MAYER•BROWN

Mayer Brown LLP
1999 K Street, N.W.
Washington, D.C. 20006-1101

Main Tel +1 202 263 3000
Main Fax +1 202 263 3300
www.mayerbrown.com

Costas A. Avrakotos
Direct Tel +1 202 263 3219
Direct Fax +1 202 263 5317
cavrakotos@mayerbrown.com

February 1, 2017

Scott Corscadden
Ombudsman, NMLS
c/o Conference Of State Bank Supervisors

Re: Disclosure of Affiliates

Dear Mr. Corscadden:

We have raised different issues related to the MU1 affiliates/subsidiaries reporting obligation in the past. As we do not see that the issues we raised have been addressed or sufficiently vetted, and as a number of our clients have never stopped raising questions as to why they must disclose commonly owned affiliates in the Nationwide Multistate Licensing System ("NMLS"), we thought it would be beneficial to bring this to the attention of the Ombudsman, the SRR and the Working Group, and all in attendance at the Conference. Moreover, with the NMLS being in effect for over eight years, we also thought it would be appropriate to again raise this issue, as state agencies may have a better sense of whether there is a need to continue with this disclosure obligation when NMLS 2.0 is developed.

For reference purposes, and for those NMLS Account Administrators for companies or businesses new to the NMLS, the MU1 Affiliates/Subsidiaries section directs an applicant or license to identify its affiliates and subsidiaries and provide some basic information about its affiliates or subsidiaries. The NMLS Guidebook provides that: "Applicants and licensees must identify each entity under common ownership (affiliate) and each entity under control (subsidiary) that provides financial services or settlement services." (For purpose of this letter, this "affiliates under common ownership disclosure" will be referred to as the Affiliates Disclosure.)

From our perspective, the MU1 obligation to identify all commonly owned affiliates of an applicant or licensee is unnecessary. Below, we discuss some of the questions that have been raised, and the concerns we see, as to the necessity of the Affiliates Disclosure

1) **Why was this Disclosure Included as Part of the MU1?**

Prior to the advent of the NMLS, very few states required an entity to identify all of its commonly owned affiliates. We do not believe many, if any, state mortgage finance licensing statutes imposed this requirement before 2008, We do not believe SRR, the CSBS Administrators of the NMLS, or state regulatory agencies ever identified the genesis of this requirement, or the information that was expected to be gleaned from the Affiliate Disclosure. We always assumed that for this disclosure obligation, some purpose was identified, or one or

Mayer Brown LLP operates in combination with other Mayer Brown entities (the "Mayer Brown Practices"), which have offices in North America, Europe and Asia and are associated with Tauil & Chequer Advogados, a Brazilian law partnership.

more states required this information, and thereby it became embedded in the NMLS. It would be good to know if that was the case, and even more worthwhile to know if the Affiliates Disclosure has achieved its intended results.

2) **This NMLS Affiliate Disclosure Obligation is Badly and Ambiguously Worded.**

The NMLS Policy Guidebook provides that "[a]pplicants and licensees must identify each and every entity under common ownership (affiliate) and each entity under control (subsidiary) that provides financial services or settlement services." The NMLS Policy Guidebook further states that for the section on identifying the "Control Relationship—identify whether the entity is under common ownership (affiliate) or under control (subsidiary) of the applicant or licensee." Therefore, an affiliate is based on a determination of ownership, but a subsidiary is based on control. Why the distinction? No numerical percentage of ownership or control is identified for purposes of determining the affiliates under common ownership.

The Guidebook does not provide any guidance, but raises more questions. Affiliate is a defined term in the Glossary section of the Guidebook, and it means "an organization that is under common control with the applicant." The term subsidiary is not defined. Questions have been raised as to why affiliate is defined by ownership in one part of the Guidebook, but by control in another part of the Guidebook? Should licensees take this to mean that the term affiliate for purposes of the Affiliates Disclosure is now based on control and not ownership, or are two different definitions of affiliate intentionally being used: one for the MU 1 question to report affiliates under common ownership, and a separate definition for all other situations where affiliate is used. Here, as above, no numerical percentage is used to determine an affiliate by ownership or control. Licensees are again left wondering as to the percentage of common ownership, or perhaps control, that must exist for an applicant or licensee to be considered an affiliate of another entity?

