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Chairman Barr, Congressman Watt, and members of the Subcommittee. Thank you for inviting me to testify on this important issue. My name is Martin Edwards. I am a REALTOR and a partner with Colliers, Wilkinson and Snowden, Inc. in Memphis,Tennessee. I am appearing here today as President of the NATIONAL ASSOCIATION OF REALTORS (NAR) on behalf of over 800,000 REALTORS engaged in all aspects of the commercial and residential real estate industry.

Mr. Chairman, we are pleased you are holding this hearing today to explore the process involved in the proposed rulemaking by the Federal Reserve Board and Treasury Department that would allow financial holding companies (FHCs) and national bank subsidiaries to operate real estate brokerage, leasing and management companies. As you know, we are opposed to this rule. We believe that redefining real estate brokerage, leasing and property management as a financial activity is an impermissible mixing of banking and commerce that Congress never intended to delegate to the regulators. Moreover, given the criteria Congress established for determining new financial activities under the Gramm-Leach-Bliley Act, we believe that the proposed rule does not conform with the intent of Congress.

The procedure followed by the regulators in proposing this rule raises many questions. It will be enlightening to hear responses to questions that would explain how and why the proposed rule came so soon after the law was enacted.

- What analysis was provided regarding the impact of the rule on the real estate industry?
- What role did the Office of Management and Budget play in reviewing the proposed real estate regulation?
- Congress authorized the Federal Reserve Board and the Treasury Department to jointly agree on new financial activities based on criteria established in Section 4(k)(3) of the Act. Do the Agencies view their authority to designate new financial activities as license to effectively hand entire industries over to FHCs and bank subsidiaries?
- Were all the criteria examined and met before the rule was issued? What weight, if any, was given to each of the enumerated criteria?
- How is it possible that in less than three months after the Act became public law the real estate industry, particularly brokerage, leasing and property management, could have changed so dramatically to merit consideration as a financial activity?
- Congress gave considerable attention to the regulation of insurance activities that are traditionally the purview of state regulators. Real estate is similarly regulated, yet the Act makes no provision to resolve conflicts of regulatory jurisdiction that most certainly will occur should FHCs and national bank subsidiaries engage in real estate brokerage and management as proposed. Have the Federal Reserve and the Treasury Department considered how real estate activities of FHCs and bank subsidiaries would be regulated?
- Was federal preemption of state regulatory and licensing authority contemplated?

In February 2000, barely a month after the Gramm-Leach-Bliley Act became public law, several banking institutions and representatives petitioned the Federal Reserve Board and the Treasury Department to grant financial holding companies and national bank subsidiaries real estate brokerage and management powers. They argued that they were allowed to participate in virtually every aspect of the real estate transaction except for brokerage. What the bankers failed to recognize was that there is a clear difference between these other aspects of the real estate transaction and the brokerage activity--the brokerage service is a commercial one. It is the provision of advice, analysis, and marketing of a tangible piece of property—real estate. It is unlike a financial or fungible product that has some monetary value. It is just like an automobile, boat, jewelry, electronic equipment or groceries. To argue that the use of some financing mechanism grants banks the power to broker the sale of the underlying durable product is to argue for elimination of the separation of banking and commerce. That debate occurred during consideration of the Gramm-Leach-Bliley Act (GLBA) and Congress upheld the continued separation of these activities. The bankers cannot now gain by regulation what they failed to gain by legislation.

