

[Link to Index Entry: Notes Link](#)

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**STATEMENT OF THE
NATIONAL ASSOCIATION OF REALTOR**

**FOR THE HEARING RECORD OF
THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
THE UNITED STATE SENATE**

**ON
FINANCIAL SERVICES MODERNIZATION**

FEBRUARY 25, 1999

**Statement by
NATIONAL ASSOCIATION OF REALTORS®
For the hearing record of
The Committee on Banking, Housing and Urban Affairs
Of the
United States Senate
On the
"Financial Services Modernization Act of 1999"
February 25, 1999**

On behalf of the more than 730,000 members of the **NATIONAL ASSOCIATION OF REALTORS®**, we present testimony on the Discussion Draft of the "Financial Services Modernization Act of 1999." Over the past several years Congress has wrestled with financial services modernization, but it seems inevitably that the complexity of the issues and competing interests doom legislation. Last year Congress nearly succeeded, but once again fell short of the reform mark, after what apparently was a sincere effort in the House and the Senate to devise a workable framework for financial services reform. **REALTORS®** congratulate Senate Banking Committee on taking up the issue again and venturing into the roiling waters of financial services modernization.

Need for Financial Services Modernization

There is general consensus that the Depression-era framework for the nation's financial services industry should be modernized to permit the cross-ownership of banking, securities, and insurance industries. The Senate draft bill, representing the Committee majority agreement, clearly addresses the broader structural reforms needed. **REALTORS®** generally support the proposal as outlined; we do not oppose financial services modernization *per se*. Contemplated authorization of new powers and affiliations and proposed new regulatory structures and relationships among the affected industries draw immediately **REALTOR®** attention and concern, however, with the potential expansion of financial services companies into non-financial businesses that are currently off limits to bank holding companies, commercial firms, and national bank subsidiaries.

We would note that the Senate Banking Committee Report on H.R.10, in the "Need for the Legislation" section, there is the statement "the committee believes that overhaul of our financial services regulatory framework is necessary in order to maintain the competitiveness of our financial institutions, to preserve the safety and soundness of our financial system, and to ensure that American consumers enjoy the best and broadest access to financial services possible with adequate consumer protections." The **NATIONAL ASSOCIATION OF REALTORS®** agrees that the objective of financial services modernization legislation should be preservation of the safety and soundness of our financial system.

Inevitably, it seems, when financial lines of business do not yield the returns anticipated, financial institutions look to real estate and real estate-related businesses as potentially profitable enterprise. It is also our belief that allowing a mix of banking and commerce, as anticipated in the Senate bill, would at some point tempt financial institutions to enter the real estate business. **REALTORS®** know from bitter experience with the aftermath of the savings and loan industry crisis and cyclical bouts of economic recession that the financial system's strength will inevitably be tested and the real estate industry will be affected.

An essential ingredient in a strong real estate market is a sound financial system to provide needed capital. Allowing financial institutions to engage in potentially risky commercial activities is a risk that the real estate industry cannot afford. The Committee Report goes on to state, "the financial services industry account[s] for 7.5 percent of our nation's gross domestic product and employ 5 percent of our workforce." While this represents a significant portion of the American economy, it is only a supporting role when considering the 12 percent of the gross domestic product that the residential real estate industry alone makes up. This 12 percent contributes \$1.4 trillion to the U.S. economy every year. Commercial and residential real estate combined is nearly 20 percent of the national gross domestic product. Additionally, some 6.6 million Americans work in the real estate industry. Real estate is an important segment of the American economy and **REALTORS®** do not want to risk endangering one of the foundations of America's prosperity.

The draft bill proposes allowing national bank with total assets of \$1 billion or less to conduct financial activities through operating subsidiaries. We note that real estate development activities (though undefined) are prohibited,

and that affiliate transaction restrictions and anti-tying prohibitions would apply to the subsidiary activities. These prohibitions are necessary. We urge, however, that the legislation expressly declare that real estate brokerage, development and related activities (including property management and counseling) are not financial activities and should be explicitly excluded from permissible subsidiary activities.

Maintain the barrier between banking and commerce

NAR's priority of issues and concerns are essentially directed to assure that real estate brokerage, development, property management, and related activities are not deemed financial in nature or become permissible activities for banks, bank holding companies, thrifts or thrift holding companies, or any new financial services companies that might be contemplated by legislation.

ÿ First, maintain the statutory and regulatory separation between banking and commerce of current law.

ÿ Second, unitary thrift holding companies should not expand. The broad powers that thrift holding companies enjoy clearly are an opportunity to further mix banking and commerce, which in turn raises the specter of potentially bad investments and business decisions made in the heat of competitiveness.

ÿ Third, national bank subsidiaries should not be permitted to engage in real estate brokerage or development. Our industry is justifiably concerned that real estate lending, development and banking decisions could be made that set up conflicts of interest skewing lending decisions that could benefit the bank subsidiary.

REALTORS® do not oppose the affiliation of banks, securities firms and insurance companies. There are clearly natural synergies that properly supervised and regulated will make financial services potentially cost-efficient and may possibly benefit financial services consumers.

Our concern, however, is that the debate on structure is tainted with the prospect of full integration of banking and commerce. Proposed broad new powers in a variety of financial corporate structures, whether permitted in national bank subsidiaries, or baskets of commercial, non-financial businesses available to banking institutions, or the continued growth of unitary thrift holding companies with their very broad powers, all assume some universal bank structure and powers. **REALTORS®** must oppose the expansion of these structure or the granting of new powers.

