

02 - 029

CHAPTER 107

Regulation #7

## ACTIVITIES PERMISSIBLE FOR FINANCIAL INSTITUTION HOLDING COMPANIES

**SUMMARY:** This regulation, originally effective November 24, 1976 and most recently amended on December 14, 1983, was promulgated to authorize Maine financial institution holding companies to engage in specific closely related activities as enumerated in the Bank Holding Company Act of 1956 or Section 408 of the National Housing Act. Numerous changes have been made to the Federal Acts and this state has kept pace with those changes by allowing the Maine regulation to maintain parity whenever changes are made in federal law or regulation.

Maine law specifically authorizes the Superintendent of the Bureau of Banking to promulgate rules which are no more restrictive than federal law and regulation. Maine law permits the promulgation of rules which would grant greater authority to Maine financial institution holding companies than federal rules. This revision grants additional powers that may be engaged in either directly or through a subsidiary of a financial institution or a financial institution holding company.

### 1. 1. Authority

Title 9 B M.R.S.A. Section 1014 authorizes the Superintendent to promulgate regulations specifying which closely related activities, permissible under either the Bank Holding Company Act of 1956 or Section 408 of the National Housing Act, shall be permissible for Maine financial institution holding companies. In 1987, Section 1014 was broadened by P.L. 1987, c. 90, by providing that the rules may authorize activities "which are no more restrictive" than those permitted by federal law and regulation.

### 2. Purpose

The Federal Reserve Board amended its Regulation Y in 1984 and 1986, which revised and broadened the range of permissible closely related activities. Many other states have been aggressive in authorizing new powers for their financial institutions which have not yet been authorized by the Federal Reserve Board. During the recent period of deregulation, both state and federal regulators have more liberally interpreted existing laws and regulations, thus broadening the scope of authorized powers. It

is the intent of the Bureau of Banking to permit Maine financial institutions or Maine financial institution holding companies to engage in activities at least as broad as, or broader than, those activities authorized by federal law and regulation.

Since specific provisions are being added and existing powers broadened on a continuing basis, it is burdensome for the Bureau to amend this regulation each time federal regulations are amended. The Bureau, therefore, authorizes all Maine financial institutions and all Maine financial institution holding companies to engage in closely related activities authorized by federal regulation as well as those additional activities authorized by this regulation, subject to approval of an application submitted pursuant to Section 3.C of this regulation.

### 3. Provisions of the Regulation

#### A. Authorization

A Maine financial institution or a Maine financial institution holding company may engage in closely related activities as provided by federal law and regulation (Bank Holding Company Act of 1956, 12 U.S.C. subsection 1841 et. seq., 12 C.F.R. subsection 225.25 or Section 408 of the National Housing Act, 12 U.S.C. subsection 1730(a), 12 C.F.R. subsection 583), unless the activity is prohibited by state law other than Title 9 B, but subject to the Bureau approval of an application submitted pursuant to Section 3.C of this regulation. In addition to those activities authorized by federal law and regulation, the activities listed below are so closely related to banking or managing or controlling banks as to be a proper incident thereto and consequently they are deemed to be "closely related activities" in which a Maine financial institution or Maine financial institution holding company may engage.

#### B. Additional activities.

The activities listed below are so closely related to banking or managing or controlling banks as to be a proper incident thereto and may be engaged in by a Maine financial institution or a Maine financial institution holding company, or subsidiary of either, subject to the requirements of a paragraph 3.C:

1. Owning and operating a real estate agency for the purpose of selling properties owned by a financial institution holding company, financial institution, or subsidiaries thereof. This property may include real estate acquired by foreclosure or deed in lieu of foreclosure, real estate acquired for investment or development, or real estate owned by a financial institution or affiliates. This activity shall be

conducted subject to the licensing and other requirements of the Maine Real Estate Commission.

