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OVERVIEW

Franklin American Mortgage Company (FAMC) complies with all requirements set forth by the Financial Crime Enforcement Network's (FinCEN) 31 CFR Chapter X (formerly 31 CFR Part 103), which restructured and reorganized provisions of the USA Patriot Act, Office of Foreign Assets Control (OFAC) 12 CFR 500, and the Bank Secrecy Act (BSA) 31 CFR Part 103. FAMC requires all non-depository lenders to have an established AML program.

OBJECTIVE

The objective of the AML Program is as follows:

- Define a comprehensive internal control and monitoring system for compliance with AML laws and regulations, specifically USC 31 Chapter 53 - Subchapter II and its implementing regulation 31 CFR Chapter X.
- Clearly establish roles and responsibilities for meeting the obligations described in the OCC Regulation, 12 CFR 21.21 – Procedures for monitoring Bank Secrecy Act (BSA) compliance.

The AML Program should also incorporate elements and the intent of the following laws or regulations:

The Bank Secrecy Act (BSA)

The Bank Secrecy Act (BSA), formerly known as the Financial Recordkeeping and Reporting of Currency and Foreign Transactions (31 CFR B Chapter 1, Part 103), specifically requires financial institutions to keep records of cash purchases of negotiable instruments, file reports of cash transactions exceeding $10,000 (daily aggregate amount), and to report suspicious activity that might signify money laundering, mortgage fraud, tax evasion, or other criminal activities. The BSA is sometimes referred to as an "anti-money laundering" law ("AML") or jointly as "BSA/AML."

USA Patriot Act

The purpose is to deter and punish terrorist acts in the United States and around the world to enhance law enforcement investigatory tools, some of which include:

- To strengthen U.S. measures to prevent, detect, and prosecute international money laundering and financing of terrorism;

- To subject to special scrutiny foreign jurisdictions, foreign financial institutions, and classes of international transactions or types of accounts that are susceptible to criminal abuse;

- To require all appropriate elements of the financial services industry to report potential money laundering; and

- To strengthen measures to prevent use of the U.S. financial system for personal gain by corrupt foreign officials and facilitate repatriation of stolen assets to the citizens of countries to whom such assets belong.

The USA Patriot Act requires that financial institutions "know their customers", and implemented guidelines for:

- Obtaining identifying information regarding persons or entities establishing loan or deposit accounts at the institution, and

- Employing methods for verifying the identity and the acceptable documentation for verification.

The Act also expanded the immunity from liability (Safe Harbor) for reporting suspicious activities (SARS) and expanded the prohibition against notification to individuals of SAR filings. The knowledge of the filing of a SAR may not be shared with anyone except to fulfill the official duties of such officer or employee.

Office of Foreign Assets Control (OFAC)

The Office of Foreign Assets Control (OFAC) of the US Department of the Treasury administers and enforces economic and trade sanctions based on US foreign policy and national security goals against targeted foreign countries and regimes, terrorists, international narcotics traffickers, those engaged in activities related to the proliferation of weapons of mass destruction, and other threats to the national security, foreign policy, or economy of the United States. OFAC acts under Presidential national emergency powers as well as authority granted by specific legislation to:

- Impose controls on transactions, and

- Freeze assets under US jurisdiction.

ANTI-MONEY LAUNDERING:

Money laundering is generally defined as engaging in acts designed to conceal or disguise the true origin of criminally derived proceeds so that the unlawful proceeds appear to have derived from legitimate origins or constitute legitimate assets. Generally, money laundering occurs in three stages:

- **Placement:** Cash generated from criminal activities is converted into monetary instruments, such as money orders or traveler's checks, or deposited into accounts at financial institutions.

- **Layering:** Funds are transferred or moved into other accounts or other financial institutions to further separate the money from its criminal origin.

- **Integration:** Funds are reintroduced into the economy and used to purchase legitimate assets or to fund other criminal activities or legitimate businesses.

SUSPICIOUS ACTIVITY:

Suspicious activity is identified as any activity, statement or document that is misleading and/or provides false information in an effort to secure funds for a home mortgage loan transaction. The lender should report all suspicious activity where it aggregates funds or other assets of at least $5,000. Such examples of this activity include, but are not limited to, the following:

- Funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity, including, without limitation, the ownership, nature, source, location, or control of such funds or assets, as part of a plan to violate or evade any Federal law or regulation.

- Mortgage loans structured and designed to evade requirements under this regulation.

