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Should Wal-Mart, Real Estate Brokers, and Banks Be in Bed Together? A Principle-Based Approach to the Issues of the Separation of Banking and Commerce*

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Related Publication 07-21

July 2007

*This paper draws heavily on White (2006b). An earlier version was presented at the Western Economic Association meetings in Seattle, June 30, 2007. The author thanks Marc Fusaro for helpful comments on that earlier draft.
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Executive Summary

The application in July 2005 by Wal-Mart to obtain a specialized bank charter from the state of Utah and to obtain federal deposit insurance re-opened a national debate concerning the separation of banking and commerce. Simultaneously, bank regulators were considering the possibility of allowing banks to enter the area of residential real estate brokerage, which is another facet of the same set of issues. Though Wal-Mart withdrew its application in March 2007, the issues and the debate continue. This paper offers a principles-based approach to these issues that begins with the recognition that banks are special and that safety-and-soundness regulation of banks is therefore warranted. Building on that recognition, the paper lays out the principle that the "examinability and supervisability" of an activity should determine if it should be undertaken by a bank or by a bank's owners. Even if an otherwise legitimate activity is not suitable for a bank, it should be allowed for a bank's owners (whether the owners are individuals or a holding company), so long as the financial transactions between the bank and its owners are closely monitored by bank regulators. The implications of this set of ideas for the Wal-Mart case, for real estate brokerage, and for banking and commerce generally are then discussed.

Should Wal-Mart, Real Estate Brokers, and Banks Be in Bed Together? A Principles-Based Approach to the Issues of the Separation of Banking and Commerce

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I. Introduction

The application by Wal-Mart in July 2005 to obtain a Utah charter and federal deposit insurance for a specialized bank (an industrial loan corporation, or ILC) raised anew, in a very public manner, the question of what kinds of enterprises should be allowed to own banks. At about the same time the banking industry was lobbying for regulatory permission to enter the field of real estate brokerage.

At first glance these may appear to be wholly separate issues. But, as will be argued below, these are closely related issues, because they raise fundamental questions of what kinds of activities banks should be allowed to undertake and what kinds of activities banks' owners should be allowed to undertake. In the financial regulatory area, these issues have come to be described as those of the intermingling of "banking and commerce", and that phraseology will be used in this paper.

Though Wal-Mart withdrew its application in March 2007, and the banks' entry into real estate brokerage appears (as of the summer of 2007) to be on regulatory hold, these banking and commerce issues nevertheless remain in public view: There are incumbent non-financial enterprises that own ILCs; prominent firms, such as Home Depot, continue to apply for ILC charters; the Congress is considering legislation that would explicitly ban such ownership; and the real estate brokers are sure to be ready to re-mount the battlements if they suspect that bank entry into real estate brokerage is again being actively considered.

Accordingly, these issues are worthy of closer examination. This paper lays out a principled policy approach that the U.S. regulatory system for banks and other depository institutions[1] should follow in considering banking and commerce issues, such as the whether non-financial companies should be allowed to own depository institutions and what kinds of activities are appropriate for banks and for banks' owners. This approach uses the concept of "examinable and supervisable" to

[1] Unless otherwise indicated, the term "banks" will broadly cover all depository institutions.

delimit the activities that should be allowable for a bank. All other activities that are otherwise legal should be permitted for the owner of a bank (including a bank holding company), so long as the activities occur outside of the bank and the direct and indirect financial relationships and transactions between the bank and its owner are closely scrutinized.

The logical implication of this approach is that any party that is otherwise qualified (e.g., is financially capable, has a sound business plan, and is of sound character) should be allowed to own a bank, so long as the bank itself is adequately capitalized and competently managed and the activities of the bank (and its relationships and transactions with its owner) adhere to the delimitations just described.

Accordingly, the ownership of ILCs by non-financial companies represents a sensible direction for public policy; indeed, banking charters generally, whether state or national, should be expanded so that non-financial companies can readily own banks, subject to the limitations that are described. If it is the Congress's judgment that the Federal Deposit Insurance Corporation (FDIC) and other bank regulators do not have the authority or capabilities to conduct the monitoring of the financial relationships between the parent/owner and the bank that is necessary, then the Congress should pass legislation that would give the regulators this authority and/or the resources to develop the capabilities – rather than preventing these potentially productive ownership arrangements.

As a related matter and following the same logic, banks or bank holding companies should be allowed to enter the business of real estate brokerage.

The rest of this paper will expand on these ideas.