The Guidebook provides little clarity as to the percentage of ownership that determines an affiliate. Ownership is not defined in the Guidebook, but, of course, the term control is defined. If we use the definition of control, as found in the Guidebook, which has seeped into many state licensing laws, a 10% test serves as the numerical basis by which to determine control, and therefore, an affiliate. Questions have been raised as to whether this definition of control should be the test for determining an affiliate. In other sections of the Guidebook, when the Guidebook's definition of control is intended to be used, the Guidebook specifically provides such direction (as in control person) or the term control is italicized (as in the definition of control affiliate). For purposes of the Glossary's definition of affiliate, control is not so designated. Therefore, as the definition of affiliate does not specifically require the applicant or licensee to rely on the definition of control in the Guidebook, it seems reasonable to conclude that for purposes of defining "common control" in the Glossary's definition of affiliate, a 10% or more test should not be used.

For purposes of federal banking law, and many state banking or licensing laws, the definition of affiliate is based on a 25% or more test. The NMLS is not intended to replace the underlying state laws, so it is not unreasonable to use a 25% or more test to determine affiliate where the state's banking code use a 25% or more test Moreover, when adding the indirect owners to a licensee's MU1 Account Record, a 25% or more test is used to determine an indirect owner. Therefore, using a 25% or more test to determine an affiliate is perfectly compatible with the NMLS. Given the ambiguity of the requirement and the terms used, we would not be surprised if licensees were using different test to determine an affiliate. Some licensees may be defining an affiliate on the basis of ownership, and others on the basis of control. Some licensees may use a 25% or more test, while other may use a 10% or more test.

3) **Much of the Information Provided by Affiliates Under Common Ownership is Provided Elsewhere**.

For purposes of identifying the indirect owners of a licensee, the 25% or more owners at each level of ownership are identified. Therefore, repeating those entities as affiliates under common ownership is unnecessary. Because the test for indirect owners is based on a 25% or more ownership test, it should be used whenever discussing affiliates. Moreover, if an affiliate of an applicant or licensee in the chain of ownership (*e.g.* a control affiliate) or any subsidiary of an applicant or licensee, has been convicted of a crime, violated a financial services-related statute or regulation, or been the subject of certain civil suits, the entity and the matter would need to be identified in the NMLS. Therefore, the most significant concerns associated with an affiliate closest to the licensee would be revealed in other NMLS-related disclosures.

4) **Only Limited Information is Required of the Commonly Owned Affiliates**

If an affiliate has no record in the NMLS, then only the name, the address, the relationship to the applicant or licensee, and business line must be disclosed. Very little is learned of the affiliates of an applicant or a licensee given this question. Of what significance is such limited information of an affiliate of a licensee for purpose of determining whether to issue a license to an applicant or renew a license for a licensee? State regulators do not pass judgment on the parties with whom the applicant or licensee is affiliated. Perhaps it has happened, but in all of the years in which we have been doing licensing work, we have never heard of an applicant for a license being denied a license because a commonly owned company, not in the chain of ownership, had sanctions against it. Yes, we have heard of an applicant being denied a license because the parent company of the applicant had a long list of mortgage finance litigation or regulatory sanctions, but such information regarding a direct or indirect owner of a licensee would be revealed independent of disclosing commonly owned affiliates. So, again we ask, what purpose is served by requiring an applicant or licensee to report all commonly owned (or perhaps controlled) affiliates?

5) Keeping this information Up-to-date is Unnecessary and Takes Time Away From Fulfilling Other State or NMLS Requirements.

Each time a commonly owned affiliate in the business of providing financial or settlement services is created, purchased or sold, or each time the address, name, or relationship of the affiliated entity changes, the Account Administrator or a Control Person must make the appropriate filings in the NMLS, and make the attestation in the NMLS. This leads to unnecessary attestations to attest to insignificant changes for NMLS purposes. To what extent do state regulators review this information? Are such updates even reviewed? If so, what is the basis by which a deficiency would be posted in connection with an update of this affiliate information?

