in this country.” *Id.*

activity or incidental to a financial activity, it creates a potential nexus of other activities that are related to the newly permissible activity.<sup>149</sup>

The statute enumerates several factors that the Board must take into account in determining whether an activity is financial in nature or incidental to a financial activity.<sup>150</sup> Among these factors are changes in the marketplace or in technology.<sup>151</sup> While it is clear that Congress intended to enable financial holding companies to adapt to changing market and technological conditions, the language employed by the statute is flawed. The statute actually allows financial activities to be defined, in part, by market conditions. The danger in such a proposition should be obvious. If financial activities are defined by the market, the mere fact that a number of less-regulated institutions that compete with financial holding companies engage in a certain commercial activity could result in that activity being delineated a financial activity. Laurence Meyer of the Federal Reserve Board noted the difficulties in applying the provision, saying that “[t]he [Gramm-Leach-Bliley] Act establishes certain factors that the Board and Treasury must consider, but it otherwise leaves the agencies with significant discretion and very little guidance regarding what is and what is not a financial activity.”<sup>152</sup> Furthermore, with such broad discretion, it is unlikely that the judiciary would find that the regulators had exceeded their authority should a determination that an activity is permissible under the Gramm-Leach-Bliley Act ever be challenged. Thus it appears that the language employed by the statute is too broad to limit the power of financial holding companies to activities that are truly financial in nature or reasonably related to financial activities.

This problem is further complicated by the fourth factor that the Federal Reserve Board must take into account: “whether such activity is necessary or appropriate to allow a financial holding company . . . to compete effectively with any company seeking to provide financial services.”<sup>153</sup> Again, this provision requires the regulators to look to the market to define a financial activity. This provision is even more expansive than the previous provision for two reasons. First, this factor allows the regulators to consider whether an activity is either necessary *or* appropriate for financial holding companies to compete.<sup>154</sup> While it would presumably be difficult to prove that it is necessary for a financial holding company to engage in a non-financial activity in order to compete effectively, proving that it is appropriate for a financial holding company to compete is a far lower burden. In fact, it would seemingly be more difficult to prove that an activity engaged in by a competitor of a financial holding company is an *inappropriate* activity for a financial holding company.

This problem is further exacerbated by the remainder of the factor, which provides that that Board must consider whether the proposed activity would allow

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<sup>149</sup>*Id.* (testimony of Rep. Charles Gonzalez).

<sup>150</sup>12 U.S.C. § 1843(k)(3).

<sup>151</sup>*Id.*

<sup>152</sup>*Hearings, supra* note 81 (statement of Laurence H. Meyer, Member, Board of Governors of the Federal Reserve System).

<sup>153</sup>12 U.S.C. § 1843(k)(3)(D).

<sup>154</sup>*Id.*

financial holding companies to compete “with any company seeking to provide financial services.”<sup>155</sup> Again, it appears that the broad language employed by Congress stretches the scope of the statute beyond what was originally intended. Under this provision, the competitive marketplace in which financial holding companies compete consists of *any* company merely *seeking* to provide financial services. Thus, it is not limited to financial holding companies or even companies primarily engaging in financial activities, but it would presumably include traditionally “commercial” companies such as manufacturers and retailers that provide or are seeking to provide financial services as a complement to their existing business lines.

If the proposed rule is not adopted, the debate is far from over. As previously mentioned, in addition to the “financial in nature or incidental to [a] financial activity” standard, the Gramm-Leach-Bliley Act also includes a provision that would allow banks to engage in any activity that “is complementary to a financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally.”<sup>156</sup> Thus, if the banks are not successful in having real estate brokerage and management services deemed financial in nature or incidental to a financial activity, they will likely request that the activities be declared “complementary” activities. The Federal Reserve Board and Secretary of the Treasury intentionally did not seek public comment on whether the proposed activities were complementary to financial activity because they were asked only to define real estate brokerage and management activities as financial in nature.<sup>157</sup> Laurence Meyer, a member of the Board of Governors of the Federal Reserve System alluded to this likelihood in response to the NAR’s opposition to the proposed rule, stating that “[i]f one accepts their contention that brokering real estate is really a commercial activity, the question can then be raised whether real estate brokerage should be permitted as an activity that is ‘complementary to a financial activity.’”<sup>158</sup>

Clearly, many of the arguments both for and against declaring that real estate brokerage and management services are financial activities would be relevant to a determination of whether the activities are complementary to a financial activity. However, in addition to finding a complementary relationship, the Act requires that the activity “does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally”<sup>159</sup> before adding it to the list of permissible activities. This requires the agencies to conduct further analysis to determine the effects of the proposed activity on the safety and soundness of not only banks, but of all participants in the financial services industry.<sup>160</sup> While the burden of establishing a complementary relationship between the activities provided by

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<sup>155</sup>*Id.*

<sup>156</sup>12 U.S.C. § 1843(k)(1)(B).

