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**TESTIMONY OF
TREASURY ACTING UNDER SECRETARY DONALD V. HAMMOND
BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
OF THE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES**

May 2, 2001

Chairman Bachus, Ms. Waters, and Members of the Subcommittee, I appreciate the opportunity to appear here today to discuss the joint Federal Reserve-Treasury rule proposal on whether to permit financial holding companies and financial subsidiaries of national banks to engage in real estate brokerage and real estate management under the Gramm-Leach-Bliley Act.

The four-month public comment period for this proposal ended yesterday. Based on the substantial number of comment letters that the Treasury and the Federal Reserve Board have received, there clearly is wide public interest in this proposal. We received comments from several of the Members and witnesses at today's hearing and note that the hearing transcript will be made part of our rulemaking record. We will carefully review the issues raised by all the commenters.

Because the rulemaking is pending, I will not be able to discuss the Treasury's views on substantive issues involved in making a final decision about the proposed rule. Instead, my prepared remarks will briefly describe the process and factors we considered in making the proposal and where it stands today.

By way of background, let me begin by highlighting the key provisions of the Gramm-Leach-Bliley Act that relate to the rulemaking.

Rulemaking Provisions of the Gramm-Leach-Bliley Act

At its core, the Gramm-Leach-Bliley Act (the Act) stimulates greater competition and innovation in the financial services industry. At the same time, the legislation promotes consumer protection and safety and soundness, and restricts the mixing of banking and commerce.

To accomplish these outcomes, the Act amended the National Bank Act to allow national banks to control qualifying "financial subsidiaries" that are permitted to engage in certain activities that

national banks may not conduct directly. This authority is separate from but has some similarities to that of “financial holding companies” under the Bank Holding Company Act.

The Act permits financial subsidiaries to engage in a broad range of specific activities, as well as other activities the Treasury determines, in consultation with the Federal Reserve Board, to be “financial in nature or incidental to a financial activity.” According to the Conference Report, the “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.

Under the Act’s consultation requirement, neither the Treasury nor the Board may determine that an activity is financial in nature or incidental to a financial activity if the other agency disagrees with such a determination in writing. We and the Board are working cooperatively in making these determinations, as the joint proposal demonstrates.

In making determinations, the Gramm-Leach-Bliley Act requires us to take into account, among other factors:

- the Act’s purposes,
- changes in the marketplace in which banks compete,
- changes in the technology for delivering financial services, and
- whether the activity is necessary or appropriate to allow a bank and its subsidiaries to compete effectively with any company seeking to provide financial services in the United States.¹

We also may consider other factors and information that we consider relevant.

The Act prohibits financial subsidiaries of national banks from engaging as principal in certain specified activities, including real estate investment and development unless otherwise expressly authorized by law.

Let me turn now, Mr. Chairman, to a description of the process that the Treasury and the Board are following and where the rulemaking stands currently.

¹ Section 5136A(b)(2) of the Revised Statutes (the National Bank Act) provides that:

“In determining whether an activity is financial in nature or incidental to a financial activity, the Secretary shall take into account –

- (A) the purposes of this Act and the Gramm-Leach-Bliley Act;
- (B) changes or reasonably expected changes in the marketplace in which banks compete;
- (C) changes or reasonably expected changes in the technology for delivering financial services; and
- (D) whether such activity is necessary or appropriate to allow a bank and the subsidiaries of a bank to –
 - (i) compete effectively with any company seeking to provide financial services in the United States;
 - (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.”

Status of the Rulemaking Process

More than a year ago the Treasury and the Board received requests from the American Bankers Association, the Financial Services Roundtable, and the New York Clearing House Association asking that we determine that real estate brokerage and real estate management activities are financial in nature or incidental to a financial activity. Shortly thereafter, the National Association of Realtors sent a letter opposing such a determination.

