

P-97-5



Office of Thrift Supervision
Department of the Treasury

Chief Counsel

1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6251

July 16, 1997

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Dear []:

This is in response to your letter of February 25, 1997 requesting that we concur with your view that your client, [] ("Holding Company"), a federally-chartered mutual holding company, has the authority to invest in a real estate brokerage agency.

On the basis of the facts presented in your request, we conclude that the Holding Company may invest, under section 10(o)(5)(D) of the Home Owners' Loan Act ("HOLA"),¹ in a separate subsidiary that engages in third party real estate brokerage activities.

Background

Section 10(o)(5)(D) of the HOLA permits a mutual holding company to, inter alia, engage in activities permissible for a service corporation of a Federal savings association. The range of activities available to a service corporation is broader than the range available to Federal thrifts directly. Indeed, HOLA² does not limit the possible activities of service corporations. The OTS has, by regulation, limited the scope of permissible

1. 12 U.S.C. § 1467a(o)(5)(D); see also 12 C.F.R. § 575.10(a)(6).

2. The HOLA does impose other restrictions on service corporations: a Federal thrift is limited in the amount it may invest in a service corporation; the service corporation must be organized under the laws of the state in which the Federal thrift maintains its home office; and the capital stock of the service corporation may be owned only by savings associations chartered in the state or Federal thrifts with their home offices in that state. See 12 U.S.C. § 1464(c)(4)(B).

service corporation activities to those that are "reasonably related to the activities of financial institutions."³ OTS has never specified criteria for the reasonably-related standard, but by regulation,⁴ OTS has pre-approved certain activities as meeting this standard.⁴ The agency also considers applications to approve other activities under this standard.

Over the past two decades, the OTS and its predecessor, the Federal Home Loan Bank Board ("FHLBB"), have occasionally considered whether Federal savings associations should be permitted to engage in real estate brokerage through a service corporation. Since 1980, real estate brokerage services have been pre-approved for service corporations on a limited basis. Specifically, a service corporation may provide brokerage services for properties owned by the institution itself, its service corporation,⁵ or a lower tier-entity in which the service corporation invests.

In 1982, the FHLBB proposed that full-scale third-party real estate brokerage be included in the list of pre-approved service corporation activities,⁶ but the proposal was ultimately withdrawn. In 1991, OTS allowed a service corporation to engage in real estate brokerage for properties owned by or acquired from third-party government agencies such as the Resolution Trust Corporation or the Federal Deposit Insurance Corporation ("FDIC") pursuant to management contracts.

Within the last year, OTS has amended its service corporation rule in two respects that are relevant here. First, the provision that permits a service corporation to broker property owned by it or the thrift no longer prohibits brokerage

3. 12 C.F.R. § 559.3(e)(2). This limitation has its origin in the legislative history of the original authorization in 1964 to invest in service corporations. Congress noted that it "does not contemplate that an association would be permitted to invest in ordinary profit making corporations or corporations not closely related in purpose to the savings and loan business." H.R. Rep. No. 1703, 88th Cong., 2d Sess., 1964 U.S.C.C.A.N. 3444.

4. See 12 C.F.R. § 559.4 (1997).

5. See 12 C.F.R. § 559.4(e)(4) (1997).

6. See 47 Fed. Reg. 9855 (Mar. 8, 1982).

7. See 48 Fed. Reg. 23046 (May 23, 1983).

8. See OTS Order Nos. 91-496, 91-501; Op. Chief Counsel (OTS) (Aug. 9, 1991).

services for property owned by third parties.⁹ Second, the reasonably-related standard is now tied to activities of financial institutions,¹⁰ rather than those solely of Federal savings associations.¹⁰

Discussion

The activities permissible for mutual holding companies are set forth in section 10(o)(5) of the HOLA. They include, among other things,

[i]nvesting in a corporation the capital stock of which is available for purchase by a savings association under Federal law or under the law of any State where the subsidiary savings association or associations have their home offices.¹¹

Third-party real estate brokerage is potentially available under this provision, which encompasses service corporations and certain other investments available to Federal savings associations,¹² and certain state law investments. In this case, only a service corporation provides the vehicle by which third-party real estate brokerage may be conducted.¹³

9. See 61 Fed. Reg. 29987, 66563 (June 13 & December 18, 1996). Compare 12 C.F.R. § 559.4(e)(4) (1997) with 12 C.F.R. § 545.74(c)(3)(v) (1996).