<sup>157</sup>*Hearings, supra* note 81 (statement of Laurence H. Meyer, Member, Board of Governors of the Federal Reserve System).

<sup>158</sup>*Id.*

<sup>159</sup>12 U.S.C. § 1843(k)(1)(B).

<sup>160</sup>*Id.*

banks and other financial service institutions and the activities of real estate brokerage and management services should be met with relative ease, the National Association of REALTORS® and other opponents of the proposed rule may have a legitimate argument regarding safety and soundness concerns.

While a debate on the effect of the proposed rule on the safety and soundness of depository institutions and the financial system as a whole was not directly relevant to the proposal, the issue was addressed by some of the parties.<sup>161</sup> Richard J. Parsons, testifying on behalf of The Financial Services Roundtable asserted that “brokerage poses little risk to the banking system” because a real estate broker acts solely in an agency capacity, rather than as a principal.<sup>162</sup> Thus, the broker does not have an interest in the property, and only derives fee income from arranging the transaction. On the surface, it may appear that allowing financial holding companies to engage in these activities would pose no risk to the safety and soundness of the institution. However, there are a number of situations where engaging in real estate could potentially pose a risk to safety and soundness. For example, a bank may be tempted to underwrite a mortgage that is below its normal standards if it is able to increase its overall return with a real estate brokerage fee. If the bank adopted this practice, it could potentially affect the overall soundness of the institution. The problem, however, is that the statute only excludes activities that pose a *substantial* risk to safety and soundness of the financial institution. While arguments can be made that a particular activity, such as real estate brokerage or management, poses a risk to the safety and soundness of a financial institution, meeting the burden of “substantial risk” would be difficult. It is clear that Congress intended to expand the scope of permissible activities beyond what was permissible under the “closely related to banking” standard. It is equally clear, however, that by using terms such as “incidental,” “complementary,” “necessary or appropriate,” and “substantial risk,” the statute goes beyond what was originally intended by the drafters, who sought to maintain the separation between finance and commerce.<sup>163</sup>

#### *B. The Roles of the Legislature and Regulators are Not Clearly Defined*

A second major criticism of the Gramm-Leach-Bliley Act is that the roles of the legislature and the regulators are not clearly defined in the Act. This is demonstrated by the proposed rule and the testimony regarding the rule.<sup>164</sup> The actual language of the rule does not indicate a strong sentiment by the agencies proposing the rule that the activities are in fact financial activities or incidentally related to a financial activity.<sup>165</sup> The proposed rule appears to be a request for additional information rather than a statement of position.<sup>166</sup> This issue was discussed during a hearing on

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<sup>161</sup>*Hearings, supra* note 81 (statement of Richard J. Parsons, Executive Vice President, Bank of America Corporation, on behalf of The Financial Services Roundtable).

<sup>162</sup>*Id.*

<sup>163</sup>*Hearings, supra* note 81 (statement of Rep. Waters).

<sup>164</sup>*See generally Hearings, supra* note 81; Bank Holding Companies and Change in Bank Control, 66 Fed. Reg. 307 (Jan. 3, 2001) (to be codified at 12 C.F.R. pt. 225).