II. <u>The Rationale for Safety-and-Soundness Regulation of Banks</u>

Banks are special. That concept lies at the center of why banks are subject to a special kind of government regulation: safety-and-soundness regulation.

Banks' specialness generally arises from their generic combination of assets and liabilities: relatively illiquid assets (usually loans) and highly liquid liabilities (deposits). This combination makes banks potentially vulnerable to rapid withdrawals of depositors' funds: "runs".[2] In addition,

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[2] Theoretical arguments along these lines can be found in Diamond and Dybvig (1983), Postlewaite and Vives

banks are at the center of the economy's payments system, so they have constant creditor-borrower relationships among themselves, leaving banks exposed to potential losses (and preemptive runs) at each other's hands.

Liability holders generally worry about a corporation's losses because of the legal principle of limited liability: Once a company's losses have exhausted its owners' equity (or net worth), the owners are generally no longer liable for any further losses, which will have to be absorbed by the liability holders. Though this is a general problem that extends to the creditors of all corporations (who then try to protect themselves through covenants and lending restrictions), it is a special problem for banks, for at least three reasons:

First, some bank depositors may be relatively unsophisticated, poorly informed, and in a poor position to protect themselves against the losses from a bank's insolvency; also, banks tend to be more opaque (and thus more difficult to be informed about) than are other enterprises.

Second, and related to the first, banks are especially vulnerable to runs by imperfectly informed depositors -- or even by informed depositors who fear runs by imperfectly informed depositors.

Third, and building on the first two, there may be a "contagion" effect, whereby imperfectly informed depositors of one bank, seeing a run on another bank, may fear for the solvency of their own bank (or may just fear that other depositors of their own bank will become fearful and begin to withdraw). Alternatively, since banks are frequently in the position of being a short-term lender or borrower vis-a-vis other banks, the insolvency of one bank may set off a cascade of insolvencies of other creditor banks (or may cause a contagion of runs by banks-as-creditors who have imperfect information and fear insolvency).

III. The Response: Safety-and-Soundness Regulation

Some version of these scenarios (plus, historically, the perceived position of banks as special lenders) has caused the American polity -- since the early nineteenth century -- to treat banks as special and to develop special regulatory regimes to deal with their specialness. At the center of

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(1987), and Chen (1999).

such regimes have been efforts to maintain banks' solvency, so that the value of their assets remains greater than the value of their liabilities -- to keep them "safe and sound".[3] Since 1933 federal deposit insurance has provided an additional layer of assurance (and thus an additional damper on potential runs) by protecting depositors against regulatory failure.[4]

At the heart of safety-and-soundness regulation are four key components:[5] (a) minimum capital (approximately, net worth) requirements, to keep banks solvent;[6] (b) limitations on activities, to prevent excessive risk-taking;[7] (c) management competency requirements, to prevent inadvertent insolvencies; and (d) in-the-field examiners and supervisors, to enforce the rules.

The discussion that follows will focus on activities limitations.

IV. What Activities Are Appropriate for a Bank?

As the previous section indicated, limitations on banks' activities are one of the key components of safety-and-soundness regulation, as part of the effort to limit banks' risk-taking (since the "downside" from risk-taking will usually be bank losses).

But what limitations on banks' activities make sense? The logic of safety-and-soundness regulation has an immediate implication: The only activities that are appropriate for a bank are those that are "examinable and supervisable":[8] those for which regulators are capable of assessing risks and of setting commensurate capital requirements[9] and also for which the regulators can make judgments about the competence of the bank's management of the activity.[10] This examinable-and-

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[3] Banks are also subject to a wide variety of other forms of regulation, including "economic regulation" (e.g., banks cannot offer interest on business checking accounts; in the past limitations on branching were widespread), information regulation, consumer protection regulation, etc. Limitations on their size – embodied in the branching limitations of the past and in the current legal restraint that a bank's deposits cannot (by merger) exceed 10% of the national total – have been a common derivative of American populism, a theme to which we will return below.

[4] In an important sense, with deposit insurance in place, safety-and-soundness regulation becomes the rules that protect the deposit insurer (as well as uninsured depositors and other creditors).

[5] Further discussion of safety-and-soundness regulation can be found in, for example, White (1991, 2003).

[6] Capital plays two important roles: First, it is a direct indicator of a bank's solvency -- the buffer of protection for depositors against a fall in the value of the bank's assets. Second, since capital is essentially the owners' equity, it provides a disincentive for the bank's owners to take risks.

[7] Activities mean broadly all kinds of assets, liabilities, or ongoing business operations of a bank.