We believe that Congressional intent was clear that Section 4(k)(3) The Gramm-Leach-Bliley Act (GLBA) allows the Federal Reserve Board and the Treasury Department to determine activities that are "financial in nature." In their consideration, the regulators are required to examine several statutory factors. They are (1) the purposes of the Bank Holding Company Act (BHCA) and the GLBA; (2) changes or reasonably expected changes in the marketplace in which financial holding companies compete; (3) changes or reasonably expected changes in the technology for delivering financial services; and (4) whether such activity is necessary or 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 U.S.; (ii) efficiently deliver information and services that are financial in nature through the use of technological means, including any application necessary to protect the security or efficacy of systems for the transmission of data or financial transactions; and (iii) offer customers any available or emerging technological means for using financial services or for the document imaging of data. BHCA section 4(k)(3). was meant to authorize new powers to banks to assist in the delivery of existing *financial* products or those that evolved as the financial services industry changed over time. Such powers might include the authority to operate a new technology to assist in the electronic delivery of financial or investment instruments. Section 4(k)(3) was not meant to grant banks the authority to operate whole new commercial businesses. There is nothing in the law or legislative history to infer that such broad legislative powers were to be delegated to the regulators. The time to consider the granting of real estate powers was during debate on GLBA, not through regulation after the close of that debate.

Even if one were to believe that Congress intended to delegate this authority, the factors enumerated in Section 4(k)(3) have not been met by the regulators.

<u>The agencies did not address all the necessary factors</u>. Although the agencies recite in cursory fashion that they have considered all of these factors, the only one they actually discuss is the first prong of the fourth factor, dealing with competition with other companies seeking to provide financial services. There is no discussion of what weight the other three factors may have been given in the agencies' decision-making process.

Furthermore, even as to the factors the agencies did consider, they undertook no factual investigation of their own. They simply cite, in a footnote, a petition from the American Bankers Association, reporting a review of various companies' websites. They merely repeat the bankers' plea to move into this area. Their analysis fails to consider the most important aspect of the issue—that real estate brokerage is a commercial activity. If anything, the mortgage is incidental to the commercial activity. Just the opposite of what the bankers argue.

Twenty percent of real estate transactions involve no institutional financing at all. They are either cash transactions, or owner financed sales. Here there is absolutely no bank involvement. There is still the commercial real estate brokerage transaction though. Logic dictates that the financing may complement certain real estate transactions, but to argue that the brokerage is incidental to the financing is to put the cart before the horse.

Congress held that commercial businesses and banks would compete in the financial services arena. This "gray area" consists of financial activities that support either a commercial or banking activity. For instance, automobile manufacturers such as General Motors provide financing for their auto purchases. Banks also provide financing for auto purchases. The competition comes in the financing arena—not in the sale of the auto. Likewise for real estate, boats, or jewelry. Congress has granted specific legislative authority to banks to include securities and insurance powers within that gray area. Thus you have both commercial firms and banks offering these products. But they were gained only by a legislative action. Even mortgage lending was granted by specific legislative authority. These examples make clear congressional intent that new industry powers can only be granted by legislation.

Existing mortgage activity in this gray area provides banks with little reason to complain. Commercial banks account for almost half of the mortgage originations in this country. Independent mortgage companies and savings and loans combined account for about the same amount. Credit Unions and real estate firm affiliated mortgage operations account for only about two percent of mortgage loan originations. The banks dominate this market already. See Mortgage Loan Origination chart

While bankers argue that some 26 states allow their state chartered banks to conduct real estate brokerage and management, further analysis shows that in fact only eighteen state banks in six states were doing any kind of real estate brokerage last year. These banks typically served the smallest communities in those states, with 0.57 percent of the U.S. population. See "State Banking and Real Estate Activity" chart There are even fewer thrifts operating real estate brokerages. There is no evidence to suggest that large national banks would serve smaller communities. Today, many of these communities have seen the local bank replaced by a national bank's ATM machine.

<u>The agencies do not explain what determination they are making</u>. Under the most natural reading of the GLB Act, an activity may be "financial in nature," or it may be "incidental" to some other financial activity. The agencies lump these two concepts together, without explaining which determination they are making. If the agencies are claiming that real estate brokerage and management are "incidental" to some other financial activity, they should explain what that activity is.

