

**Real Estate**

**confronts**

**the BANKS**

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**Dennis Galloway & Kenneth Jenny**

# Real Estate confronts the Banks

*Discussion on the Gramm-Leach-Bliley Act  
and the possible involvement of banks in the real estate brokerage industry.*

## Preface

Rarely has pending legislation suggested changes to the financial services arena as controversial as the recent *Gramm-Leach-Bliley Act (GLB Act)*. The proposed rule would declare real estate brokerage, real estate management, and employee relocation to be activities that are “financial in nature” or “incidental to a financial activity” under the *GLB Act*. This would allow financial holding companies and national bank subsidiaries to enter these businesses. The impact on the real estate brokerage industry has escalated and this *GLB Act* has become one of the most highly profiled changes positioned to impact the real estate brokerage industry since its inception.

More than a legal source or definitive research work, the purpose of this white paper is to provide both the banking industry and the real estate industry with a “plain text” synopsis of the facts and discussions surrounding this pending legislation. The *GLB Act* has already been the subject of numerous research projects and countless related articles and it is impossible to cover the subject matter in its totality in this single writing.

Contrary to many other research papers and articles which address the matter of the Banks’ involvement in real estate brokerage, the intent of this white paper is not to promote one specific viewpoint above another but rather to provide a more objective overview detailing the major views points. The authors have endeavored to do so in an objective and balanced manner, highlighting both the positive and negative of each viewpoint and commenting where deemed appropriate to suggest possible counter arguments.

At a 30,000-foot view the issues in question are:

- If financial institutions are allowed to engage in real estate brokerage activities, is this the first step in mixing commerce and finance?
- Could this legislation have grim consequences for the nation’s financial system and destroy one of the country’s largest entrepreneurial industries?
- Would it enhance professional customer service, streamline the currently fragmented and complex transaction and will it reduce costs to the consumer?

The debate is furious and both sides have major players in their camps.

Opposing is the *National Association of Realtors® (NAR)* claiming that the consumer would be the real loser if financial institutions entered the real estate brokerage industry. *NAR* fears that a few large financial institutions would dominate the industry resulting in less competition and higher costs.

Supporting is the *American Bankers Association (ABA)*, which contends that the benefit to the consumer is access to greater choice and healthy competition. *ABA* further feels that it will work to simplify the current real estate brokerage process and introduce the convenience of true one-stop-shopping for the consumer.

Clearly the controversy is turning out to be one of the most perplexing challenges the Federal Government will face in 2001. Although the proposed rule includes real estate brokerage, real estate management and employee relocation, this white paper will only focus on the real estate brokerage side of the debate.

The authors have also decided to include an added dimension to this work by outlining some possible scenarios for involvement by financial institutions. Some of these dimensions are irrespective of whether or not proposed changes are approved. It is important to note that all scenarios referenced are hypothetical and are not meant to reflect the actual plans of any one company or institution. Also, no proprietary information known to the authors has been referenced and no confidential information obtained under restriction of any confidentiality agreement or limited in terms of a Consultant/Client relationship has been included.

Enjoy the read.

**Stefan Swanepoel, Dennis Galloway and Kenneth Jenny**  
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## **SECTION 1 - History and Overview**

Spurred by the 1929 market crash and in the belief that the stock market speculation by the banks led to their collapse, the 1933 Banking Act was aimed at restoring confidence in the banking system. It established the *Federal Deposit Insurance Corporation (FDIC)*, which insured customer accounts and prohibited banks from both accepting deposits and underwriting securities. In a section called the *Glass-Steagall Act (GS Act)*, it forced the separation of commercial and investment banking.

Following World War II, banks sought ways around the restrictions by forming holding companies that in turn engaged in commercial activities. Then in 1956 the *Bank Holding Company Act (BHC Act)* (amended in 1970) placed further restrictions on what banks can do in the insurance business and once again reinforced the division of commercial and investment banking activities.

### **Shortcomings of the Glass-Steagall Act**

Since the 1980's there has been extensive debate about the shortcomings of the *GS Act* and over the last two decades, The *Board of Governors of the Federal Reserve System (FRS)* and the *Secretary of the Treasury* (collectively referred to as the *Agencies*) have softened some of the *GS Act* separation.

The motivation has been twofold; at the domestic level, the *GS Act* is working against market forces and prevents banks, state, and local government enterprises, from realizing the cost, efficiency, and other benefits that would result from greater competition; and at the international level, U.S. banks are limited by restraints that do not inhibit their foreign counterparts.

By 1986 the *FRS* decided that an investment banking affiliate of a well-capitalized commercial bank would not be considered "principally engaged" in prohibited activities if no more than 5 percent (today that percentage has grown to 10%) of the investment banks' revenues came from those activities.

As the distinction between commercial and investment banking became increasingly blurred, the debate concerning complications and risks historically associated with mixing banking and commerce heated-up, (i.e. concentration, conflicts, unfair competition and breaches of fiduciary responsibility). Earlier efforts to repeal the *GS Act* including reforms proposed by: Rep. Jim Leach (R. Iowa), chairman of the House Banking Committee; one by Sen. Alfonse D'Amato (R. New York), chairman of the Senate Banking committee and Rep. Richard Baker (R. Louisiana); and Treasury Secretary Robert Rubin; met with stiff resistance.

### **Repeal of the Glass-Steagall Act**

By the mid 1990s many economists and policymakers viewed the terms of the *GS Act* to be largely unnecessary and in November 1999 President Clinton repealed the *GS Act* and introduced the *Gramm-Leach-Bliley Act (GLB)*. This specifically allows a bank holding company or a foreign bank that qualifies as a financial holding company to engage in a broad range of activities that are defined by the *GLB Act* to be “financial in nature” or “incidental to a financial activity.”