- Transaction has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage in business; and upon further examining the transaction, learning that there is no reasonable explanation for said transaction.

- Involves use of the mortgage company to facilitate criminal activity.

MORTGAGE FRAUD

Fraud is a false representation of a matter of fact, whether by words or conduct, by false or misleading allegations, or by concealment of what should have been disclosed, that deceives and is intended to deceive another so that the individual will act upon it to his or her legal injury. Mortgage fraud occurs when the misrepresentation of fraud involves an attempt to obtain a mortgage loan by false representation of matters of fact. Mortgage fraud (fraud) is often motivated by greed, desperation, desire for housing, commissions or other payment of money or loyalty. Many times several factors are at work in a single fraud attempt (scheme). The borrower may be motivated by desire for housing while the seller is motivated by profit, the real estate agent or broker is motivated by commission and the escrow or closing agent may act as a facilitator to one or more parties to a loan transaction for personal or monetary gain. Two of the most common motivations are fraud for property and fraud for profit.

Fraud for Property

Fraud for property occurs when the borrower or other interested party or parties misrepresents or omits information with the intent to deceive or mislead a lender into extending credit for which the borrower would not otherwise qualify, or to obtain more favorable terms. This type of fraud, while illegal, may pose a lower financial risk to the lender because the fraud may be a one-time occurrence and the buyer intends to repay the loan.

Fraud for Profit

Fraud for profit occurs when the borrower of other interested party or parties abuse the system for financial gain. Fraud for profit schemes often involve a group of people who defraud a prospective homebuyer or mortgage lender and the schemes often involve fictitious properties, straw buyers or borrowers, and inflated property values. This type of fraud poses a higher financial risk because the participants often do not intend to repay the loan, the property has been intentionally and substantially overvalued, or the lender's collateral interest in the mortgaged or to be mortgaged property has been impaired.

DETECTING MISREPRESENTATIONS AND OTHER FRAUD SCHEMES

Identifying fraud requires awareness of common fraud schemes, attentive review of individual transactions, and observation of trends. Recognizing common elements and red flags helps to identify and prevent fraud. As with any type of fraud, one of the best defenses is common sense. As new schemes emerge and fraud methods change, so may the red flags that draw attention to these new schemes and methods.

Three commonly seen categories of mortgage fraud:

- **Origination fraud:** Fraud associated with securing the approval of a new loan to purchase or refinance a property that is often perpetrated with misrepresentations in the loan application, purchase agreement, or appraisal.

- **Settlement fraud:** Fraud facilitated by a settlement agent regarding the status of title, chain of title, terms of closing, chronology of transactions, disbursement of loan proceeds, or misappropriation of funds.

- **Servicing fraud:** Fraud that occurs after origination and involves misrepresentation of qualifications for modifications, concealment of a higher offer for a short sale or REO, or falsifying closing documents to misrepresent a sales price or payouts.

Most fraud detections tools, training, and media coverage focus on origination fraud. It is important to understand all types of mortgage fraud because multiple schemes can be present in the same incident. For example, a single scheme may include short sale fraud (deflated value & flip), settlement fraud (terms of closing), an inflated property value (new loan) and a straw buyer.

Some common fraud schemes include:

- **Affinity Groups:** Persons belonging to a commonality are exploited to the benefit of one or more members or someone posing as a member of the group.

- **Air Loans:** An air loan involves a loan with misrepresented collateral or fictitious properties and/or borrowers.

- **Builder Bailout:** With a builder bailout, sales prices are inflated to maximize. The mortgage amount and is offset with hidden incentives to the buyer. This scheme may also involve straw buyers to seemingly validate sales prices.

- **Buy and Bail (Strategic Default):** This occurs when a borrower, contemplating default on his present home because values have drastically fallen, purchases a home priced in line with the current lower market. Then after closing on the new home, allows the first home to go into foreclosure.

- **Chunking:** Chunking occurs when multiple loan applications to purchase multiple properties are submitted to multiple lenders within a compressed period without disclosing the intent to purchase the other properties and take on additional debt.

- **Churning:** This is excessive lending activity for the purpose of generating fees and commissions.

- **Document Misrepresentation:** This includes fabricated or altered employment, income and asset documentation.

- **Double Escrows:** Double escrows occur when two sales of the same property close back to back with a higher sales prices on the second sales contract. May involve a straw buyer.

- **Equity Theft:** This involves the forging of a deed transfer or a lien satisfaction in an attempt to obtain a cash-out refinance or sale to a straw buyer of a property that is owned free and clear by an unsuspecting property owner.