6) Information on Commonly Owned Affiliates is not Readily Known or Available to an Applicant or Licensee

For smaller companies, reporting and keeping track of commonly owned affiliates may not be a burdensome task. However, for larger companies, which may be a one of scores, if not of hundreds, of companies in a global network of affiliated companies under the common ownership of a multinational company, identifying, tracking, and reporting on changes on such commonly owned affiliates for purpose of establishing an applicant's Account Record, or keeping the licensee's Account Record up-to-date, is not easily achieved. A licensee in the United States may not know of affiliates engaged in financial services or settlement services activities in other parts of the world, let alone know of any reportable changes in the affiliates.

7) An Advance Change Notice Filing Must be Made in the NMLS to Add or Drop an Affiliate

We always have questioned why an Advance Change Notice filing must be made to add or drop an affiliate from the MU1. Some states require the Advance Change Notice to be filed 15 to 60 days in advance of adding or dropping an affiliate. Is there any state mortgage financing statute that ever required a licensee to provide advance notice when a parent holding company adds or extinguishes a subsidiary, which would be an affiliate of a licensee. We doubt the parent company will determine its timing based on the licensee needing to provide advance notice to state regulators of this change. Has any regulator ever sanctioned a licensee because an affiliate was added by the parent company without notice being provided by the licensee to its state regulators?

8) Requiring Licensees to Report on Affiliates Unintentionally Leads to False Attestations

Every time a filing is made in the NMLS, the Account Administrator or a Control Person must make a certain attestation, that "to the extent any information previously submitted was not amended, such information remains accurate and complete," in addition to the other

certifications to which the person must attest. Even if no changes are known to have been made to the affiliates of a licensee under common ownership, the attestation attests that the affiliates have not changed. For some licensees, there may be no time, opportunity or pathway to investigate if affiliates engaged in financial or settlement services were changed. To have the known and reportable changes in the NMLS take effect, such as changes in the ownership, control persons, or disclosure answers, an attestation must be made which affects the Affiliates Disclosure. There may be no design, desire or decision to make an attestation that could be inaccurate, but for the business to continue to operate without interruption when changed information is reported in the NMLS, the attestation must be made. It should not be a surprise that this could unintentionally result in the making of a false attestation.

9) **What Purpose is there for this Question?**

We fail to see what purpose is served by the Affiliates Disclosure, or what value it provides to state regulators in determining whether a license should be issued or renewed. As indicated in my introduction, the NMLS has been in effect for over eight years, and by now, the state agencies should have a better sense of the need to continue with the Affiliates Disclosure, and the purpose it serves. If there is value in determining whether to license an entity by obtaining this information that outweighs the trouble of providing it and keeping it current, then please let us know. If there is little value or this information is rarely considered when licensing a company, then this affiliate question should be discontinued, or modified to obtain the significant information and minimize the burden of continuing to answer the question.

10) **If this "Affiliates Under Common Ownership Disclosure" Must be Kept, Then Limit its Reach**

When the NMLS was first introduced to the world, applicants and licensees only had to identify each affiliate or subsidiary that provided settlement services. Soon thereafter, the Affiliates Disclosure was broadened to reach affiliates providing financial services well as settlement services. If the Affiliates Disclosure must be retained, then limit the question to (i) a set number of affiliates under common ownership, (ii) affiliates licensed or chartered under state or federal law, (iii) affiliates conducting financial or settlement services in the United States, or (iv) affiliates wholly owned by the company that owns the licensee.

* * *

The good folks in the New Hampshire Department of Banking issue a memorandum on January 31st that speaks to our suggestion related to the Affiliates Disclosure. In the January 31st Memorandum, Governor Sununu requested that all agencies "review each and every regulation under the Agency's jurisdiction." The Governor's Memorandum identified five tests against which all New Hampshire regulations are to be evaluated, including that (i) there is a clear need

for the regulation, (ii) its costs do not exceed its benefits, and (ii) the "regulation is the least restrictive or intrusive alternative that will fulfill the need which the regulation addresses." Each test is noteworthy and merits consideration. We recommend that it be read by all in attendance and the it serve as the benchmark against which to develop a new and improved NMLS 2.0.

Sincerely,

Costas A. Avrakotos