### **The Current Controversy**

The current controversy started on December 31, 1999 when the *Agencies* issued a proposed rule at the request of the *ABA* and *Fremont National Bank & Trust* to define real estate brokerage activities as financial in nature under section 103(a) of the *GLB Act*. Section 103(a) of the *GLB Act* already enumerates certain activities that are considered to be “financial in nature” or “incidental to a financial activity” under the statute. Included among those activities are traditional banking functions, activities that the *FRS* had previously determined to be “closely related to banking” or permissible for banking holding companies to engage in, securities and insurance activities, and merchant banking activities.

Previously when considering whether an activity was closely related to banking the *Agencies* looked to see if the banks generally:

- (i) Conducted the proposed activity;
- (ii) Provided services that were operationally or functionally so similar to the proposed service as to equip them particularly well to provide the proposed services; or
- (iii) Provided services that were so integrally related to the proposed service as to require their provisions in a specialized form.

Many however believe that in 2000 when Congress debated the legislation that became the *GLB Act* their intent was that real estate activities were non-financial, commercial activities. The new proposed rule would, however, now declare real estate brokerage, real estate management, and employee relocation to be activities that are “financial in nature” under the *GLB Act*.

The *Agencies* need to therefore jointly determine whether real estate brokerage is an activity that is “financial in nature” or “incidental to a financial activity.”

**AUTHORS' COMMENTS**

*The Federal Reserve Bank previously determined that real estate brokerage was not closely related to banking for purposes of the BHC Act. In fact, on three occasions Congress has debated and voted decisively to keep real estate brokerage 'off the table.'*

*However, the interpretation this time has to be based on an expanded wording 'financial in nature or incidental' (in the GLB Act) compared to the previous wording of "closely related to banking" (in the BHC Act.)*

*Change would not require new legislation. The only requirements would be for the Board of Governors to amend Subpart I of the Board's Regulation Y to add 'real estate brokerage' to the list of activities and for the Secretary of the Treasury to amend its financial subsidiary regulations by adding 'real estate brokerage' to the list of approved business activities.*

**Consumer Privacy Protection**

One of the major items of the *GLB Act* is the provision that institutions engaged in certain financial-related activities must:

- (i) Establish privacy policies with regard to information they accumulate about consumer customers,
- (ii) Notify customers of those privacy policies,
- (iii) Give customers the right to "opt-out" of any disclosures of such customers' non-public information to third parties.

Virtually all companies, including banks, insurance companies, and leasing companies, engaged in the processing of any consumer financial information, including applications that detail salary, credit or debt information, are covered by the above *GLB Act* and/or the *Fair Credit Reporting Act (FCR Act)*. Penalties for non-compliance of privacy issues can be severe, resulting in fines of up to \$11,000 for each infraction.

Compliance is so complicated and daunting that the *Federal Trade Commission (FTC)* decided to delay implementation of some data sharing disclosure regulations from the original November 2000 deadline to mid 2001.

## SECTION 2 – The Current Debate

### 2.1. Taking Position Against Allowing Banks into Real Estate

The historical advocate against involvement in real estate brokerage by financial institutions has been the *National Association of Realtors (NAR)*. It has, however, received significant support for this position from various large real estate trade associations including: CCIM Institute, the Institute of Real Estate Management, the International Association of Shopping Centers, the National Affordable Housing Management Association, the National Association of Home Builders, the National Auctioneers Association, and the National Leased Housing Association.

Due to a massive grass roots campaign (an alleged 50,000 communiqués hit Washington) orchestrated by the *NAR*, the original public comment date of March 2001, was delayed until May 2001. Following are the main arguments and viewpoints supporting the *NAR's* contention that financial institutions should not be permitted to practice real estate brokerage:

- (i) The *GLB Act* does not specifically authorize financial holding companies (*FHC*) to engage in real estate brokerage.

#### **AUTHORS' COMMENTS**

*Although this contention is true, from time to time, the GLB Act also authorizes each Agency to supplement the statutory activities with additional activities.*

- (ii) It would be inappropriate for the Board of Governors to now permit *FHCs* to provide real estate brokerage services because the Board prohibited bank holding companies from acting as a real estate broker in 1972.

#### **AUTHORS' COMMENTS**

*The Board's 1972 decision was made pursuant to the original 'closely related to banking' standard. The GLB Act now authorizes the Board to approve any activity that is 'financial in nature' or 'incidental to a financial*

- (iii) Financing real estate or any other tangible assets or durable goods does not transform that asset into a financial instrument.

#### **AUTHORS' COMMENTS**

*The home is the largest single investment for many individuals and serves as a means for the creation of a valuable asset through appreciation. Real estate is different from most other assets and could in fact be a financial instrument.*



- (iv) Banks offering a wider range of commercial type services will face more risk and be financially more fragile and the country could experience another Savings and Loan (S&L) fiasco as was experienced in the decade of the 80s.

**AUTHORS' COMMENTS**

*The charge that the S&L industry lost billions of dollars because of deregulation is misleading when in fact the industry was already insolvent by the late 1970s, before deregulation existed. Also, during the 1930s only 15 of the 207 nationally chartered banks with securities affiliates failed – a lower percentage than the rate of failure for the banking community as a whole. We could find no solid evidence that the combination of commercial and investment banking escalated the failure of any banks.*

- (v) Pitting federally subsidized, highly advantaged financial institutions (with a high barrier to entry) against unsubsidized, less advantaged real estate brokerage firms (with a relative low barrier to entry) is a recipe for trouble.