The universal bank structure is alluring because it appears to be an efficient, cost-effective corporate structure. But advocates of this structure, contemplating a full integration of banking and commerce, ignore the significant threat to the financial system should the positive marketplace and economic environment change to the negative. The Asian crisis of this past year is the most recent demonstration of the glaring weaknesses of the universal bank structure as related to the safety and soundness of the financial system. The integration of banking and commerce continues to expose the Japanese financial system to significant threats.

The Japanese banking model could be viewed as an extreme situation, but we think not. Information technology, one of the driving forces of financial services modernization, blurs the distinctions between financial services institutions and commercial firms and products. This same technology can take on the qualities of a virulent virus when marketplace and national economies are weakened or exposed to economic downturns.

Undecided Issues

The draft bill leaves open for debate key issues that were unresolved last year as the Senate committee worked on financial services modernization proposals. These are substantive issues in the financial services modernization debate. **REALTORS®** are particularly concerned because these proposals, if adopted, would allow a dramatic

mixture of banking and commerce. As proposed, those advocates of full integration of banking and commerce would have full license to proceed, despite the prospect of phase-ins and application of current restrictions.

Commercial basket. A proposed 25% basket permitting a bank holding company (other than a commercial company that is a bank holding company) to engage in non-financial activities or to control a company engaged in such activities, though limited to 25% consolidated annual net revenue and total non-financial assets limits, based on a 5-year average, is an unacceptable proposal. This is a very large "basket" that, even with the proposed phase-in period, is likely to generate a near stampede of banks to engage in non-financial activities or to control such companies, accelerating a mix of banking and commerce. This proposal would be put the deposit insurance system at risk whenever a banking institution would engage in commercial activities.

We would point out that last year it was estimated that the 15% basket adopted by the House Banking Committee last year would have permit thousands of commercial companies to engage in banking. Clearly, the proposed 25% basket being discussed would increase that number.

Though the Senate has not voted on a commercial basket proposal, the debate and decision in the House could be instructive. Last year the full House removed from H.R.10, the "Financial Services Competitiveness Act of 1997," a similar proposal that contemplated a 5% basket by a 229-193 vote. This was considerably wider than the one vote margin to adopt the bill itself. NAR supported that successful House amendment and would do so again.

It should also be noted that the 5% basket provision in H.R.10 was originally proposed at 15% and adopted in the House Banking Committee by only a 25-23 vote. The purpose of mentioning the House activity is to highlight that the mixing of banking and commerce issue was hotly debated and was ultimately removed from H.R.10 before final adoption. NAR will adamantly oppose any provision in the Senate bill that allows a mix of banking and commerce. We are not alone on this issue. Federal Reserve Board Chairman Alan Greenspan and Treasury Secretary Robert Rubin recognize the potential threat to the financial system's safety and soundness posed by permitting commercial firms to own banks and engage in non-financial businesses.

Unitary bank holding company. Permitting a commercial company to become a bank holding company may address the market-driven aspects of commerce and banking integration. This proposal would seem to be a substitute for the unitary thrift holding company and a universal bank surrogate. REALTORS® have grave reservations about this proposal regarding safety and soundness concerns as well as regulatory oversight. We note that the Federal Reserve Board denies real estate activities to bank holding companies. Should the Senate committee agree to the proposal, there should be an equivalent expression deny real estate activities to the unitary bank holding company. Specifically, activities such as real estate brokerage, land development, real estate syndication, property management, and real estate advisory services should expressly continue to be denied, in law and regulation, to the new bank holding company.

Unitary thrift holding company. The expansion of unitary thrift holding companies is not addressed in the Senate draft or the undecided issues. We must infer that by leaving this issue out of the debate is an affirmation of current law and regulation regarding unitary thrifts.

Yet the expansion of unitary thrift holding companies is a principal concern for REALTORS® because permissible activities, despite OTS regulations, are so much broader than bank holding companies. This corporate structure could be the vehicle for commercial firms to expand into real estate brokerage, development and related lines of

business. **REALTORS®** accept the argument made by Treasury Secretary Rubin and Federal Reserve Board Chairman Greenspan in testimony before the Senate Banking Committee that unitary thrift holding companies present the opportunity for a broad mixture of banking and commerce since commercial firms under current rules permit commercial firms to control banking institutions, though they may be thrifts. At the very least, existing thrift holding companies should be grandfathered, and constraints should be placed on transferability.

Conclusion

The nation's financial services system is admittedly operating under a framework that clearly needs repair. The financial marketplace has evolved since the Depression such that significant banks, securities firms, and insurance companies may now legitimately need significant revision to the system. But the draft Senate bill, if adopted, as contemplated could well sanction nearly revolutionary changes that could make our financial system operate similar to and be similarly vulnerable to old and new threats because the reforms would jettison the significant statutory and regulatory barriers that separate banking and commerce. We urge this Committee to move with great caution. A better integration of the banking, securities, and insurance industries may well be necessary. But to move beyond the repeal of the Glass-Steagall Act to establish a framework that will threaten the safety and soundness of the financial system and make it more vulnerable to the risks of mixing banking and commerce is retrograde. We have lessons from our recent past that should be continually remembered.

REALTORS® urge the Committee to move with great caution and we are willing to work with you to fashion financial services reform legislation that will serve the best interests of the financial services industry and the system that supports it.