<sup>165</sup>*Id.*

<sup>166</sup>*Id.*

the rule in the House Subcommittee on Financial Institutions, when Rep. Melvin Watt (D-NC) specifically asked Donald Hammond<sup>167</sup> whether someone in the Treasury actually advocated the proposed rule or if it “would in effect be a rule promulgated for debate purposes to clarify the law?”<sup>168</sup> Mr. Hammond responded that the rule was proposed in order to interpret the statute, stating that the issue of whether real estate brokerage and management services were financial activities or incidentally related to financial activities “very clearly met a threshold standard, that the request came in, [and] met enough of the statutory requirements to put it forward as a proposal.”<sup>169</sup> He further noted that between the time the rule was initially proposed and the time of the hearing, the Administration had changed, so the sentiment of the Department of Treasury may have changed as well.<sup>170</sup> Laurence Meyer, representing the Federal Reserve Board, testified that it was not crucial that the agencies advocate the position, so long as the request was reasonable enough to seek public comment.<sup>171</sup> He added, however, that the proposals are usually supported “by some sense of advocacy.”<sup>172</sup> Further, it was the understanding of the agencies that the proposition of a rule was the proper mechanism for determining whether an activity was within the parameters of the Gramm-Leach-Bliley Act, and that after agreeing that a threshold case could be made, the agencies “put it out in this form to get the discussion going, to get feedback from practitioners, from market participants from both sides to help us sort out the issues and hopefully make a very informed decision.”<sup>173</sup> From these statements by the representatives of the Federal Reserve Board and the Secretary of the Treasury, it is unclear as to the level of support for the proposed rules from the respective agencies. What is clear, however, is that the statute is ambiguous as to when a proposal should be issued.<sup>174</sup>

This lack of clarity has already led to tremendous inefficiencies. While the Federal Reserve Board and the Secretary of the Treasury issued the proposed rule primarily as a solicitation of public comment, both houses of Congress have responded with proposed legislation to render the proposed rule moot.<sup>175</sup> These resolutions have been referred to the appropriate committees and are pending further

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<sup>167</sup>Donald V. Hammond is the Acting Under Secretary for Domestic Finance, Department of the Treasury.

<sup>168</sup>*Hearings, supra* note 81 (testimony of Rep. Melvin L. Watt).

<sup>169</sup>*Id.* (testimony of Hon. Donald V. Hammond, Acting Under Secretary for Domestic Finance, Department of the Treasury).

<sup>170</sup>*Id.*

<sup>171</sup>*Id.* (statement of Hon. Laurence H. Meyer, Member, Board of Governors of the Federal Reserve System).

<sup>172</sup>*Id.*

<sup>173</sup>*See generally Hearings, supra* note 81.

<sup>174</sup>*Id.*

<sup>175</sup>Community Choice in Real Estate Act, H.R. 3424, 107th Cong. (2001); Community Choice in Real Estate Act, S. 1839, 107th Cong. (2001).

action.<sup>176</sup> Clearly, Congress would not have vested the regulatory agencies with the authority to determine that activities were permissible under the Gramm-Leach-Bliley Act if it intended to enact separate legislation in response to each proposed rule. However, because the roles of both the regulators and the legislature were not clearly defined in the Act, that is exactly what has resulted.

*C. The Scope of the Rule is Too Expansive*

One of the major differences between the “closely related to banking” standard under the Bank Holding Company Act and the “financial activity or incidentally related to a financial activity” standard under the Gramm-Leach-Bliley Act is the scope of its effect. Prior to the enactment of the Gramm-Leach-Bliley Act, “the law directed the Board to consider whether banks engaged in the activity, but did not explicitly authorize the [Federal Reserve] Board to consider whether other financial service providers engaged in the activity.”<sup>177</sup> The enactment of the Gramm-Leach-Bliley Act, however, “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 [financial holding companies].”<sup>178</sup> As previously stated, twenty-five states and the District of Columbia currently permit their state-chartered banks to engage in real estate brokerage.<sup>179</sup> If financial holding companies and financial subsidiaries of national banks are permitted to engage in these activities, they would arguably be able to more adequately compete with the state-chartered banks in the states where such activities are currently permitted. Conversely, however, it would appear that the newly empowered financial holding companies and national banks would have a competitive advantage over state-chartered banks in the states where these activities are currently impermissible. It is likely, then, that the states that have historically not permitted real estate brokerage and management by banks would be pressured by the state banks to amend their current regulations to allow banks to engage in previously impermissible activities. Those states that do amend their regulations may do so contrary to the reasons that have kept them from amending their regulations prior to the current proposal. Those states that do not amend their regulations to permit state banks to offer real estate brokerage and management services could be hurt as state-chartered institutions lose market share to potentially out-of-state financial holding companies.