**AUTHORS' COMMENTS**

*Although it would not be a level playing field, many a competitive contest has been waged on an uneven playing field and the larger competitor has not always been the winner. Over the years the real estate industry has seen various large capital players enter the industry – Sears, Merrill Lynch, Metropolitan Life, Prudential, and Cendant, to name a few – and none have dominated the industry. Also the GLB Act was specifically drafted to insulate banks and to allow for fair competition.*

- (vi) Vertical integration of the transaction will magnify the market power of integrated firms thereby raising barriers to entry, limiting choice, and possibly increasing costs for consumers.

**AUTHORS' COMMENTS**

*Many believe that to the contrary, the opposite will actually happen – increased choice and costs savings will occur. Also, banks learned with their involvement in securities, that they have to conduct business according to the same licensing and other regulatory rules as everyone else in the industry. It should be noted that when financial services companies engaged in securities brokerage activities, there was a decline in overall commission rates.*

- (vii) Banks will make real estate commissions a loss leader to undercut independent real estate brokers, gain the business, and then cross sell the banks' products.

**AUTHORS' COMMENTS**

*Although it is highly unlikely that Banks would introduce an immediate wholesale commission reduction or price war, more negotiation of real estate commissions is inevitable. Consumers have for a long time felt that the industry average commission rate of 6% rate is excessive. With recent online initiatives via the Internet, web portals and new paradigm real estate brokerages have been formed the decline in commission rates is already very much in process.*

- (viii) Real estate brokerage is a cyclical volatile business subject to economic downturns. This could pose safety and soundness risks to banks.

**AUTHORS' COMMENTS**

*There are specific laws in place protecting deposit-taking institutions. It would further appear that many large banks are better capitalized than most if not all traditional real estate brokerages. With solid business decision making and business principles these institutions should certainly be able to survive and prosper in nearly any shift of the economic environment.*

- (ix) Large real estate brokerage firms do not have significant advantages over smaller real estate firms. Therefore it would seem that banks are unlikely to benefit from economies of scale, cross selling, or diversification.

**AUTHORS' COMMENTS**

*Numerous large real estate companies such as NRT and HomeServices have proven that size does matter. Both have continued an aggressive path of expansion and both are profitable. We believe cost savings and additional savings could occur if real estate brokerage and banking is combined into one delivery vehicle.*

- (x) The Agencies should delay their finding until such time as FHCs gain experience in conducting the various other new activities authorized by the GLB Act.

**AUTHORS' COMMENTS**

*This does not support the argument that suggests prohibiting financial institutions from engaging in real estate activities. It does though make a valid argument to postpone such involvement.*

**2.2. Taking Position in Favor of Allowing Banks in Real Estate**

In requesting the change, the ABA has been the strongest proponent in favor of permitting financial institutions to become involved in real estate brokerage. Other associations supporting this position include: America's Community Bankers (ACB), the Consumer Bank Association (CBA), the Financial Services Roundtable, and the New York Clearing House Association.

Following are the main arguments and viewpoints supporting the ABA's contention that financial institutions should be permitted to practice real estate brokerage:

- (i) Financial institutions will enhance competition, change the market place, and raise the bar, forcing improvements in efficiency, pricing and service levels – all to the benefit of consumers.

**AUTHORS' COMMENTS**

*Although this is true the counter argument is that financial institutions might be able to cross-subsidize their real estate services with federally insured banking operations and undercut independent real estate brokers with a more negotiable discount brokerage model.*

- (ii) Real estate is a financial asset because: (a) the home is the largest asset for many individuals; (b) real estate serves as the underpinning for hundreds of billions of dollars of mortgage-backed securities; and (c) real estate serves as a means of wealth creation by increasing in value over time and providing tax benefits.

**AUTHORS' COMMENTS**

*Although real estate brokerage does have certain characteristics of a financial transaction, being the largest single investment in an individual's portfolio does not necessarily imply it is a financial asset.*

- (iii) The sale or lease of real estate is a financial transaction because it is the most complex and financially difficult transaction most individuals will make.

**AUTHORS' COMMENTS**

*Real estate transactions are occasionally originated for investment purposes. The complexity of such transactions does not determine whether or not the transaction is financial in nature. A very significant percentage of all real estate transactions are however dependent upon obtaining a home loan - a financial instrument.*

- (iv) Real estate brokerage is a financial complement to a bank's current business lines.

**AUTHORS' COMMENTS**

*Depending on how and where one draws the line , this could be either a true or a false statement. The lingering question is however, where will the service delivery end, and if other commercial-like activities will also be bundled in the future.*

- (v) Integrated real estate and financial services already exist with many large companies such as Cendant, GMAC Home Services, Long & Foster, and Prudential Insurance Company of America owning and operating both brokerage and mortgage operations and thus offering to the consumer the benefits of one-stop-shopping.

**AUTHORS' COMMENTS**

*This is a strong argument. It is inconsistent for real estate brokerages to enter the mortgage industry and to also argue that others should be prohibited from entering the real estate brokerage business.*

- (vi) Bank-affiliated real estate brokerages will be subject to stronger consumer protections and anti-tying provisions. This will benefit consumers.

**AUTHORS' COMMENTS**

*How long will that last? Banks might later complain that the playing field is not level because the new environment favors non bank-affiliated real estate brokerages.*

- (vii) Numerous states have already permitted state-chartered banks to own and operate real estate brokerage companies.