[8] This concept is introduced in White (1996) and Shull and White (1998).

[9] Capital requirements should, of course, be set in a portfolio context.

[10] Of course, some bank products and services that are examinable and supervisable might nevertheless be deemed

supervisable decision ought to be a regulatory judgment, but the political appointees heading the regulatory agency should be held accountable for those judgments.

V. What Activities Are Appropriate for a Bank's Owners?

Any activity that is not appropriate for a bank (because regulators are unable to set capital requirements and/or to judge managerial competence with respect to the activity) should nevertheless be permitted for the bank's owners, *regardless of whether the owners are individuals, a corporation, or a bank holding company*.[11] However, it is crucial that all transactions between the bank and its owners (or subsidiaries of the owners, or friends and associates of the owners) must be closely monitored by regulators, because it is relatively easy for funds to be siphoned out of a bank (and thus leave the bank insolvent): The bank can pay excessive dividends to its owners; or it can undercharge for the services that it provides to its owners (e.g., it can extend loans to owners at concessional interest rates or that simply do not get repaid); or it can overpay for goods or services bought from its owners.[12]

In essence, any direct or indirect transactions between the banks and its owners and affiliates must be on arm's-length terms and monitored closely by regulators, and penalties for violations must be severe. This is the logic that sensibly underlies Sections 23A and 23B of the Federal Reserve Act.

A stylized way of portraying the appropriate locations for activities and the need for monitoring is provided in Figure 1.

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unsuitable for banks on other grounds (e.g., consumer protection); for example, certain kinds of sub-prime mortgages have recently been deemed inappropriate for banks on consumer protection grounds.

[11] The location of the (non-examinable-or-supervisable) activity -- whether it is lodged directly with the owners (or the bank holding company) or in a separate subsidiary of the owners or a subsidiary of the bank (so long as that subsidiary is separately capitalized -- i.e., the subsidiary's net worth does not count as an asset for the bank) -- is much less important than its exclusion from the bank itself. For discussions of this subsidiary location issue, see Edwards (1979) and Shull and White (1998).

[12] The risks of siphoning funds out of the bank through undercharging or overpaying also apply to transactions with associates or friends of the owners, who may in turn provide the owners with commensurate compensation or favors.

VI. Some Examples

As a practical matter, it is clear that loans and loan-like products -- commercial loans, personal loans (including credit card debt), real estate mortgages, etc. -- are highly likely to be deemed appropriate for a bank. Regulators are familiar with them and believe that they can set appropriate capital requirements and judge managerial competence with respect to loans.[13]

At the other extreme, suppose that the XYZ National Bank wants to own and operate a delicatessen. In principle, the Office of the Comptroller of the Currency (OCC) – the primary regulator of nationally chartered banks -- could probably hire restaurant consultants who could advise the OCC on how to judge XYZ's managerial competency in running a delicatessen and what an appropriate capital requirement for owning a delicatessen should be. In practice, it is more likely that the OCC would decide that this is not an area in which it has (or wants to acquire) expertise. Among other reasons, the restaurant business is just one among a myriad of categories of enterprise that banks might be interested in entering, and the OCC could not hope to acquire the expertise for all of them. Therefore, the OCC would likely conclude that running a delicatessen is not an activity that would be appropriate for a national bank.

However, there is no principled reason to prevent the owners of the XYZ National Bank -- whether as individuals, or as a bank holding company -- from owning and operating a delicatessen. But the relationships and transactions between the bank and the delicatessen need to be on arm's-length terms and would need to be tightly monitored by the OCC, to make sure that these transactions do not become a vehicle for siphoning funds out of the bank and into the pockets of the owners -- e.g., the OCC needs to make sure that the bank does not make under-priced (or hopelessly unrealistic) loans to the deli and/or that the bank does not buy over-priced pastrami sandwiches from the deli for the bank's employees' lunches.

And, of course, the same concepts should apply to the bank owners' operation of any kind of business, regardless of whether that business is a software company, an automobile dealership, an airline, a forestry company – or the world's largest retailer. And, again, these concepts should apply

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[13] However, Litan's (1987) arguments to the contrary led him to advocate a "narrow bank" structure, in which a bank would hold only short-term, highly safe and highly liquid assets, such as U.S. Treasury bills.

to all categories of owners, *regardless of whether they are individuals or a holding company*.