### C. Requirements.

A Maine financial institution or a Maine financial institution holding company proposing to engage in any closely related activity shall make application to the Superintendent, as required by Title 9 B M.R.S.A. Section 1015, for prior approval of the activity. The application will describe the nature of the proposed activity, the extent to which the activity will be provided, and any other information requested by the Superintendent. The application shall be accompanied by an application fee of \$2,500. The activities, enumerated in paragraph 3, may be engaged in directly by the Maine financial institution or Maine financial institution holding company or through a subsidiary of either. Any subsidiary engaging in closely related activities may be jointly owned by two or more financial institutions or financial institution holding companies or subsidiaries of either.

EFFECTIVE DATE: February 28, 1989

## BASIS STATEMENT

### I. FACTUAL AND POLICY BASIS OF THE RULE

The Bureau promulgated Regulation #7 on December 14, 1983 which authorized financial institution holding companies pursuant to Title 9 B Section 1014.1 and financial institutions pursuant to Section 446 to engage in "closely related activities" as authorized by the Bank Holding Company Act of 1956 and Section 408 of the National Housing Act subject to the application

requirements of Sections 446 and 1014. Regulation #7 was originally promulgated on November 24, 1976. It was amended December 14, 1983 to provide contemporaneous changes in the list of permitted "closely related activities" as the federal regulatory agencies added new activities to the list. Title 9 B Section 1014.1 was broadened by the passage of P.L. 1987, c. 90 in May, 1987. This amendment to Section 1014.1 required the Superintendent to promulgate rules for closely related activities that were no more restrictive than federal law and regulations. Implied in the new statute regarding closely related activities is the authority for the Superintendent to permit financial institution holding companies and financial institutions to engage in closely related activities not authorized by federal law. Pursuant to this additional rule making authority, the Savings Banks Association of Maine and the Maine Bankers Association petitioned the Superintendent pursuant to Title 9 B M.R.S.A. Section 255.2 to amend Regulation #7 to permit financial institutions and financial

institution holding companies to conduct commercial real estate brokerage and travel agent activities.

Pursuant to the provisions of Maine's Administrative Procedure Act, a draft of Chapter 107 (Regulation #7) was promulgated September 30, 1988 with the public comment period to expire November 21, 1988. A public hearing was held November 10, 1988. Several requests for an extension of the comment period were received. As a result, proposed Regulation #7 was reopened for an additional 30 day comment period which closed December 23, 1988.

#### COMMENTS COMMERCIAL REAL ESTATE BROKERAGE

The Bureau received 7 written comments from proponents regarding the commercial real estate brokerage portion of the proposed rule. These proponents included the Savings Bank Association of Maine ("SBA"), the Maine Bankers Association ("MBA"), and several individual bankers. Several members of the banking industry also testified in favor of the regulation at the public hearing. SBA and MBA offered amendments at the public hearing and in subsequent written comments. One amendment would permit brokering of property acquired through foreclosure or property in process of foreclosure. Another amendment would grant the Superintendent the authority to permit financial institutions and financial institution holding companies to engage in unlisted activities. Another amendment related to the assumption of public benefits and increased safety and soundness for applications to conduct closely related activities. (These latter two amendments are discussed in a subsequent section.) Those commenting and/or testifying on behalf of the banking industry provided the following reasons for adding commercial real estate brokerage to the list of closely related activities:

1. Commercial real estate brokerage is a natural extension of banks' real estate lending and equity investment authority. The skills and knowledge required to successfully conduct commercial real estate lending and real estate investment are also fundamental to the competent practice of real estate brokerage.
2. Conduct of real estate brokerage would enhance the safety and soundness of the banking industry by providing additional fee income with incremental increase in risk.
3. Non bank competition are involved in real estate brokerage. Financial service firms such as Merrill Lynch, Sears, etc. which compete directly with banks for many services are in the real estate brokerage business.
4. Certain areas of the state, which lack adequate commercial real estate brokerage services, would benefit.
5. Consumers would benefit from the increased competition created by the entry of banks into this field.
6. Twelve other states permit banks to conduct real estate brokerage.