Further exacerbating the issue is the fact that many states have “wild card statutes,”<sup>180</sup> which would automatically permit state-chartered banks to engage in any activity permissible for a national bank or financial holding company, taking the power to decide on the issue away from state regulators. This could create a

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<sup>176</sup>Bill Summary and Status for the 107<sup>th</sup> Congress, <http://rs9.loc.gov/cgi-bin/bdquery/z?d107:s.01839>: (last visited Feb. 19, 2002); <http://rs9.loc.gov/cgi-bin/bdquery/z?d107:h.r.03424>: (last visited Feb. 19, 2002).

<sup>177</sup>Bank Holding Companies and Change in Bank Control, 66 Fed. Reg. 307, 309.

<sup>178</sup>*Id.* at 309-10.

<sup>179</sup>*Hearings, supra* note 81 (statement of Neil Milner, President and CEO, The Conference of State Bank Supervisors).

<sup>180</sup>Henry N. Butler & Jonathan R. Macey, *The Myth of Competition in the Dual Banking System*, 73 CORNELL L. REV. 677, 705 (1988).



multitude of problems, as state-chartered banks could engage in these activities without adhering to the heightened requirements of financial holding company status. As currently written, the rule does not include any provisions that would limit the scope of the Act to applicable state laws, therefore preserving the integrity of the dual banking system.<sup>181</sup>

## VII. CONCLUSION

The rule to permit financial holding companies and financial subsidiaries of nationally chartered banks to engage in real estate brokerage and management activities was proposed over a year ago, and there is no indication that the issue will be resolved in the very near future.<sup>182</sup> Regardless of how the issue is finally resolved, the current debate has highlighted some of the inadequacies of the provision in the Gramm-Leach-Bliley Act that provides for the expansion of the list of permissible activities for financial holding companies. Among these inadequacies are the overly broad language of the statute, the ambiguously defined roles of the regulatory agencies, and the expansive scope of the provision. When enacted, the Gramm-Leach-Bliley Act had the strong support of the legislature, regulatory agencies, industry groups and consumer groups,<sup>183</sup> but if the above-listed deficiencies are not addressed, the effectiveness of the Act could be severely compromised.

The most efficient and effective manner in which to correct the perceived inadequacies of the Act would be for Congress to amend the provisions expanding the list of permissible activities. Throughout the debate on the issue, there has been a clear sentiment in Congress that the broad language and ambiguities of the Act should be addressed by the legislative branch rather than leaving it to the interpretation of the regulatory agencies of the executive branch.<sup>184</sup> This sentiment is evidenced by the comments made by a number of legislators during the House subcommittee hearings, as well as the by the pending bills in the House and Senate.

It is not uncommon for a law to be amended shortly after its promulgation if the effects of the law are not commensurate with the intent. Some members of Congress have suggested that the provisions of the Act allowing for the expansion of permissible activities may need to be amended as well. In his opening statement during the hearing on the issue, Rep. Paul Kanjorski stated, “[i]f the agencies fail to deliberate on this issue judiciously, Congress may find itself again considering legislation designed to close the loopholes created by their regulatory excess.”<sup>185</sup> Later in his testimony, he accused the regulatory agencies of expanding the authority beyond what was intended and actually granted by Congress.<sup>186</sup> Rep. Brad Sherman also felt that permitting financial holding companies to engage in real estate

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<sup>181</sup>See generally *Bank Holding Companies and Change in Bank Control*, 66 Fed. Reg. 307.

<sup>182</sup>*Id.*

<sup>183</sup>See Dee DePass, *Stocks Rise as Clinton Signs Finance Reform Bill Into Law; Wall Street Expects Measure to Prompt Flurry of Mergers*, MINNEAPOLIS STAR TRIBUNE, Nov. 13, 1999, at 1D.

<sup>184</sup>See generally *Hearings*, *supra* note 81.

<sup>185</sup>*Hearings*, *supra* note 81 (statement of Rep. Paul E. Kanjorski).

<sup>186</sup>*Id.*

brokerage and management activities exceeded the authority of the regulating agencies, saying that if the Gramm-Leach-Bliley Act were to be dramatically expanded, it should be done by Congress, “and there shouldn’t be an end run around the authority of Congress where we are told less than a year after we pass a bill it needs to be updated by putting something into it that many of us who supported the bill never intended.”<sup>187</sup>

The first step in the amendment process would be to narrow the language of the provisions to more accurately match the actual intent of Congress. It seems clear that if financial holding companies are permitted to engage in activities that are only “incidental” or “complementary” to a financial activity, involvement in such activities should be more restricted than involvement in true financial activities. The extent to which these activities are to be limited, perhaps via increased capital requirements for subsidiaries engaging in these activities or a limitation on the percentage of net income a financial holding company could derive from such activities, is beyond the scope of this Note. However, simply limiting the power to engage in “incidental” or “complementary” activities should greatly reduce the room for abuse under the Act.