**AUTHORS' COMMENTS**

*Few state-chartered banks have actually exercised the right to enter into the real estate brokerage business. It is therefore difficult to evaluate the exact impact of such national approval to do so. Entrance into this market will most likely be gradual and will vary with each institution.*

According to a survey conducted by the *Real Estate Settlement Procedures Organization (RESPRO)*, two-thirds (67%) of their membership believe that banks should be allowed to engage in real estate brokerage. One fourth (25%) oppose involvement while 8% are undecided. *RESPRO* membership consists mainly of financial institutions, title companies, and real estate brokerages. The majority of *RESPRO* real estate broker members are also in the mortgage business.

### **2.3. Consumer Surveys**

To gain more support for their viewpoints both sides in this debate have commissioned independent consumer surveys.

On March 22, 2001 Yankelovich published *A Study on Real Estate Brokerage and Banking*. This was conducted on behalf of the *NAR*. A regionally representative sample of 2,049 Americans was interviewed telephonically between March 15 and March 19. On May 1, 2001 Mathew Greenwald & Associates published their *Consumer Real Estate Survey* on behalf of the *ABA*. This national survey was also conducted telephonically scarcely a month later, between April 23 and April 29.

**AUTHORS' COMMENTS**

*These two surveys are inconclusive as evaluation of both questionnaires reflected leading questions - effectively voiding the accuracy and therefore the value of the results. Both surveys supported the respective viewpoints of the sponsoring party.*

## **SECTION 3 – The Industry in Question – Real Estate Brokerage**

### **3.1. Is Real Estate a Financial Transaction?**

With home ownership at an all-time high in the United States, real estate also remains the cornerstone asset in most household portfolios. In many cases it has become the best means of wealth creation.

Real estate brokerage could be summarized as being in the business of bringing together parties interested consummating a real estate purchase and negotiating a contract on behalf of such parties for the:

- (i) Purchase, sale, or exchange of real property; or
- (ii) Lease or rental of real estate or the improvements thereon for others on a fee basis.

It is accepted that real estate brokerage does not generally involve the purchasing or selling of real estate with the real estate company acting as a principal.

#### **Real Estate Seen as a Commercial Transaction**

One of the arguments raised by opponents is that selling is fundamentally a commercial transaction. If banks are permitted to enter real estate brokerage they would be mixing commerce and finance, resulting in a violation of the longstanding federal policy of keeping the two separate. The opponents fear that through sheer power and size, huge banks could buy up existing brokerages and thereby control a significant portion of the industry.

Bank-controlled real estate brokerages would then become marketing arms of mortgage departments and would develop more interest in making the loan or selling mortgage insurance than helping the customer negotiate the best transaction. This could lead to higher costs for consumers, as banks could cross-sell other products and services through this new captive real estate brokerage subsidiary.

#### **Real Estate Seen as a Financial Transaction**

The proponents counter this argument by stating that real estate brokerage can only be conducted today pursuant to various state laws and regulations including licensing, qualification, and sales practices. Those laws currently applicable to real estate brokers would equally apply to bank-owned or affiliated real estate brokerages. In effect, consumer protection could be heightened because of additional protections currently contained under the *BHC Act*. These protections currently do not apply to non bank-affiliated real estate brokerages.

Proponents are therefore arguing that real estate brokerage services fall squarely into the category of “arranging ... or facilitating financial transactions for the account of third parties.” As part of the home purchase transaction, the buyer generally must provide a significant down payment on the property and then make a long-term commitment of his or her financial resources to repay the mortgage loan.

Opponents argue that the mortgage is in fact only incidental to the purchase of a home and that a significant number of consumers involved in real estate transactions require no financing at all.

### **Issues of Cross Selling**

Concerns have also been raised that excessive cross selling by banks could take place. Currently *Real Estate Settlement Procedures Act (RESPA)* governs the relationship between a real estate client who is looking for a mortgage or other settlement service from a real estate company’s lending or other affiliate/alliance partner. Although the *RESPA* has various stringent disclosure requirements, numerous debates and findings of circumvention indicate that the Act might also require some changes should the current proposed changes to the *GLB Act* be approved.

#### **AUTHORS’ COMMENTS**

*It would not appear that a bank selling real estate would pose a risk to the nation’s financial system nor does it violate any protection of the consumer. The concern is whether or not such a move would put Banks in a significantly preferred competitive position, is restricting their involvement in real estate brokerage an unfair regulatory intrusion on their rights.*

### **3.2. Is the Real Estate Brokerage Industry Changing?**

The home buying process is one of the single most complicated and complex consumer transactions. For this reason there are a multitude of statutes and regulations providing consumer protection and requiring comprehensive disclosures. Consumers are increasingly beginning to view the home buying transaction as a single, integrated process. Indeed, all participants in the transaction have attempted to package the process as a seamless one-stop-shopping experience.

Today’s customers are increasingly taking control of the transaction. Many of the trends outlined in *Real Estate confronts the e-Consumer* (RealSure, Inc. 2000) such as one-stop-shopping, online customer acquisition, and the wireless revolution have already changed and continue to change the business rules within the real estate industry.

A growing number of companies have diversified and moved aggressively toward offering one-stop-shopping for real estate. Examples include major companies such as:

**(i) Cendant**

The nation's largest real estate franchiser and the parent for three of the nation's largest six real estate franchises namely: Coldwell Banker, Century 21, and ERA Real Estate. Combined, Cendant has over 12,000 franchised and company-owned real estate brokerage offices and nearly 200,000 real estate agents worldwide. Cendant has created Cendant Mortgage and has very successfully expanded into the financial arena by leveraging off its real estate companies to become the nation's fifth largest retail mortgage loan originator with over \$22 billion in mortgage financing in 2000.