The Bureau received approximately 208 written comments from real estate brokers in opposition to all or portions of this proposed regulation. Several individuals testified in opposition at the public hearing, including a representative of the Maine Association of Realtors ("MAR"). The oral and written opposition are summarized as follows:

- 1) Allowing banks to conduct commercial real estate brokerage is anti competitive because banks would have an unfair advantage of providing financing whereas brokers do not.
- 2) The proposal is detrimental to consumers as buyers generally rely on a bank's objectivity in financing a transaction to protect the buyers interest as well as the banks. Since a bank who may also be acting as broker is representing and receiving a commission from the seller, a bank's traditional objectivity may be compromised.
- 3) The proposal also impacts consumers negatively as brokers may choose not to introduce potential buyers to banks which compete in the brokerage business. This would also adversely affect sellers.
- 4) There is an inherent potential for banks to be more inclined to book marginal loans for the sake of earning a sales commission.
- 5) Competing brokers would not refer clients to banks in the commercial real estate brokerage business, which would negatively impact a bank's loan volume.
- 6) Many brokers specializing primarily in residential real estate also stated that this proposal would ultimately lead to banks getting involved in residential real estate brokerage.

#### STATUTORY CONSIDERATIONS COMMERCIAL REAL ESTATE BROKERAGE

The Bureau is required to consider these arguments within the context of the Maine Administrative Procedures Act, Sections 8052 and 9052, and the Maine Banking Code, Sections 111 and 1014.1.

Section 111 of the Banking Code requires the Bureau of Banking to supervise the activities of financial institutions in a manner to insure the strength, stability, and efficiency of all financial institutions, to assure reasonable and orderly competition, thereby encouraging the development and expansions of financial services advantageous to the public welfare. Promulgation of rules, therefore, must consider this legislative declaration of policy.

Section 1014.1 requires that the Bureau find that non banking activities be closely related to banking. Although this requirement is not explicitly stated in Section 1014.1, it is implied by the references to federal law incorporated in the statute, use of the phrase "closely related activities" in Section 1015.1, and by

legislative history. When Section 1014.1 was originally enacted into law, it required the Superintendent to determine which of the non banking activities authorized by the Federal Reserve Board pursuant to the Bank Holding Company Act of 1956 and the Federal Home Loan Bank Board pursuant to Section 408 of the National Housing Act would be authorized for Maine financial institution holding companies and financial institutions. These references to federal law are still contained in Section 1014.1. Section 4(c)(8) of the Bank Holding Company Act requires the Federal Reserve Board to determine that activities be "so closely related to banking or managing or controlling banks as to be a proper incident thereto..." Section 408(c)(2)(F)(i) of the National Housing Act references the Bank Holding Company Act of 1956 and Section 408(c)(2)(F)(ii) references a list of activities prescribed by regulation (12 CFR 584.2 1(b)) which generally related to traditional savings and loan real estate activities (real estate brokerage not included). Section 1015.1 of the Maine Banking Code sets forth application requirements for engaging in a closely related activity. The Governor's Banking Study Advisory Committee Report, which formed the basis for the 1975 Banking Code Recodification, recommended that state statutes "paralleling the Federal Bank Holding Company Act be enacted and that statutory criteria for decision making conform to Federal criteria." Although the passage of P.L. 1987 c. 90 removed certain parallelisms with federal statute, the statement of fact accompanying L.D. 1208 states, "... allows the superintendent to determine what constitutes banking related activities..." Since the statute provides no criteria for determining what constitutes a "banking related" or "closely related" activity, the Bureau has applied the criteria of the Federal Reserve Board. These criteria were established by the courts in the National Couriers Association v. Board of Governors 516 F.2d. 1229 (1975), and are as follows:

1. Banks have generally provided the proposed service;
2. Banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed services;
3. Banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form.

#### CONCLUSION COMMERCIAL REAL ESTATE BROKERAGE

Applying these criteria, the Bureau concludes that commercial real estate brokerage could be considered a closely related banking activity. Admittedly criteria #1 and #3 are not applicable, but #2 is applicable to commercial real estate brokerage. Many of the state's savings banks and trust companies have been actively involved in commercial real estate lending for many years. The skills and knowledge required by a bank and its employees to successfully engage in commercial real estate lending are also fundamental to success in the commercial real estate brokerage field. Brokers and lenders must have expertise in finance, market conditions, zoning ordinances, property valuation

and appraisals, project viability analysis, and related tax law in order to be successful in the commercial real estate field.