Next, Congress should amend the factors that the agencies must consider “[i]n determining whether an activity is financial in nature or incidental to a financial activity.”<sup>188</sup> While it seems reasonable for the agencies to consider changes in the marketplace and technology when determining the permissibility of an activity, it is very dangerous that a financial activity could actually be defined by the market. Thus, Congress might allow financial holding companies to engage in non-financial activities based on competitive factors, but any involvement in such activities should be severely limited to what is absolutely necessary for the financial holding companies to compete.

Finally, when considering “complementary” activities, Congress should limit the ability of financial holding companies to engage in such activities beyond only those that “pose a substantial risk to the safety or soundness” of a bank.<sup>189</sup> It has already been established that “complementary” activities are wholly commercial activities that simply serve to complete financial activities.<sup>190</sup> These activities clearly would not have been permissible prior to the Gramm-Leach-Bliley Act and do indeed involve a mixing of banking of commerce. Therefore, it would seem reasonable to prohibit involvement in such activities that pose “moderate” or even “significant” risks to the safety or soundness of banks. While terms such as “moderate” and “significant” would be subject to interpretation, they would clearly be more restrictive than the present “substantial risk” standard.

The second major initiative for Congress should be to further define the role of the regulatory agencies in the process of expanding the list of permissible activities under the Gramm-Leach-Bliley Act. While the Act seemed to clearly describe the process to be followed by the Federal Reserve Board and Secretary of the Treasury upon a request for a determination of whether an activity is permissible under the

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<sup>187</sup>*Id.* (testimony of Rep. Brad Sherman).

<sup>188</sup>12 U.S.C. § 1843(k)(3).

<sup>189</sup>12 U.S.C. § 1843 (k)(1)(B).

<sup>190</sup>*See supra* note 141.

Act,<sup>191</sup> it is clear from the subsequent testimony that confusion exists among the parties involved. Improving the language of the statute, as recommended above, should serve to minimize much of the confusion. However, Congress should also explicitly provide the criteria necessary before a public rulemaking is proposed. As previously noted, both the Federal Reserve Board and the Secretary of the Treasury interpreted the statute to require a request for public comment once a threshold case is made by the party requesting that a determination be made.<sup>192</sup> It seems apparent from the testimony and subsequent comments by members of Congress, however, that it was their intention that the agencies actually make a determination that an activity is financial in nature or incidentally related to a financial activity before proposing a rule.<sup>193</sup> Resolving this ambiguity would minimize the inefficiencies of agencies proposing rules that they do not actually advocate and Congress in turn proposing legislation against proposed rules that seem contrary to their intent.

The final step in the amendment process would be to attempt to limit the effect of the provisions. It seems clear that adding to the list of permissible activities for financial holding companies will dramatically change the competitive landscape for all companies providing financial services. Congress can limit the scope of the Act by requiring that such activities be “conducted pursuant to applicable state laws.”<sup>194</sup> If Congress amends the provisions of the Gramm-Leach-Bliley Act as suggested, the law will more closely reflect the original intent of Congress and would remain an invaluable vehicle for adapting to changes in the financial services industry for years to come.

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<sup>191</sup>12 U.S.C. § 1843 (k)(2).

<sup>192</sup>*Hearings, supra* note 81 (testimony of Laurence H. Meyer, Member, Board of Governors of the Federal Reserve System and Hon. Donald V. Hammond, Acting Under Secretary for Domestic Finance, Department of the Treasury).

<sup>193</sup>*Id.* (testimony of Rep. Melvin L. Watt).

<sup>194</sup>*Id.* (statement of Neil Milner, President and CEO, The Conference of State Bank Supervisors).

<sup>195</sup>The author would like to thank Professors William Tabac and Beverly Blair of the Cleveland-Marshall College of Law for their insight and instruction. Special thanks to Brandy Burke whose unconditional encouragement and support made this Note possible.