- **Flipping:** Flipping occurs when a property is purchased and quickly resold for a significant profit involving a misrepresentation, frequently property value.

- **Identity Fraud:** Identity fraud involves materially misrepresenting a borrower's identifying information including: name/SSN mismatches, created identities, and fabricated or altered identity or eligibility documents.

- **Inflated Appraisals:** An inflated appraisal may contain fabricated or altered values and supporting information, or may contain the use of inappropriate comparables or adjustments.

- **Money Laundering:** Money laundering is the process of "washing" away the paper trail of illegally obtained funds. Criminals often purchase real estate as a way to launder the proceeds from illegal activities. It usually involves large principal curtailments (greater than required monthly payments).

- **Occupancy Misrepresentation:** Occupancy misrepresentation is an attempt to acquire a rental property or a second home on more favorable financing terms available only for owner-occupied primary residences. It may also include an attempt to take advantage of loan programs restricted to primary residences.

- **Settlement Agent Misconduct:** This involves duties not performed as required, misrepresentation of title, misrepresentation of the transaction (purchase transaction closed as a refinance), or financial misconduct or misappropriation of funds connected with the closing.

SHARING AML INFORMATION WITH FEDERAL ENFORCEMENT AGENCIES AND OTHER FINANCIAL INSTITUTIONS

A SAR, and any information that would reveal the existence of a SAR, is confidential and shall not be disclosed except as authorized in the lender's program.

No officer, employee or agent of the lender, should disclose a SAR, or any information that would reveal the existence of a SAR, to any individual involved, or thought to be associated with a person involved in any suspicious or fraudulent activity or to any person or entity outside of the lender.

Any officer, employee or agent of the lender that is subpoenaed, or otherwise requested to disclose a SAR, or any information that would reveal the existence of a SAR, should decline to discuss or to produce the SAR or the existence of any SAR, citing 31 U.S.C. 5318(g)(2)(A)(i), and shall notify FinCEN of any such request and the response thereto. Only the documentary evidence that lead to the SAR should be shared, and only then in accordance with the provisions of the Right to Financial Privacy Act.

CUSTOMER IDENTIFICATION VERIFICATION AND BORROWER AUTHORIZATION

The lender should establish, document, and maintain a process for customer identification including the collection of certain minimum identification information from each customer that engages in any mortgage loan transaction. The lender should utilize risk-based measures to verify the identity of each customer; record customer identification information and the verification methods and results; provide notice to customers that the lender will seek identification information and compare customers identification with government-provided lists of suspected terrorists.

The lender should implement procedures for collecting and verifying standard information, such as a customer's name, address, date of birth and taxpayer identification number, on every mortgage loan that is closed and funded. These procedures are sometimes referred to as a Customer Identification Policy (CIP) or a Know Your Customer Policy (KYC). Below is an outline that may be used as a guide but the lender is responsible for ensuring their program is compliance with the law.

Internet, Mail and Phone Applications

- **Internet**: All applicants must provide the identifying information (name, address, date of birth, and Social Security numbers) on the credit application. If the identifying information is not completed, the application is considered incomplete and the information must be requested from the applicant.

- **Mail**: All applicants must provide the identifying information (name, address, date of birth, and Social Security number) on the credit application. If the identifying information is not completed, the application is considered incomplete and the information must be requested from the applicant.

- **Phone:** The interviewer must request the identifying information (name, address, date of birth, and Social Security number) from the applicant and record the information on the credit application. If the identifying information is not completed, the application is considered incomplete and the information must be requested from the applicant.

Note: Both documentary and non-documentary methods of verifying identification information should be employed by the lender, as appropriate. When obtaining identifying-verifying documents is impractical, non-documentary methods may be used to verify the identifying information on the credit application (e.g. contacting the customer, verifying the customer's identity through comparison of information obtained from a consumer reporting agency or other risk-mitigation report utilized by the lender, determining if the customer is included on any agency exclusionary or watch list). However, Social Security numbers must be verified directly with the Social Security Administration. Third-party Social Security verification services are not acceptable unless the verifications are made directly with the Social Security Administration.

Acceptable Identification Documentation

The Department of Treasury requires, at a minimum, documentation that verifies the following:

- Name of the applicant;
- Date of birth;
- Street address of primary residence; and
- An identification number.