Despite our conclusion that commercial real estate brokerage could legitimately be considered a closely related activity, other potentially adverse effects of the proposed rule must be considered. The opponents of the rule argued that the inherent conflicts of interest of being both a lender and broker for a particular transactions could be detrimental to all parties involved. Opponents submitted that banks may make poorer quality loans to earn sales commissions. Buyers, who traditionally view a bank's objective lending decision as protecting their interest in a transaction, may also suffer from "sales oriented" lending decisions by banks. Sellers, buyers, and financial institutions would also suffer as commercial brokers would have a tendency not to introduce clients to financial institutions competing in the brokerage business. This would reduce a buyer's financing options and could result in the seller not receiving as much value for his property. Opponents also argued that brokers could not effectively compete with banks for listings due to sellers' perceptions that a bank could more effectively market property because of its ability to also provide the financing. The fact that brokers do not feel comfortable approaching a competitor for their own financing needs would also reduce competition.

Proponents of the rule did not effectively address these issues in their written and oral testimony. No evidence was presented on the effects on competition and consumers in states which permit banks to conduct brokerage activities or in states where it is common for brokers to provide residential financing through affiliations with mortgage companies. Also, potential methods for dealing with the conflicts of interest issues were not addressed. The Bureau is particularly concerned that the mutually beneficial relationship which exists between banks and real estate brokers will be adversely altered to the detriment of the banking industry, the brokerage industry, and the general public. It is possible that brokers, approximately 80% of whom derive a portion of their income from selling commercial property, will choose not to do business with banks, including those not conducting commercial brokerage, whenever possible. Considering that banks have many non bank competitors providing residential and commercial mortgage financing in Maine and in other states, a change in the relationship between banks and brokers has the potential to be significantly detrimental to the state. Proponents also failed to demonstrate a public need for additional commercial brokerage services. There are approximately 2,800 members of the Maine Association of Realtors. Approximately 4% of these engage primarily in commercial real estate brokerage. An estimated 80% of brokers primarily engaging in residential sales occasionally sell commercial properties. MAR also believes there are significant numbers of brokers, whose sole business is commercial real estate, that do not belong to their organization. The Bureau also believes this is not an appropriate time for banks to become more heavily involved in commercial real estate activities. During 1988, the volume of non performing commercial real estate loans increased significantly in

Maine and the other New England states. For these reasons, the Bureau is not including general commercial real estate brokerage activities on the list of permissible activities at this time.

The Bureau does, however, support the concept that financial institutions and financial institution holding companies be permitted to broker any real estate it owns directly or through subsidiaries subject to the laws and regulations of the Maine Real Estate Commission. The original amendment offered by SBA and MBA was limited to properties acquired by foreclosure and those in process of foreclosure. Since Chapters 54, 64, and 74 permit trust companies, savings banks, and savings and loan associations directly invest in real estate subject to certain capital limitations, it follows that financial institutions should be permitted to broker real estate acquired for development, investment, or other purposes as well. This is consistent with 12 CFR Section 545.74(c)(3)(v) which permits federal savings and loans to broker owned property through service corporations. Many of the brokers who commented did not object to this concept as they considered it analogous to a "For Sale by Owner" situation. The Bureau, however, chooses not to extend this authority to property in process of foreclosure due to conflicts of interest between a bank and a borrower in a loan default situation.

#### COMMENTS TRAVEL AGENCY ACTIVITIES

The Bureau received seven written comments from proponents regarding the travel agency portion of the proposed rule. These proponents included the Savings Bank Association of Maine ("SBA"), the Maine Bankers Association ("MBA"), and several individual bankers. Several members of the banking industry also testified in favor of the regulation at the public hearing. The arguments of the proponents for the rule can be summarized as follows:

1. Nine other states permit banks to own and operate travel agencies;
2. One financial institution in Maine operates a "grandfathered" travel agency;
3. Consumers will obtain better quality and/or lower priced travel services as a result of increased competition;
4. Other financial intermediaries, such as American Express and Sears Roebuck are involved in providing travel services;
5. The providing of travel service is not materially different from providing quality financial service.