**(ii) General Motors Acceptance Corporation (GMAC)**

GMAC is one of the world's largest financial services companies. Company holdings include GMAC Residential Holdings that in turn owns GMAC Mortgage Corporation, GMAC Bank and GMAC Home Services. GMAC Real Estate, formerly Better Homes and Gardens Real Estate is one of the nation's six largest real estate franchisers, with some 1,500 offices and nearly 25,000 agents. As of December 2000 GMAC Mortgage is the nation's seventh largest mortgage servicer, with a portfolio of \$73 billion and nearly 1.8 million customers. In 2000 GMAC Mortgage originated \$17.8 billion in residential mortgages and was the eight largest mortgage originator.

**(iii) HomeServices**

Publicly traded HomeServices.com, Inc., based in Minneapolis, owns and operates ten of the nation's premier independent regional real estate companies in 12 states. HomeServices is the second-largest independent residential real estate brokerage firm in the U.S. based on closed transaction sides. The HomeServices.com system offers integrated real estate services, including mortgage, title and closing services, and various related e-commerce services. Some of its companies have partnered with Wells Fargo Home Mortgage to originate residential loans.

**(iv) Long & Foster Real Estate**

Long & Foster Real Estate, Inc. is the Washington D.C. area's largest real estate firm with over 160 offices and 7,000 sales associates throughout the mid-Atlantic region. In 2000 Long & Foster generated over \$13 billion in sales and ranked fourth in a list of all real estate brokers nationwide by Real Trends, an industry publication. Management states that they provide consumers with the convenience of one-stop shopping with their financial services (mortgage, title, and insurance) available through one convenient and financially stable source: The Long & Foster Companies, which include Long & Foster Real Estate, Prosperity Mortgage, Mid-States Title, and Long & Foster Insurance.



## SECTION 4 - Financial Services' Historic Involvement

### 4.1. In the Real Estate Industry

According to our research 26 states have permitted state-chartered banks to engage in real estate brokerage. By way of example Iowa code § 524.802 states that “A state bank shall have.... the power to...engage in the brokerage of insurance and real estate subject to the prior approval of the superintendent” and the New Jersey Admin. Code tit. 3, §11-11.5(a)(4) permits a subsidiary of a New Jersey state-chartered bank to provide real estate brokerage services.

#### **AUTHORS' COMMENTS**

*We were unable to validate evidence of any abuse or harmful effects for few examples could be found of state-chartered banks engaging in real estate brokerage. It would seem that the involvement in real estate brokerage by banks has not had a major impact on the industry, nor has it disrupted the industry in any significant way.*

Financial institutions, through their subsidiaries and affiliates, have long participated in virtually every other aspect of the real estate transaction including:

- (i) Holding bank real estate assets and acquiring real estate in a fiduciary capacity or in full or partial satisfaction of a debt previously contracted,
- (ii) Making real estate investments that have, as their primary purpose, community development,
- (iii) Providing real estate appraisal services,
- (iv) Arranging commercial real estate equity financing,
- (v) Real estate lending,
- (vi) Real estate leasing,
- (vii) Providing real estate settlement and escrow services,
- (viii) Providing real estate investment advisory services.

They are also currently engaged in a variety of activities that are functionally and operationally similar to real estate brokerage such as:

- (i) Insurance agency services,
- (ii) Securities brokerage,
- (iii) Private placement services,
- (iv) Futures commission merchant services,
- (v) Agency transactional services relating to swaps and other derivative instruments.

Since 1982, national banks have also had authority to serve as a finder in locating, analyzing, and making recommendations regarding the purchase or sale of property. Since the passage of the *GLB Act*, *FHCs* and financial subsidiaries have also been able to provide title insurance, private mortgage insurance, and any other types of insurance to the parties of the transaction.

#### **AUTHORS' COMMENTS**

*It would appear that banks are already participating in nearly every aspect of the real estate transaction, other than brokerage. Numerous banks currently own 'affiliated' real estate brokerages to manage their REO portfolio - at a reduced commission.*

*Expect later this year or next year proposed changes to RESPA and the Truth in Lending Act (TILA). This is needed to level the playing field for all providers, regardless of their industry or affiliation. There is also a need for significant clarification of fees, disclosures, advertising, and Internet transactions.*

#### **4.2. In the Securities and Insurance Industries**

The enactment of the *GLB Act* also lifted previous barriers that had prevented banks from selling securities and life insurance. This change was seen by some, similar to many in the real estate industry today, as a threat while others viewed this change as an opportunity.

Both sides seem to have examples to support their respective viewpoints. Although there hasn't been a stampede since the change, banks have acquired nearly 140 insurance agencies and the number seems to be growing. Important point to remember would be that even prior to the *GLB Act* banks were permitted to be in the securities business in a limited way.

However in other cases banks provide access for their customers to independent insurance sales agents, who follow up with the needs analysis, close the sale, and process the business. The banks retain the ownership of the relationship with the customer, and save money by not investing in the infrastructure required to operate an insurance agency.

**AUTHORS' COMMENTS**

*Most likely the real estate industry will also experience a variety of different strategies. See the following section for possible entry methods.*

## **SECTION 5 : Entry Strategies into the Real Estate Industry**

### **5.1. Possible Methods of Entry by Financial Institutions into Real Estate**

With the current focus centered on the possible changes to the *GLB Act*, it would seem that the majority of real estate companies have anticipated that banks' entrance into the real estate brokerage industry will be facilitated through acquisitions.

#### **Acquisitions**

Although approval of the new proposed rule could launch a flurry of such acquisitions, it is unlikely. The real estate brokerage industry is extremely fragmented. Outside of the franchises, there are relatively few large independent national or large regional real estate brokerages that could provide the necessary geographic coverage and licensing for a nationwide real estate brokerage delivery. However, for those few brokerages that fall into that category a profitable exit strategy may result.