Primary Identification

Acceptable Primary Identification will consist of the following unexpired government-issued photo identification:

- Valid permanent in-state driver's license;
- Valid state-issued identification card;
- Valid U.S. passport; or
- Valid U.S. military identification.

Acceptable Identification for Non-U.S. Persons
The applicant must provide two of the following, unexpired items having a remaining valid period determined by credit policy plus one of the additional items required by this section:
- Valid permanent resident card;
- Valid resident alien card:
- Valid employment authorization card;
- Valid temporary resident card

Note: An expired visa may be acceptable, for conventional loans only, provided the applicant can show confirmation of application for extension. Documentation must be one of the following:
- USCIS Form I-797C or I-797E (must not state the application has been declined);
- Application for extension of current visa or application for Green Card (form i-539 pr Form I-485) together with an electronic verification of receipt from the USCIS website.

Note: If applicant is sponsored by his employer, the employer must verify that they are sponsoring the visa renewal.

Insufficient Identification
Circumstances that may result in the lender's denial of the application or not proceeding with the closing are:
- The applicant's inability to provide unexpired, acceptable identification documentation as outlined above;
- The applicant's refusal to provide unexpired, acceptable identification documentation as outlined above;
- The applicant provides expired identification documentation; and
- The documents provided are in such a condition as to render them illegible, or are in a form that cannot reasonably be used to verify the information (e.g. documents are in a foreign language).

Obtaining Identification Documentation
Identification documentation must be collected on every mortgage loan purchased by FAMC. A Customer Identification Verification form must be completed for each applicant that is a party to the transaction (this includes anyone signing for the purpose of releasing homestead or community property rights). The Customer Identification Verification form must be acknowledged by the individual that reviewed the identification documentation.

Prohibited Customers and Accounts

Lenders should preform due diligence to ensure a borrower does not have any ownership interest in any of the ineligible business or account types referenced below.

- **Anonymous/Numbered Accounts:** An anonymous/numbered bank account is a normal bank account in which the name of the customer is replaced by a number or code word. As such account is designed to hide the customer's true identity, it is considered high-risk due to vulnerabilities associated with money laundering.

- **Embassy and Foreign Consulates:** Embassies contain the offices of the foreign ambassador, the diplomatic representative and staff. Foreign consulate offices act as branches of the embassy and perform various administrative and governmental functions. Embassy or foreign consulate accounts may pose a higher risk of money laundering. Refer to Politically Exposed Persons for additional details.

- **Internet Gambling Businesses:** Internet gambling businesses, including gaming, have been identified as potentially high-risk businesses due to vulnerabilities associated with money laundering. Internet gambling businesses allow for a high degree of secrecy and anonymity because transactions are conducted primarily through debit and credit cards.

- **Money Services Businesses:** A Money Services Business (MSB) is defined as each agent, agency, branch or office of any person engaged as a business in the transfer of funds (real or virtual), including currency dealers or exchangers, check cashers, issuers of traveler's checks, money orders, or stored value, sellers or redeemers of traveler's checks, money orders, or stored value, and money transmitters or remitters.

- **Non-US Shell Companies:** A shelly company refers to non-publicly traded corporations, limited liability companies (LLCs), and trusts that typically have no physical presence other than a mailing address. Shell companies can be used for money laundering and other crimes because they are easy and inexpensive to form and operate. In addition, ownership and transactional information can be concealed from regulatory agencies and law enforcement.

- **Payable-Through Accounts:** A payable-through account is defined as a master correspondent account established in a US bank, usually by a foreign bank through which the foreign bank's customers conduct banking transactions. A foreign bank is a bank operating in a foreign country under authority of the laws of a foreign country. Typically, the foreign bank will provide its customers, commonly referred to as "sub-account holders", with checks that enable the sub-account holder to draw on the foreign bank's account at the US bank. Payable-through accounts are considered high-risk due to the fact the banks providing the accounts may not subject the end customer to the same level of scrutiny as their own customers.

- **Bearer Shares:** A bearer share is an equity security that is wholly owned by whoever holds the physical stock certificate. The issuing firm neither registers the owner of the stock nor does it track transfers of ownership. The company disperses dividends to bearer shares when a physical coupon is presented to the firm. Because the share is not registered to any authority, transferring the ownership of the stock involves only delivering the physical document. Bearer shares lack the regulation and control of common shares because ownership is never recorded. Similar to bearer bonds, these shares are often international securities.