10. See 12 C.F.R. § 559.3(e)(2) (1997).

11. 12 U.S.C. § 1467a(o)(5)(D). Real estate brokerage would not be within the scope of the other activities permissible for mutual holding companies under the other provisions of section 10(o)(5) of the HOLA. See 12 U.S.C. § 1467a(o)(5)(A)-(C), E).

12. In addition to service corporations, the other capital stock investments available to Federal savings associations are operating subsidiaries, Federal home loan banks and Fannie Mae (12 U.S.C. § 1464(c)(1)(D)), Freddie Mac (12 U.S.C. § 1464(c)(1)(E)), Sallie Mae and Ginnie Mae (12 U.S.C. § 1464(c)(1)(F)), the National Housing Partnership Corporation (12 U.S.C. § 1464(c)(1)(N)), certain small businesses (12 U.S.C. § 1464(c)(1)(S)), business development credit corporations (12 U.S.C. § 1464(c)(4)(A)), small business investment companies (12 U.S.C. § 1464(c)(4)(D)), and banker's banks (12 U.S.C. § 1464(c)(4)(E)).

13. In this case, the Holding Company could proceed with the proposed investment without an opinion from OTS if [] law permitted a savings association to engage in third-party real estate brokerage. [] law, however, largely incorporates federal law on permissible service corporation activities. See []

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The issue before us, then, is whether a service corporation of a Federal savings association may engage in third-party real estate brokerage. The applicable legal standard is whether such brokerage is reasonably related to the activities of financial institutions. HOLA does not specifically restrict the possible activities of service corporations, and the OTS has not adopted specific criteria for determining whether an activity is reasonably related to the activities of financial institutions. Typically, OTS has approved an activity because it is linked to an established banking activity or a pre-approved activity.¹⁴ The closest the agency has come to a more detailed treatment of the phrase is a recent opinion permitting a service corporation to offer viatical services.¹⁵ This opinion focused on the nature and purpose of the proposed lending activity and the kind of risk presented by the activity.

In this case, we believe that both the nature of the activity itself and the type of risk it presents provide an adequate legal basis for the OTS to determine that third party real estate brokerage is "reasonably related" to the activities of financial institutions.

As to the nature of third party real estate brokerage, we believe that it complements mortgage lending in several respects. Most mortgage loans are issued in connection with the purchase of a home, a transaction that typically is brokered. Moreover, the analysis that a broker may conduct of a potential buyer's ability to support the purchase is similar to the analysis the mortgage lender will undertake. Indeed, it is common practice for the sale of a home to be conditioned on a mortgage lender's willingness to extend credit to the buyer. Thus, mortgage lending and real estate brokerage are necessarily linked.

Further, the OTS already has approved real estate brokerage services for properties owned by the Federal savings association itself, its service corporation, and by certain government agencies. In our opinion, allowing service corporations to provide real estate brokerage services to third parties conforms

14. See, e.g., Legal Opinion (Business Transactions Division, July 23, 1996) (deposit-taking and providing investment capital under certain circumstances); Legal Opinion (Corporate and Securities Division, May 31, 1994) (securities brokerage activity involving solicitation of transactions in specific securities).

15. See Legal Opinion (Business Transactions Division, May 7, 1997).

with the "reasonably related" rationale of those activities.¹⁶ We note as well that the Office of the Comptroller of the Currency ("OCC") and FDIC have permitted a national bank and a state savings association, respectively,¹⁷ to invest in subsidiaries engaged in real estate brokerage. Additionally, we understand that nineteen states would permit at least some form of state-chartered, FDIC-insured depository institution to engage in real estate brokerage either directly or through a subsidiary.