The Bureau received approximately 37 comments in opposition to the travel agency section of the proposed rule. These comments included a comprehensive study, *The Travel Agency Industry in Maine and Impacts of Revising Regulation #7*, by Raymond P. Neveu, Ph.D., Professor of Finance at the University of Southern Maine. Maine AAA, a large travel agency with six offices in the state, testified in opposition along with four other representatives of the travel agency

industry in Maine at the public hearing. The arguments of the opponents can be summarized as follows:

1. The activity represents a mixing of banking and commerce. Agents should not be in the position of having to obtain business financing from a competitor;
2. The proposal is anti competitive as travel agents could not compete with a bank and its resources;
3. Travel agent activities are not related to banking. The combination of knowledge and skills required is not comparable to traditional banking functions;
4. Consumers would not benefit;
5. Banks would not benefit financially from the travel agent business as it is marginally profitable.

#### STATUTORY CONSIDERATIONS TRAVEL AGENCY ACTIVITIES

The statutory considerations for travel agency activities are discussed in the commercial real estate brokerage section.

#### CONCLUSION TRAVEL AGENCY ACTIVITIES

Upon consideration of the evidence presented and the Federal Reserve Board criteria discussed previously, the Bureau is not persuaded that travel agency activities are now closely related activities. Banks have not generally provided this service in the past, less than 1% of commercial banks in the nation engaged in travel services in 1978; there is no evidence that banks provide services that are operationally so similar to the business of travel agencies as to equip them particularly well to provide this service; and, there is not a banking service that is so integrally related to travel agency services as to require a bank to provide the service in a specialized form. In those few other states which permit banks to own and operate travel agencies, all but one authorized this activity directly by statute; whereas, the Bureau must make a determination that an activity is closely related to banking within the context of rule making. Although the state is not necessarily bound by the decisions of federal regulators and federal courts, the Bureau is not persuaded that a material change in the facts have occurred since a federal court decision in the *Arnold Tours, Inc. v. Camp*, 472 F.2d. 427 (1st Cir. 1972) which overturned a Comptroller of the Currency regulation permitting national banks to provide travel services or the *Association of Bank Travel Bureaus, Inc. v. Board of Governors*, 568 F.2d. 549 (7th Cir. 1978) case in which the court upheld the Federal Reserve Board's determination that travel agency services were not closely related to banking. For these reasons, the Bureau will not add travel agency activities to the list of permissible activities at this time.

#### OTHER PROPOSED AMENDMENTS

As stated previously, the banking industry proposed an amendment that would permit a financial institution holding company or financial institution to apply to the Superintendent for prior approval to conduct unlisted activities as permitted by the Bank Holding Company Act. The Bureau rejects this amendment as it exceeds our statutory authority. Section 1014.1 states "... The Superintendent shall adopt rules specifying which activities are permissible..." At this time, there is no statutory foundation for the Superintendent determining which activities are closely related to banking on a case by case basis for individual financial institution holding companies or financial institutions.

The banking industry also proposed the following amendment to section 3.C. of the rule:

"Unless the record demonstrates otherwise, the commencement or expansion of any activity pursuant to this rule is presumed to result in benefits to the public and increase safety and soundness through increased competition."

The proponents of this amendment purport that this language is similar to 12 CFR Section 225.24 governing applications to the Federal Reserve Board and can be based upon the statutory references to the Bank Holding Company of 1956 in Title 9 B Section 1014.1. 12 CFR Section 225.24, however, states that public benefits result through increased competition from commencement or expansion of a non banking activity on a de novo basis unless the record demonstrates otherwise. Secondly, enhancements in the safety and soundness of the applicant are clearly not presumed by Section 225.24. Regardless of the language and intent of Section 225.24, the Bureau rejects the amendment as it is contrary to the requirements of the Maine Banking Code. Title 9 B M.R.S.A. Sections 446 and 1015.2 refer to the requirements of Sections 252 and 253. Section 253 establishes the criteria for decision making regarding and application and states clearly that the burden for proving public convenience and advantage and enhancements to the financial strength of a financial institution rest with the applicant.