#### **Start-Up**

In the short to medium term it is also unlikely that national financial institutions will chose to start-up their own real estate brokerages. Those who may, whether with independent agents or salaried employees, will soon discover the high levels of frustration associated with the existing brokerage structure. The inefficiencies of the current real estate industry will become apparent. Economies of scale will be difficult to exploit because of the anticipated clash between the banking culture and the real estate culture.

#### **Other Participants**

Also, entrance is not limited only to the banks. Companies such as Cendant and GMAC have effectively and aggressively entered the real estate industry. Therefore watch carefully as other companies related to the real estate industry, such as title insurance underwriters, P&C insurance carriers, and utility companies become involved in providing complementary services.

Good examples include; the recent acquisition by Fidelity National Financial of VISTA Info (owner of Moore Data, the nation's largest Multiple Listing Service [MLS] service provider) and RISCO (nation's third largest MLS service provider); as well as Berkshire Hathaway's ownership of both MidAmerican Energy Holdings and HomeServices (the nation's second largest real estate brokerage).

## **Methods of Entry**

Methods of entry could include:

- (i) Capitalizing and building new start-up real estate brokerages,
- (ii) Designing and building a new real estate business model,
- (iii) Franchising current real estate brokerages under the bank's brand,
- (iv) Partial investment in existing real estate brokerages,
- (v) Acquisition of existing real estate brokerages,
- (vi) Acquisition of franchised or otherwise networked brokerages; and/or
- (vii) Partnering strategically with existing real estate brokerages.

## **5.2. Potential Candidate Types to Partner or Acquire**

### **Classifications of Companies Closest to the Point of Sale Contact**

- (i) Large real estate companies,
  - a. National brokerage operations such as National Realty Trust (NRT),
  - b. Large regional brokerages such as John L. Scott Real Estate, DeWolfe Companies, and Weichert Realtors,
  - c. New paradigm e-real estate companies such as ZipRealty, YHD, SOMA Living, eRealty, and BlueEdge Realty (owned by Coldwell Banker),
- (ii) Large home building contractors and their related in-house real estate and mortgage operations such as Centex, Pulte, and Kaufman & Broad,
- (iii) Online mortgage originators such as LendingTree and E-LOAN.

### **Classifications of Companies Slightly Removed from the Point of Sale Contact**

- (i) Traditional mortgage brokers,
- (ii) National relocation networks such as RELO,
- (iii) Online real estate portals such as HomeStore, HomeSeekers, RealEstate.com, and HomeAdvisor, or even more traditional portals like AOL and Yahoo,
- (iv) Traditional and/or re-engineered MLS service providers.

### **Classifications of Companies Related to the Transaction But Not Directly Involved in the Point of Sale Contact**

- (i) Certain technology and specialty online initiatives such as HomeGain,
- (ii) Certain home-services related initiatives such as Home-Link, Vital HomeServices, and Improvenet,
- (iii) Title insurance and escrow/closing companies. These companies have the most complete existing database of information on homes and owners.
- (iv) Software providers to the real estate industry,
- (iv) Internet service providers to the real estate industry.

#### **AUTHORS' CONCLUDING COMMENTS**

*Your opinion on whether or not banks should be allowed to engage in real estate brokerage will follow the side of the argument that is most favorable to your position. Review the points made by both sides, against or in favor (section 1).*

*It is the opinion of the authors that the proposed inclusion of real estate brokerage, from a legal stand point meets the statutory test, and ultimately will be approved. The concerns about removing the restrictions are overstated and the main reason that the Agencies might not approve the request in 2001 will be due to the magnitude of industry commentary and/or political pressure.*

*You can be assured that banks will in the future play an increasing role in the real estate brokerage industry - in one form or another (refer to section 5). Different financial institutions will most certainly select different courses of action. However, whether they choose to conduct real estate brokerage in-house with salaried employees, separately through holding company subsidiaries or indirectly through new transactional related services, expect their impact to be considerable.*

*The United States and its consumers operate within one of the most fragmented financial systems in the world. Much of its structure which remains in place today dates as far back as the early 20th Century. With the accelerated change we have experienced in the early 21st Century, we believe there exists a multitude of opportunity to improve the present systems and processes.*

*At the end of the day, whether or not you are in favor of the approval of this legislation, improving the overall process on the behalf of the consumer should be the ultimate driver of the magnitude of such change.*

## APPENDICES

APPENDIX A  
**TOP Mortgage Originators in 2000**

APPENDIX B  
**TOP Real Estate Brokerages in 2000**

APPENDIX C  
**Acronyms and Terminology**

## APPENDIX A

**TOP 10 Retail Mortgage Originators in 2000**

(For 12 months – Dollars in Billions)

Ranking in 2000		Lender	Retail Originations in \$ Billions	Total Originations in \$ Billions	Ranking in 1999
1	1*	Wells Fargo Home Mortgage	\$40.47	\$76.46	1
2		Bank of America Mtg. & Affl.	\$21.45	\$51.82	2
3		Golden West Financial	\$19.80	\$19.80	8
4		Countrywide Credit Industries	\$18.31	\$61.69	3
5		Cendant Mortgage Corp.	\$17.80	\$22.14	6
6		Chase Home Finance	\$17.53	\$76.01	5
7	2*	Washington Mutual	\$17.41	\$50.73	-
8		GMAC Mortgage Corp.	\$13.24	\$17.82	7
9		National City Mortgage Corp.	\$12.44	\$21.49	9
10		CTX Mortgage	\$8.45	\$8.50	11

*Source: Inside Mortgage Finance, Copyright 2001*

1\* – Resulting from numerous acquisition including Norwest Mortgage.