The agencies offer no explanation for why the regulations should apply to leasing of real estate. The agencies' rationale for describing real estate brokerage as "financial in nature" rests on the theory that "banks and bank holding companies participate in most aspects of the typical real estate transaction other than brokerage." 66 Fed. Reg. at 309. That may be true as to residential purchases of real estate, for which banks commonly provide mortgages and incidental services like appraisals. But it is not generally true as to leasing of real estate B often a relatively simple transaction that does not require financing, appraisals, settlement services, escrow services, or insurance. Yet the proposed regulations would apply to brokerage for lessors and lessees of real estate, as well as purchasers and sellers. The agencies offer no explanation as to why bank affiliates should be permitted to engage in these activities.

The agencies offer no explanation for why the regulations should apply to commercial real estate transactions. The agencies' reasoning also appears to focus primarily on the purchase of residential real estate by individuals. See 66 Fed. Reg. at 310. Yet the proposed regulations would apply to both commercial and residential real estate brokerage. Commercial enterprises frequently buy, sell, or lease real estate. The agencies offer no explanation why such transactions should be viewed as "financial" activities, rather than as part of a business's ordinary commercial activities.

There is no indication whether the Treasury Department's proposed regulation have been reviewed by OMB. Under Executive Order No. 12,866 (3 C.F.R. 658 (1994)), any "significant regulatory action" by an Executive Branch agency must generally be reviewed by the Office of Management and Budget ("OMB"). A "significant regulatory action" includes any action
that is likely to result in a rule that may * * * [h]ave an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities.

Id. ' 3(f). Although that requirement does not apply to the Federal Reserve Board (an independent regulatory agency), it does apply to the Treasury Department. There is no indication in the proposed regulations whether Treasury considers them to be a "significant regulatory action," or whether it plans to submit them (or has submitted them) to OMB.

Congress needs to reassert its authority to prevent regulators from usurping the power to determine whether it is in the best interests of our country to mix banking and commerce. This decision should not be left to unelected regulators.

We are calling on Congress to enact The Community Choice in Real Estate Act (H.R. 3424/S. 1839) to clarify congressional intent to prohibit the mixing of banking and commerce. REALTORS® have let members of Congress know where they stand on the issue. More than 75,000 REALTORS® sent letters to their elected representatives urging support for *The Community Choice in Real Estate Act*. Before the legislation was even introduced, the Federal Reserve Board and the Treasury Department received more than 40,000 letters each opposing the proposed regulation that would allow financial holding companies and national bank subsidiaries to broker real estate and manage property. REALTORS® from all over the nation sent over 50,000 letters to President Bush urging his support.

But REALTORS® are not alone on this issue. A number of diverse trade associations and consumer groups stand with the NATIONAL ASSOCIATION OF REALTORS®. Consumers Union testified before the House Financial Institutions Subcommittee and raised significant questions about the diminished consumer choices and quality of service that would likely follow from banks brokering and managing real estate. The National Community Reinvestment Coalition, the National Fair Housing Alliance, and the National Association of Hispanic Real Estate Professionals have formally urged members of Congress to support H.R. 3424 and S.1839.

The issue of banks in real estate cuts across the entire spectrum of real estate and related industries, and the FHCs' aggressive attempts to use regulations to define real estate brokerage and property management as financial activities in order to expand their powers threatens other related industries. Consequently, other trade groups representing both residential and commercial real estate interests have sent comment letters to the Federal Reserve and the Treasury Department opposing the proposed regulation. The National Association of Real Estate Professionals (NAREP), the National Association of Home Builders (NAHB), the National Association of Real Estate Investment Trusts (NAREIT), the Real Estate Roundtable, the Institute for Real Estate Management (IREM), the International Council of Shopping Centers, and the National Apartment Association are all standing with the NATIONAL ASSOCIATION OF REALTORS® in keeping large banks out of real estate brokerage and property management.

We look forward to the testimony and questions at this hearing and hope they will shed further light on how this process unfolded. Our written materials include further information and data from surveys conducted on this issue.