In March 2000, the Treasury issued an Interim Final Rule setting forth specific procedures for requesting determinations under the Act, and we invited the American Bankers Association and the Financial Services Roundtable to resubmit their requests to conform to these procedures. The American Bankers Association did so in July, and a month later Freemont National Bank submitted a request that referenced the American Bankers Association's request.

After considering the factors specified in the Act and other relevant information, and consulting with the Federal Reserve Board and its staff, in December we agreed with the Board to issue a joint notice of proposed rulemaking with a 60-day comment period. The proposal was published in the Federal Register on January 3rd.

Following publication, it soon became apparent that there was a great deal of public interest in the proposal. Given this wide public interest and our desire to give the public sufficient time to consider and comment on the proposal, and in view of letters we received requesting an extension, the Treasury and the Board decided to extend the comment period another 60 days.

As I mentioned, the comment period has now closed and we are shifting to the comment review process. Of the numerous comment letters we and the Federal Reserve have received, most have come from real estate brokers expressing the same or similar views. We are in the process of reading and analyzing the comment letters, and we will give serious consideration to the views expressed.

Mr. Chairman, let me highlight just a few points about the proposal itself.

The Elements of the Proposal

In assessing the requests we received to approve real estate brokerage, we concluded that a threshold case can be made that direct competition exists between real estate brokers and banking organizations. For example, as the proposal notes, some depository institutions already engage in real estate brokerage. According to information provided by the Conference of State Bank Supervisors, 26 states appear to permit their state-chartered banks or subsidiaries to act as general real estate brokers. The Office of Thrift Supervision has determined that service corporation subsidiaries of federal savings associations may provide general real estate brokerage services.

In addition, banks and bank holding companies participate in most aspects of the typical real estate transaction other than brokerage. These activities include real estate lending, leasing, appraisal and investment advisory services, settlement and escrow services, arranging

commercial real estate equity financing, and providing title and private mortgage insurance. Banks and bank holding companies also engage in a variety of activities that at first glance seem functionally and operationally similar to real estate brokerage, including finder activities and securities and insurance brokerage.

The proposal notes that as the financial marketplace continues to evolve, it appears that many financial companies are adding real estate brokerage to their menu of services. Buyers and sellers of real estate increasingly may look to a single company to provide all their real estate-related needs.

The proposal also notes that existing federal and state laws should operate to mitigate the potential adverse effects of combining banking and real estate brokerage. For example, the antitying rules would prohibit the bank from extending credit, furnishing any service, or varying the consideration for any loan or service on the condition that the customer obtain real estate brokerage services from the bank or any affiliate, including a financial subsidiary.

If a customer obtained real estate brokerage services from a bank affiliate or financial subsidiary, the Federal Reserve Act would require any mortgage loan made by the bank to that customer to be on market terms. The Federal Reserve Act also would limit the amount of credit and certain other forms of support that a bank could provide to a real estate brokerage affiliate or financial subsidiary.

In addition, because the proposed real estate brokerage services are activities conducted as agent, with no principal risk involved, the proposed brokerage activity does not appear to present significant financial risks to banking organizations or their depository institution affiliates.

In discussing brokerage activities, our proposal highlights the issue of employee relocation services, some of which seem less obviously a part of real estate brokerage than others. The proposed rule would prohibit brokers from taking title to real estate brokered by the company, but the proposal invites comment on whether taking title might be considered incidental to real estate brokerage under certain circumstances.

We express some doubts in the proposal as to whether all aspects of real estate management are financial in nature or incidental. For example, our proposal would preclude a financial subsidiary or a financial holding company that provides real estate management services from itself repairing or maintaining the managed real estate.

Conclusion

In conclusion, Mr. Chairman, we intend to carefully consider the issues raised by all the commenters, including the views expressed at this morning's hearing. As we move forward, the Treasury will work closely with the Federal Reserve to ensure that this and other rulemakings under the financial in nature authority are consistent with the criteria Congress prescribed, the legal process, and the public interest.

Thank you. I am happy to respond to any questions.