2\* – Resulting from numerous acquisitions including Home Savings of America.

**TOP 10 Wholesale Mortgage Originators in 2000**

(For 12 months – Dollars in Billions)

Ranking in 2000		Lender	Wholesale Originations in \$ Billions	Total Originations in \$ Billions	Ranking in 1999
1		Chase Home Finance	\$58.48	\$76.01	1
2		Countrywide Credit Industries	\$43.39	\$61.69	2
3		Wells Fargo Home Mortgage	\$36.07	\$76.46	3
4		Washington Mutual	\$33.32	\$50.73	8
5		Bank of America Mtg. & Affl.	\$30.37	\$51.82	5
6		Fleet Mortgage Group	\$20.87	\$23.39	4
7		Homeside Lending, Inc.	\$20.84	\$21.55	6
8		ABN AMRO Mortgage Group	\$20.35	\$23.84	7
9		PNC Mortgage	\$17.43	\$22.34	13
10		CitiMortgage	\$14.41	\$19.65	9

*Source: Inside Mortgage Finance, Copyright 2001*



**TOP 10 Mortgage Servicers in 2000**

(For 12 months – Dollars in Billions)

Ranking in 2000	Lender	Volume in \$ Billions	Ranking in 1999
1	Wells Fargo Home Mortgage	\$452.57	3
2	Chase Home Finance	\$361.64	1
3	Bank of America Mtg. & Affiliate	\$335.86	2
4	Countrywide Credit Industries	\$284.88	4
5	Homeside Lending, Inc.	\$187.55	7
6	Washington Mutual	\$186.84	5
7	GMAC Mortgage Corp.	\$173.13	6
8	Fleet Mortgage Group	\$136.40	8
9	First Nationwide Mortgage	\$111.99	9
10	ABN AMRO Mortgage Group	\$109.23	13

*Source: Inside Mortgage Finance, Copyright 2001*

## APPENDIX B

## The 20 Largest Real Estate Brokerages in 2000

	Company	Sales Volume in \$ Billions	Sides	Offices
1	<b>NRT</b>	<b>\$105.69</b>	<b>351,550</b>	<b>672</b>
2	<b>Weichert, Realtors</b>	<b>\$18.40</b>	<b>80,525</b>	<b>200</b>
3	<b>HomeServices.com Inc</b>	<b>\$14.26</b>	<b>87,931</b>	<b>167</b>
4	<b>Long &amp; Foster Real Estate, Inc</b>	<b>\$14.22</b>	<b>73,981</b>	<b>164</b>
5	<b>Prudential California/Americana/John Aaroe</b>	<b>\$12.83</b>	<b>38,501</b>	<b>78</b>
6	<b>GMAC Real Estate</b>	<b>\$12.44</b>	<b>31,721</b>	<b>118</b>
7	<b>Arvida Realty Services</b>	<b>\$8.20</b>	<b>38,804</b>	<b>100</b>
8	<b>Alain Pinel Realtors, Inc.</b>	<b>\$7.72</b>	<b>7,861</b>	<b>23</b>
9	<b>Prudential Fox &amp; Roach</b>	<b>\$6.22</b>	<b>28,618</b>	<b>48</b>
10	<b>DeWolfe Companies, Inc</b>	<b>\$6.09</b>	<b>25,922</b>	<b>95</b>
11	<b>John L Scott Real Estate</b>	<b>\$4.96</b>	<b>22,633</b>	<b>39</b>
12	<b>Realty Executives</b>	<b>\$4.52</b>	<b>26,485</b>	<b>17</b>
13	<b>Baird &amp; Warner, Inc.</b>	<b>\$4.10</b>	<b>16,297</b>	<b>35</b>
14	<b>Prudential California / Nevada Realty</b>	<b>\$4.04</b>	<b>12,136</b>	<b>38</b>
15	<b>Coldwell Banker Bain and Associates</b>	<b>\$4.01</b>	<b>13,397</b>	<b>24</b>
16	<b>RE/MAX Atlanta</b>	<b>\$3.73</b>	<b>18,005</b>	<b>12</b>
17	<b>Ebby Halliday, Realtors</b>	<b>\$3.73</b>	<b>17,841</b>	<b>25</b>
18	<b>Gundaker Realtors</b>	<b>\$3.35</b>	<b>22,540</b>	<b>31</b>
19	<b>Sotheby's International Realty, Inc.</b>	<b>\$3.34</b>	<b>2,125</b>	<b>16</b>
20	<b>RE/MAX Alliance</b>	<b>\$3.02</b>	<b>13,165</b>	<b>14</b>

Source: RealTRENDS 500, Copyright 2001

Various companies use “branchizing” as a method of expansion. Those numbers are not included in the above table, which reflects company owned businesses only. Notable additional numbers listed below effect the totals above and should be added to gain an overall total.

Company	Additional Sales Volume in \$ Billions	Additional branchized offices
<b>Windemere</b>	<b>\$15.63</b>	<b>201</b>
<b>Long &amp; Foster Real Estate, Inc</b>	<b>\$0.03</b>	<b>1</b>
<b>Prudential California / Nevada Realty</b>	<b>\$5.06</b>	<b>80</b>
<b>John L Scott Real Estate</b>	<b>\$2.87</b>	<b>61</b>
<b>Sotheby's International Realty, Inc.</b>	<b>\$1.14</b>	<b>175</b>

Source: RealTRENDS 500, Copyright 2001

**APPENDIX C**

**Acronyms and Terminology**

Quick guide to acronyms used in this white paper.

