

# Needed: A “Defining” Moment

by David Lereah, NAR Chief Economist

Recent events have again highlighted some of the continuing differences of opinion between the banking and real estate industries. The Office of the Comptroller of the Currency (the OCC) in three separate interpretive letters has permitted national banks to “cross over” the line that traditionally separates banking and commerce. This action has galvanized REALTORS® who are once again reminded of the now five-year old battle between banks’ desire to engage in real estate brokerage and property management activities and our industry’s attempts to keep them out of the real estate business.

The separation of banking and commerce was mandated by Congress to protect consumers from potential conflicts of interest. The devastating savings & loan crisis of the 1980s and the historic collapse of the Japanese banking system of the 1990s are prime reminders of the toxic aftermath of mixing banking and commerce. Unfortunately, the OCC has let the fox into the hen house. Banks are now permitted to engage in some types of real estate development, raising eyebrows throughout both the banking and real estate industries.

Mark Twain once said, “History never repeats itself, but sometimes it rhymes.” This situation may not be as broad as Japanese banks taking equity ownership in different commercial industries during the 1980s and 1990s. But with the OCC’s ruling, U.S. national banks are now permitted to develop and operate a luxury hotel; finance, develop, operate and lease space in a mixed use building (including developing residential condominiums); and hold a 70 percent equity stake in a windmill business, qualifying for special tax credits. Three national banks were given the green light to engage in these activities. How many other national banks will engage in these real estate development activities tomorrow? We don’t yet know.

Permission was granted based on the rationalization that ownership limitations are imposed and that these deals are necessary to further bank operations. But from a real estate perspective, the OCC rulings are inconsistent with Federal statutes and other OCC precedents. The rulings also underscore concern that these actions will inevitably lead to an irreparable breach in the wall separating banking and commerce.

In light of the recent OCC rulings, it is time to remind ourselves and others of why REALTORS® are opposed to banks

engaging in real estate brokerage and property management activities. There are the usual competitive reasons. Bank entry into the real estate brokerage business would unlevel the playing field since banks are special government-subsidized institutions. Banks have advantages that real estate brokerage companies don’t have, such as the ability to borrow funds in the federal funds market or the Federal Reserve discount window. We can also say (as stated above) that banks involved in real

estate brokerage activities raise conflicts of interest issues. How can banks stay objective and fair when they are potentially granting loans to the same companies it finds itself competing with?

Banks counter that REALTORS® are afraid of the additional competition that their entry would provide. They also argue that they can build firewalls to minimize conflicts of interest and unfair competition issues. Both sides argue their positions until both are blue in the face with emotions running high.

But there is one question in this debate that has not often been asked that must be answered: is real estate brokerage a financial activity or incidental to a financial

activity; or is real estate brokerage a commercial activity? If real estate brokerage is a financial activity or incidental to a financial activity, then under the Gramm-Leach-Bliley Act, banks are permitted to engage in this activity. If real estate brokerage is a commercial activity, then banks are clearly *not* permitted to engage in this activity. Banks claim that real estate brokerage is a financial activity and thus they are permitted to engage in this activity. REALTORS® claim that real estate brokerage is a commercial activity and so banks are not allowed to participate.

To put this argument in the proper context, consider how the U.S. economy is categorized. At one end of the economy is the banking system, with its special subsidies. At the other end are commercial companies (e.g., automobiles, boats, furniture, and real estate brokerage). In between the two is a third category called financial services. It is here where both banks and commercial companies can compete head to head. Banks are permitted to engage in financial services such as insurance and the securities business. So are companies that engage in commerce. For instance, this is the space where General Motors or General Electric can have finance companies that compete against banks for consumer loans. This is also the space where

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real estate brokerage companies can offer what is often called “one-stop shopping” (real estate brokerage, title insurance and mortgage lending), and where banks can also offer one-stop shopping, including banking services (deposits, savings accounts), mortgage lending, and title insurance. But it is important to note: Real estate brokerage companies are not able to offer banking services and banking companies are not able to offer real estate brokerage services. And it is just as important to note: The system works! The financial services arena is fiercely competitive with both banks and commerce companies competing at a high level. Commercial companies are not permitted in banking and banking companies are not permitted in real estate brokerage.

The recent application of Wal-Mart to open an Industrial Loan Company (considered a bank) is a good case in point. REALTORS® are opposed to Wal-Mart getting into the banking business. It would be a violation of the separation of banking and commerce. REALTORS® have been consistent on this point. The same cannot be said for banks. On the one hand, banks oppose Wal-Mart’s entry into the banking business, leaning heavily on the principle of separating banking and commerce. On the other hand they argue that banks should be permitted to engage in the commercial activity of real estate brokerage. You can’t have it both ways.

Of course, banks claim that real estate brokerage is a financial activity, not a commercial one. Only Congress has the right and ability to define real estate brokerage as a financial activity. The good news is that our national legislature has already determined that real estate brokerage is a commercial activity. Banks want that definition changed and are looking for the Federal Reserve and Treasury Department to accept a new “financial” definition. Congress needs to settle this battle once and for all and define the real estate brokerage business for what it is—commerce.

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