It is worth noting that there has been an extensive history of non-financial firms' owning savings and loan institutions, through a unitary thrift holding company arrangement, with few problems arising as a consequence.[14]

VII. <u>Where – and Why -- Did U.S. Policy Go Wrong?</u>

U.S. banking policy, from its origins in the late eighteenth and early nineteenth centuries, have recognized that banks are special and that the activities of banks needed to be restricted to "traditional" activities such as making loans, issuing bank notes, and taking in deposits.[15] In an important sense, this was an implicit expression of some form of the "examinability and supervisability" criterion. Further, the activities of banks' owners – whether individuals or enterprises (the latter as a holding company) – were largely unrestricted.

The first important restrictions of banking activities and especially holding company activities came in the Glass-Steagall Act of 1933 (which constituted Sections 16, 20, 21, and 32 of the Banking Act of 1933), which severely restricted commercial banks and their owners and affiliates from engaging in investment banking activities.[16]

Next, the Bank Holding Company Act (BHCA) of 1956 restricted BHCs that controlled two or more separately chartered banks. The BHCA was motivated by the Congress's desire to prevent both the spread of interstate operations by BHCs that controlled multiple banks and the expansion of BHCs and their non-bank affiliates into non-banking activities. With respect to the latter, BHCs were restricted to activities "of a financial, fiduciary, or insurance nature" that were "so closely related to the business of banking or managing or controlling banks as to be a proper incident thereto". In essence, the BHCA eliminated the ability of multi-bank holding companies from engaging in "commerce", with the prohibited area also encompassing the insurance business.

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[14] See, for example, White (1991).

[15] This discussion draws heavily on Shull (1983, 1994), White (1993, 1995), and Shull and White (1998). See also Symons (1983), Halpert (1988), Blair (1994), and Haubrich and Santos (2003).

[16] An interesting indicator of the extent of the Congress's concern about this issue was the absence of any "grandfathering" provision that would have allowed banks with incumbent investment banking activities to retain those operations.

Left unaddressed were the activities of a holding company that owned only a single bank. This "loophole" was closed in the BHCA Amendments of 1970, which applied the 1956 Act's restrictions to the one-bank BHC and also added anti-tying restrictions.[17] It is important to note that the BHCA restrictions as to activities of the owner applied only to BHCs and not to individual owners of banks, who remained unrestricted in the activities that they (or enterprises that they might own) could undertake.

Another loophole developed when sharp-eyed lawyers realized that the 1970 BHCA Amendments had defined a bank to be an institution that *both* made commercial loans *and* offered demand deposits. By the 1980s a number of non-financial firms had acquired "non-bank banks" that either made commercial loans or offered demand deposits, but not both. This loophole was closed in the Competitive Equality Banking Act (CEBA) of 1987.

The Gramm-Leach-Bliley Act (GLBA) of 1999 erased the Glass-Steagall prohibitions and allowed BHCs to underwrite insurance; but the prohibitions on banks' and BHCs' engaging in "commerce" remained intact.

These restrictions have been largely a continuing expression of the American polity's fear of large financial institutions and the economic and political power that is thought to flow from size. These forces of populism were also influential in restricting intra-state branching in many states and in restricting interstate branching through the early 1990s; both sets of restrictions, of course, meant that banks could not grow in size by establishing geographically dispersed branch networks.

Although the restrictions on banks' and BHCs' engaging in "commerce" may be understandable in light of this history of American populism, it nevertheless leaves the banking system in the anomalous -- and likely inefficient -- position where it is alright for the local car dealer to own a bank but not alright for AutoNation, Inc. (a large corporate operator of multiple car dealerships) to own a bank. This personal/corporate distinction in the activities that a bank's owners can undertake makes little economic sense.

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[17] It is worth noting that the Savings & Loan Holding Company Act of 1967 applied the BHCA-type restrictions to S&L holding companies that owned two or more chartered S&Ls but left the "unitary" thrift (S&L) holding company relatively unrestricted. Though this "loophole" was closed in 1970 for banks, it was not closed for S&Ls until the Gramm-Leach-Bliley Act of 1999.

VIII. The Implications of the Principles-Based Approach

The implications of the approach that has been outlined above are clear: Any party that is otherwise qualified (e.g., is financially capable, has a sound business plan, and is of good character) should be allowed to own a bank, so long as the bank is adequately capitalized and competently managed, the activities of the bank are restricted to those that are examinable and supervisable, and the relationships and transactions between the bank and the owner are closely monitored by bank regulators.

