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# U P D A T E

## News of Developments in the Financial Sector and Related Areas

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### *Real Estate Activities of Financial Holding Companies*

In connection with the proposed rule permitting real estate brokerage and management activities for financial holding companies, their subsidiaries and subsidiaries of national banks, the United States Congress has continued to bar the Federal Reserve Board and the Treasury Department from taking action to finalize the proposed rule. The proposed rule would have permitted financial holding companies and financial subsidiaries to provide real estate brokerage and management services including, among other things, acting as agent for a buyer, seller, lessor or lessee of real estate; listing and advertising real estate; providing advice in connection with real estate transactions; and providing real estate management services, including procuring tenants, negotiating leases, and generally overseeing the inspection, maintenance and upkeep of real estate. The National Association of Realtors, which has been thus far successful in its efforts to lobby Congress, opposes the proposed rule and takes the position that real estate brokerage is a commercial and not a financial activity, and the proposed rule would allow financial holding companies and financial subsidiaries to buy up large brokerage firms and force the closure of smaller brokers who are unable to compete with the financial resources of banking entities. Proposed legislation has been introduced in both the United States Senate and the House of Representatives that is substantially identical to legislation introduced last year, which would bar banks from such activities and which would prevent federal regulators from finalizing a rule allowing banking companies into the real estate business. Because of the support which has been gathered by the National Association of Realtors, it is expected that Congress will enact legislation prohibiting financial holding companies and national banks from engaging in real estate brokerage and management activities.

### *Preemption of State Law*

The Federal Deposit Insurance Corporation ("FDIC") has scheduled a public hearing on May 24, 2005, on a preemption petition from the Financial Services Roundtable ("Roundtable"), a trade association for integrated financial services companies. The Roundtable has asked the FDIC to issue a rule that would provide that a state bank's home state law governs its interstate activities and those of its subsidiaries to the same extent that the National Bank Act governs a national bank's interstate business. In January 2004, the Office of the Comptroller of the Currency ("OCC") issued two final regulations relating to the preemption of state laws by federal banks

over national banks. These two final regulations by the OCC have been controversial with state regulatory authorities, particularly in the area of preemption of corporate subsidiaries of national banks and the applicability of preemption of state laws relating to these corporate subsidiaries. The Roundtable has indicated its belief that the adoption of a similar rule by the FDIC would create parity between state-chartered banks and national banks with interstate activities and operations. The FDIC believes that public participation will provide valuable insight into the positions presented by the petition and will assist the FDIC in responding to the rulemaking request. Regardless of the outcome of the public hearing, there is a legal issue as to whether or not the FDIC has the authority to promulgate a regulation which would in essence work like a wild card for state-chartered banks in providing them with parity with national banks.

### *Securities Activities of Banks*

The Securities and Exchange Commission ("SEC") proposed Regulation B to implement provisions of the Gramm-Leach-Bliley Act ("GLB Act") that delineate the securities activities banks may engage in without registering as brokers. The GLB Act replaced the exception of banks from the definitions of *broker* and *dealer* with eleven functional exceptions. Regulation B defines some of the statutory terms used in the eleven exceptions. Probably one of the most important exceptions for banks is the statutory third-party brokerage (networking) exception which allows banks to partner with broker-dealers in offering their customers a wide range of financial services, including securities brokerage. Under this exception, a broker-dealer offers brokerage services to bank customers and shares the compensation with the bank. The exception also allows unregistered bank employees to receive incentive compensation in the form of a "nominal one-time cash fee of a fixed dollar amount" for referring bank customers to the broker-dealer. Regulation B defines nominal compensation to be a fee not exceeding (i) a flat $25; (ii) the employee's base hourly rate of pay; or (iii) $15 adjusted for inflation from 1999. Another exemption applies to trust and fiduciary activities of banks and permits a bank to assess its compliance on an aggregate, rather than an account-by-account, basis using a proportion of 9 to 1 as the ratio for relationship to sales compensation when calculating how much compensation is received from "relationship activities" such as annual fees versus referral fees. If 90% of compensation comes from relationship activities, Registration would not be required. Regulation B also provides certain exceptions for banks acting as a custodian permitting them to engage in securities transactions while holding funds and securities relating to those transactions. Under the small bank custody exemption, registration would not be required in those situations where annual revenue was $100,000 or less from securities trans-actions, the bank has less than $500 million in assets, the bank is not part of a bank holding company with more than $1 billion in consolidated assets and other specified criteria. Federal banking regulatory agencies have expressed their disagreement to Regulation B as currently proposed, taking the position that the proposal clashes with the GLB Act. Some members of the Senate Banking Committee have also taken the position that proposed Regulation B is fundamentally flawed. Because of the negative feed back from federal banking regulatory agencies and others, the SEC has delayed action on the implementation of Regulation B until September 30, 2005, pending consideration of comments on its proposal. It is expected that once Regulation B becomes effective, banks will be given a period of time to comply.