- **Payday and Other Predatory Type Lenders:** Payday lenders offer small dollar, high interest rate loans marketed to financially distressed consumers with bad or no credit. Similar to payday lenders, title loan companies also offer similar products with the exception that title of the customer's vehicle is used as form of collateral. These predatory type loans generally have common features: dollar amounts ranging from $200 to $3,000 but could reach up to $10,000; borrowers must repay them within a short period of time, typically around the time of their next employment payday; require the customer to repay the full amount and the lender is often given full access to repayment through a claim on the customer's deposit account. The average customer takes months to repay such loans, incurring more fees totaling more than the loan was actually worth in some instances. Due to the predatory nature of payday lending and because most customers will be primarily engaged in MSB activity, payday lenders and similar predatory lenders should be prohibited borrowers.

- **Medical and Recreational Marijuana Dispensaries and Marijuana Related Businesses (MRBs) and Hemp/Hemp Related Businesses:** Income from marijuana related business cannot be used for qualification.

POLITICALLY EXPOSED PERSON (PEP)

Lenders are not prohibited from lending to a PEP. However, they represent a higher risk due to their position and influence that can potentially be abused for the purpose of committing money laundering offenses and related predicate offenses, including corruption and bribery, as well as conducting activity to terrorist financing. PEPs are defined as follows:

- **Foreign PEPs:** Individuals who are and have been entrusted with prominent public functions by a foreign country (i.e., Heads of States or of government, senior politicians, senior government, judicial or military officials, senior executives of state-owned corporations, important party officials).

- **Domestic PEPs:** Individuals who are or have been entrusted domestically with prominent public functions (i.e., Heads of States or government, senior politicians, senior government, judicial or military officials, senior executives of state-owned corporations, important party officials).

- **International Organization PEPs:** Persons who are or have been entrusted with a prominent function by an international organization. This refers to members of senior management or individuals who have been entrusted with equivalent functions (i.e., directors, deputy directors or members of the board of equivalent functions).

- **Family Members:** Individuals related to a PEP either through blood relation or marriage or similar forms for partnership.

- **Close Associates:** Individuals closely related to a PEP either socially or professionally.

OFFICE OF FOREIGN ASSETS CONTROL (OFAC)

Before engaging in any mortgage loan transaction, which potentially may involve money laundering, and on an ongoing basis, the lender should check to ensure that a customer does not appear on the Treasury's OFAC "Specially Designated Nationals and Blocked Persons" List (SDN List) or any other sanctions list administered by OFAC and not from, or engaging in transactions with people or entities from, embargoed countries and regions listed on the OFAC website (www.treas.gov/offices/enforcement/ofac/sdn/index.html).

All credit bureaus contain an OFAC alert section as well. In the event the lender should determine a customer, or someone with or for whom the customer is transacting, is on the OFAC Sanctions List, is from or engaging in transactions with a person or entity located in an embargoed country or region, or has an OFAC Alert from one of the credit bureaus, the lender must develop and implement a plan to reject the transaction and notify the appropriate authorities.

TRAINING

Another core element in an AML program is the training of all employees. Lenders should develop ongoing training for all employees to equip them with the ability to discern and recognize, at a high level, any red flags or money laundering and suspicious or fraudulent activities. Training should be designed to improve the knowledge, performance and skills of an employee with regard to complying with the required regulations; policies and procedures the lender has in place, and the employee's responsibilities to assist in identifying, preventing, and reporting of potential money laundering, fraud and other violations of law of suspicious activities.

ANTI-MONEY LAUNDERING PROGRAM REQUIREMENTS

The BSA/AML Rule requires all non-depository institutions to implement the following four pillars into their Anti-Money Laundering program:

1. Incorporate policies, procedures and internal controls based upon the loan or finance company's assessment of the money laundering and terrorist financing risks associated with its product and services.

2. Designate a compliance officer who will be responsible for ensuring that the AML program is implemented effectively, is updated as necessary and ensure appropriate persons are educated and trained in accordance with the new rule.

3. Provide for on-going training of appropriate persons concerning their responsibilities under the program.

4. Provide for independent testing to monitor and maintain an adequate program.

REQUIREMENT FOR FAMC NON-DEPOSITORY CORRESPONDENT LENDERS

On an annual basis, each FAMC approved non-depository correspondent lender must submit an attestation affirming their company's adherence to all applicable requirements of the AML requirements. The request for this annual attestation form will be included in FAMC's annual recertification process.

FAMC will not initially require, but reserves the right to request, the policy and procedures documentation from any non-depository correspondent lender to ensure compliance.