<b>Agencies.....</b>	The collective reference to The Board of Governors of the Federal Reserve System and the Secretary of the Treasury.
<b>ABA.....</b>	American Bankers Association. The ABA brings together all categories of banking institutions, including community, regional and money center banks, and holding companies, savings associations, trust companies, and savings banks.
<b>ACB.....</b>	America's Community Bankers
<b>BHC Act.....</b>	Bank Holding Company Act
<b>CBA.....</b>	Consumer Bank Association
<b>FCR Act.....</b>	Fair Credit Reporting Act
<b>FDIC.....</b>	Federal Deposit Insurance Corporation
<b>FHC.....</b>	Federal Housing Commission
<b>FRB.....</b>	Federal Reserve Board
<b>FRS.....</b>	Federal Reserve System
<b>FTC.....</b>	Federal Trade Commission
<b>GLB Act.....</b>	Gramm-Leach-Bliley Act
<b>GMAC.....</b>	General Mortgage Acceptance Corporation
<b>GS Act.....</b>	Glass-Steagall Act
<b>NAHB.....</b>	National Association of Home Builders
<b>NAR.....</b>	National Association of Realtors®. The NAR was formed in 1908 and today has 760,000 real estate agents as members. It has frequently worked successfully to advance home ownership, real estate investment, private property rights, and the free enterprise system.
<b>NRT.....</b>	NRT Incorporated (formerly National Realty Trust). Formed in 1997. Today the nation's largest real estate brokerage. The company is 49% owned by Cendant.
<b>MLS.....</b>	Multiple Listing Service
<b>OCC.....</b>	Office of the Comptroller of the Currency
<b>OTS.....</b>	Office of Thrift Supervision
<b>RESPA.....</b>	Real Estate Settlement Procedures Act
<b>RESPRO.....</b>	Real Estate Settlement Procedures Organization
<b>S&amp;L.....</b>	Savings and Loan
<b>TILA.....</b>	Truth in Lending Act
<b>YHD.....</b>	Your Homes Direct. A new paradigm lower fee based brokerage.

### **Stefan Swanepoel**

Stefan is widely regarded as one of the leading authorities in the country on e-business and trends in the real estate industry. He currently serves on the Board of Directors/Advisors of various real estate, financial, technology and telecommunication companies. Previously Stefan served as SVP of Cendant as well as President of a large California-based real estate group, with real estate brokerage, mortgage, title, escrow and insurance divisions. Prior to calling California home in 1994, he lived on three continents and developed a broad international background. Stefan co-founded ERA Real Estate in South Africa and helped build the franchise to 120 offices in two years. He is also credited for conceptualizing and subsequently building in 1991 the first integrated multiple-listing and computerized mortgage origination system in the world. His academic accomplishments include a bachelor's in science, a master's in business economics and diplomas in arbitration, computer science and marketing. Stefan is a prolific writer and has penned five books on the industry including *"Real Estate confronts Reality,"* (ranked as the #1 Real Estate Business Book for 1998 by Amazon.com) and his current best seller, *"Real Estate confronts the e-Consumer"* (published November 2000). Stefan is a high-energy speaker, weaving rapidly through complex subject matter in an informational and entertaining manner. His enthusiasm is contagious and his messages are optimistic and intermingled with statistics and thought provoking ideas.

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### **Dennis Galloway**

Dennis' reputation for innovative and visionary thinking and business development acumen is well known. His extensive knowledge of the real estate industry and ancillary services is gained from first-hand experience. He began his real estate career as sales associate, then became broker owner of a multi-office company. This was followed by positions as Regional Owner and International Marketing Director for Realty World. He then co-founded and was EVP of Coldwell Banker Residential Affiliates and the Prudential Real Estate Affiliates, where he also served on their Board of Directors. He was instrumental in building these franchisees into the national presence they enjoy today. Dennis has also held positions such as President of Dial One, a network of franchised home services contractors and SVP of Partnerships for Improvenet, a networked affiliation of contractors providing home improvement services. As a consultant he has specialized in intranet strategies for e-commerce business solutions for clients such as Homes and Land Magazine, ERA Real Estate, Homes.com, Realty.com, Focus 360, Yahoo, The School Report.com and US Web. Dennis was selected to serve a 5-year term on a Special Advisory Board by the Real Estate Commissioner of the State of California. He was also recognized for serving (80-89) as state advisor to the American Security Council, a bipartisan coalition of members of the House of Representatives and United States Senate.

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### **Kenneth Jenny**

Ken has been involved in all aspects of the residential real estate industry for more than 23 years. As a Senior Executive of two major international real estate franchise organizations (Coldwell Banker Residential Real Estate Services and Prudential Real Estate Affiliates) he has developed a very thorough understanding of the real estate brokerage business and the sales model from the point of sale through closing the transaction. During the course of his career he has designed, built, marketed and delivered effective business solutions to more than 4,000 real estate offices and in excess of 200,000 real estate agents. As a consultant, Ken has served in various key strategic roles as a change agent and expert in the residential real estate industry for companies such as; Electronic Data Systems, Inc. (EDS), Hewlett-Packard, Interealty Corp, RealEstate.com, HomeGain.com, Merrill Corporation, ERA Real Estate, Inc., Harcourts Group, and Vital HomeServices.com. Ken has contributed numerous articles and has been quoted in books dealing with the subject matter of general business strategy and change within the real estate industry including books such as; *"Sacred Cows Make the Best Burgers,"* *"Real Estate confronts the e-Consumer"* and *"Real Estate confronts Reality."*

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