The risks presented to the thrift by third-party real estate brokerage in a service corporation do not differ significantly from the risks presented by real estate development activities conducted by service corporations on a pre-approved basis. In both cases, the principal safety and soundness concern is that the prospect of a making a sale or generating a fee may create an incentive to make an imprudent loan.¹⁸ In approving real estate

16. We are aware that the report of the Congressional Conference Committee accompanying the Garn-St Germain Depository Institutions Act of 1982 stated that the managers of the bill desired that the FHLBB limit service corporation activities to those activities permissible for a Federal savings association directly and to such other activities as the FHLBB had approved as of 1982, and that any new activities should be authorized by Congress. See H.R. Rep. No. 97-899, 90th Cong., 2d Sess. 88 (1982). On the basis of this statement, the FHLBB withdrew the then-pending third-party real estate brokerage proposal.

The 1982 Committee statement appears to conflict with the statutory language enacted in 1964, which imposes no limitations on service corporation activity. Moreover, since 1982 OTS has approved numerous new service corporation activities without objection by Congress. Indeed, in the 1983 final rule withdrawing the third-party real estate brokerage proposal, the FHLBB added a new activity -- leasing personal property -- to the list of pre-approved service corporation activities. See 48 Fed. Reg. 23046 (May 23, 1983). This addition was not in keeping with the Committee statement, but Congress made no further objection to the FHLBB action.

17. The national bank case involved the conversion to a national bank charter of a state bank with a real estate brokerage subsidiary. OCC did not require that the converting bank divest the real estate brokerage subsidiary. In the case of the state thrift, the FDIC determined that operation of a real estate brokerage posed "no significant risk" to the insurance fund, the standard of review under 12 U.S.C. § 1831e(c)(2).

18. The amount of risk posed by real estate brokerage is probably less than that presented by real estate development activities. Home mortgage loans typically are much smaller than development loans, and the amount at stake for the service corporation -- a single broker's commission -- is a modest incentive to make an

development activity, the OTS relies on sound underwriting policies and procedures and periodic reviews during examinations to prevent imprudent extensions of credit. We believe these same mechanisms are suitable for monitoring loans made on properties brokered by a service corporation of the Federal thrift, and would mitigate any potential risks.

The FDIC has identified litigation risk as the "primary" risk of real estate brokerage through a service corporation. Real estate brokers act as agents for their customers, and, the FDIC found, legal claims may arise from a broker's asserted failure to perform the duties of an agent. The thrift involved in the FDIC case satisfactorily resolved the FDIC's concern by committing to obtain general liability, blanket bond, and directors and officers liability insurance to mitigate such risks. OTS regulations reflect a similar concern: a service corporation must maintain its corporate separateness from the parent Federal thrift.¹⁹ In this instance, where the real estate brokerage will be owned by a mutual holding company (rather than by a Federal thrift), we see no reason to impose conditions comparable to the commitments made to the FDIC. In reviewing any service corporation applications from Federal thrifts, OTS will have authority to impose such conditions as it deems necessary to ensure that the brokerage operation does not affect the parent savings association adversely.

Accordingly, in our view, there is adequate legal basis to conclude that third party real estate brokerage is reasonably related to the activities of financial institutions.

Conclusion

Based on this analysis, we conclude that the Holding Company may engage, through a separate subsidiary, in third party real estate brokerage activities.

In reaching the foregoing conclusion, we have relied on the factual presentations contained in the materials presented to us. Our conclusions depend upon the accuracy and completeness of those representations. Any material change in facts and circumstances from those set forth in your submission could result in conclusions different from those expressed herein.

(Footnote 18 continued from previous page)
 unsound loan. In real estate development, the service corporation typically has an equity interest in the property securing a loan.

19. See 12 C.F.R. § 559.10 (1997).

We trust that the foregoing has been responsive to your request. Any questions regarding this matter should be directed to Eric E. Berg, Counsel (Banking & Finance), Business Transactions Division, at (202) 906-6464, or Dwight C. Smith, Deputy Chief Counsel for Business Transactions, at (202) 906-6990.

Sincerely,

/s/

Carolyn J. Buck
Chief Counsel

cc: Regional Directors
Regional Counsel