Consequently, with respect to ILCs, so long as the state that has chartered an ILC and the FDIC (which has regulatory responsibility, since an ILC's deposits are required to be federally insured) can do a good job of monitoring the financial relationships between the parent and the ILC, along the lines described above, ILCs represent a sensible direction for public policy. Indeed, bank charters generally should be expanded so as to allow non-financial companies to own banks, subject to the restrictions described above.

If it is the Congress's judgment that the FDIC and other bank regulators do not have adequate authority or sufficient capabilities to monitor banks (including ILCs) and their owner/parents in the way described above, then enacting legislation to provide the regulators with the necessary authority and/or the resources to develop the needed capabilities is the best response – rather than to prevent these potentially productive ownership arrangements.

IX. The Wal-Mart Application and "Unfair Competition"

The event that drew extensive public attention to the banking and commerce issue and the existence of ILC charters was Wal-Mart's July 2005 application to obtain a Utah ILC charter and FDIC deposit insurance for its ILC. Because that application, although withdrawn in March 2007, remains the "900 pound gorilla in the room", it is worth addressing the Wal-Mart issues directly.

The Wal-Mart application drew a great deal of attention because of Wal-Mart's success and expansion in general retailing. The opposition to and fears of Wal-Mart's application did not primarily concern the issues of safety and soundness that have been addressed above. Instead, rival

bankers expressed fears that a Wal-Mart Bank would expand at their expense, perhaps with the financial help of the parent; rival retailers feared that a successful Wal-Mart Bank would supplant rival banks and reduce the retailers' supply of credit and thereby disadvantage the retailers.[18] However, neither set of fears would likely translate into a realistic scenario.

First, Wal-Mart had stated that it planned to use its bank exclusively as a way of reducing its "back office" financial transactions costs. This use surely could not have generated any of the feared scenarios.

But let us suppose that Wal-Mart's rivals' worst-case scenario in terms of Wal-Mart's subsequent bank expansions were to prove correct: that Wal-Mart would have expanded its banking operations so as to attract retail customers -- say, through opening retail branches in its stores and even opening free standing-branches. What then?

If this were a convenient and efficient arrangement for Wal-Mart and for some shoppers, then the latter would become bank customers. Rival banks would lose some customers. Some rivals would likely be unable to compete effectively and would seek merger partners; others would devise new strategies to attract and retain customers.

Would a successful Wal-Mart Bank sweep the countryside clean of all rivals, and would Wal-Mart's retailing rivals thereby be deprived of finance and consequently be at a disadvantage? This seems highly unlikely. The executives of small banks had a history of claiming dire consequences every time a state legislature contemplated allowing expanded intra-state branching privileges during the 1960s, 1970s, and 1980s, and again as the Congress contemplated permitting nationwide branching in the 1980s and 1990s. And, yet, despite today's near ubiquitous nationwide branching possibilities and over two decades of active mergers and banking consolidation, there are still (as of year-end 2006) 7,402 commercial banks chartered in the U.S., as well as 1,279 savings institutions and over 8,300 credit unions. Further, despite the substantial banking consolidation, thousands of new (de novo) banks have been formed over the past few decades, as enterprising

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[18] In addition, labor union leaders and those sympathetic to them expressed their opposition to Wal-Mart's wage and benefits policies and thus their opposition to Wal-Mart's expansion in any realm; these issues will not be addressed in this paper.

bankers have seen and embraced new business opportunities, often in the wake of mergers.[19] Existing banks have extended their branch networks as well. A similar pattern could be expected if an expanded Wal-Mart bank were to leave the financial needs of groups of customers unfulfilled.

America's bankers may not like the competition; but they are creative and resourceful, and most would survive.

Might the parent Wal-Mart have subsidized the bank so as to allow the bank to behave in a predatory manner and eliminate financial rivals? First, note that the parent's subsidizing the bank would be the exact opposite of the usual scenario -- that the parent might try to drain funds *out of the bank* -- that should worry bank regulators. Second, for predatory behavior to be ultimately successful and profitable, the initial "investment" period of subsidized behavior must be followed by a "recoupment" period when monopoly profits can be achieved.[20] But if bank charters remain readily available for de novo entrants and branch extensions remain easy to achieve for incumbents, such recoupment is unlikely, which should discourage any initial attempts at predatory behavior. And third, the U.S. antitrust laws remain as a policy tool for dealing with predatory behavior.

Might Wal-Mart have "leaned" on its suppliers to use the Wal-Mart Bank as a condition for being allowed to sell their goods in Wal-Mart stores? If the Wal-Mart Bank's terms were otherwise not as favorable for the supplier as the latter's original bank, then Wal-Mart would have to give up something else -- perhaps Wal-Mart would have to accept a higher wholesale price when buying the supplier's goods. And, as a consequence of such "leaning", Wal-Mart's retailing rivals would be that much more attractive to the suppliers as outlets for their goods. Also, such conditioning would bring Wal-Mart under antitrust scrutiny for "tying".

Much of this discussion, and the fears expressed, has the same flavor as those expressed by the securities industry in the 1970s, 1980s, and 1990s, as it opposed the gradual breaking down of the Glass-Steagall barriers that had separated the commercial banking industry from the securities

[19] See, for example, Berger et al. (2004).

[20] It is worth noting that in the discussion of whether Wal-Mart acts in a "predatory" fashion toward its retailing rivals, there have never been any claims that Wal-Mart has raised its prices subsequent to some initial low-price period.

industry since the 1930s.[21] Those fears -- that banks would somehow behave in a predatory fashion toward the securities industry, that banks would somehow decimate and dominate the securities industry, and/or that entrance into the securities industry would somehow weaken the safety and soundness of banks -- all proved to be unfounded. The same would likely be true of the scenarios advanced by Wal-Mart's foes.

In sum, the "doomsday" scenarios of Wal-Mart's rivals were (and continue to be) far-fetched and unrealistic. Such scenarios ought not to be guiding bank regulatory policy.

X. What about Real Estate Brokerage?

Banks have periodically expressed a desire to extend their activities into residential real estate brokerage. Since most banks are already heavily involved in residential real estate lending, an expansion into the complementary activity of real estate brokerage appears to many to be a good fit.

Not surprisingly, the real estate brokerage firms themselves (as expressed through their trade organization, the National Association of Realtors [NAR]) have opposed such expansion by banks. And, when the Wal-Mart ILC and deposit insurance applications were being considered, the NAR expressed its strong opposition to the Wal-Mart application.[22] The NAR argued that the issue of non-financial companies' being granted a banking charter and the issue of banks' being allowed to enter the real estate brokerage business were intertwined.

The NAR is, of course, correct as a general matter. Both issues raise the general points that are discussed above. And both should be addressed in the same way: Non-financial companies should be granted bank charters, subject to the conditions just described; and, as a matter of policy, banks -- or at least bank holding companies -- should be allowed to enter the real estate brokerage business (with the distinction between whether banks directly or only bank holding companies are permitted to undertake real estate brokerage hinging on whether real estate brokerage activities are considered examinable and supervisable by bank regulators).

The issue of banks' entry into residential real estate brokerage is noteworthy because of

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[21] See, for example, the discussion in Goldberg and White (1979) and Walter (1985).

[22] See, for example, NAR (2006) and Stevens (2006).

continuing policy concerns that competition in real estate brokerage is less than fully vigorous and that entry by banks could be especially beneficial.[23] The special benefits from bank entry could arise because banks would be "outsiders" and more likely to be "mavericks" in the culture of real estate brokerage and because banks might well decide that an entry strategy that focused on being distinctive "discount brokers" would be worthwhile. This latter possibility is suggested by the history of bank entry into securities brokerage, where banks largely focused on "discount brokerage" as their way of being distinctive. Also, since banks are already heavily involved in residential mortgage lending, they may be able to offer packages or bundles of services that could, again, mean a reduction in the effective price that would be charged for the real estate brokerage part of the package.

XI. Conclusion

This paper has offered a principles-based policy approach to the issues of banking and commerce: what activities should be permitted for a bank, what activities should be permitted outside of a bank, who should be allowed to own a bank, and how the relationships and transactions between a bank and its owner should be structured and monitored.

This approach has a clear implication for banking policy: So long as ILCs are adequately examined and supervised, they represent a sensible direction for public policy. Indeed, bank charters generally should be expanded so as to allow non-financial companies to own depository institutions, subject to the conditions described above. Following a similar logic (and depending on regulators' judgments as to examinability and supervisability), banks or bank holding companies should be allowed to enter real estate brokerage; and, indeed, they should be permitted to enter the complete range of legitimate commercial activities (again, subject to the conditions described above). And if the Congress judges that bank regulatory authority or capabilities are not adequate for the job of monitoring these wider sets of possibilities for banks, then the Congress should enact legislation that would strengthen that authority and/or those capabilities – rather than restricting potentially productive ownership arrangements.

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[23] See, for example, Hahn et al. (2005, 2006) and White (2006a).

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Figure 1: Stylized Structure of Locations of Appropriate Activities for a Bank and of Other Activities