ATTACHMENT A

1. Since at least January 2006, Franklin American Mortgage Co. ("Franklin American") has been a Direct Endorsement lender approved by the Federal Housing Administration ("FHA") and U.S. Department of Housing and Urban Development ("HUD"). As a Direct Endorsement Lender, Franklin American is authorized by HUD to originate and underwrite mortgage loans on HUD's behalf, including determining a borrower's creditworthiness and whether the proposed loan met all applicable HUD requirements. Franklin American obtained Lender Insurance status in June 2006. As a Direct Endorsement lender with Lender Insurance status, Franklin American is authorized to endorse mortgage loans for HUD insurance without any pre-endorsement review of the mortgage application by HUD. Prior to obtaining Lender Insurance status, HUD performed a limited review of loans Franklin American submitted for FHA insurance pursuant to the requirements of 24 C.F.R. § 203.255(c).

2. HUD required Direct Endorsement lenders, such as Franklin American, to follow applicable HUD regulations and underwriting requirements in originating and underwriting mortgage loans for FHA insurance, including those requirements set out in HUD's Handbooks and Mortgagee Letters.[1]

3. HUD required Direct Endorsement lenders, such as Franklin American, to submit certain proposed FHA originations through a HUD-approved Automated Underwriting System ("AUS") in conjunction with a tool known as Technology Open to Approved Lenders ("TOTAL"). According to the FHA's TOTAL Mortgage Scorecard

[1] The requirements referenced in paragraphs two through eleven of this document reflect standard HUD-FHA program requirements for Direct Endorsement lenders as provided in HUD's Handbooks and Mortgagee Letters.

User Guide, TOTAL evaluated the overall creditworthiness of the applicants based on a number of credit variables. After a proposed loan was submitted, TOTAL would either: (1) approve the mortgage subject to certain eligibility criteria or other conditions, including conditions that the lender validate the information that formed the basis for TOTAL's determination; or (2) refer the mortgage application for manual underwriting by the lender in accordance with HUD requirements. Franklin American understood that TOTAL's determination was based on the integrity of the data supplied by the lender. HUD has promulgated requirements for calculating data used by TOTAL.

4. HUD required Direct Endorsement lenders, such as Franklin American, to implement and maintain a quality control program in accordance with HUD Handbook requirements for FHA loans in order to maintain Direct Endorsement lender status. HUD required the FHA quality control function to be independent of FHA mortgage origination and underwriting functions. HUD required Direct Endorsement lenders, such as Franklin American, to review a sample of loans based on the number of FHA loans originated and/or underwritten per year. HUD Handbook 4060.1 REV-2, § 7-6.C. Direct Endorsement lenders, such as Franklin American, were also required to review each FHA mortgage loan that became 60 days delinquent within the first six payments, which HUD defined as "early payment defaults" or EPDs. *Id.* HUD required Direct Endorsement lenders, such as Franklin American, in performing these quality control reviews, to review the mortgage loan file, re-verify certain information, review the soundness of underwriting judgments, document the review and any findings in a quality control report, and report the findings to senior management within one month.

5. HUD required Direct Endorsement lenders, such as Franklin American, to self-report to HUD all findings related to FHA mortgage loans that constituted "material violations of FHA or mortgagee requirements and represent an unacceptable level of risk" and all findings of "fraud or other serious violations." HUD Handbook 4060.1 REV-2, §§ 7-3.J & 7-4.D. Direct Endorsement lenders, such as Franklin American, were also required to take "prompt action to deal appropriately with any material findings." *Id.* § 7-3.I.

6. In order to obtain Direct Endorsement status, HUD required Direct Endorsement lenders, such as Franklin American, to certify as follows:

> I certify that, upon the submission of this application, and with its submission of each loan for insurance or request for insurance benefits, [Franklin American] has and will comply with the requirements of the Secretary of Housing and Urban Development, which include, but are not limited to, the National Housing Act (12 U.S.C. § 1702 *et seq*.) and HUD's regulations, FHA handbooks, mortgagee letters, and Title I letters and policies with regard to using and maintaining its FHA lender approval.

7. Additionally, HUD required a Direct Endorsement lender, such as Franklin American, to submit an Annual Certification stating:

> I know, or am in a position to know, whether the operations of [Franklin American] conform to HUD-FHA regulations, handbooks, and policies. I certify that to the best of my knowledge, [Franklin American] conforms to all HUD-FHA regulations necessary to maintain its HUD-FHA approval, and that [Franklin American] is fully responsible for all actions of its employees including those of its HUD-FHA approved branch offices.

Alternatively, HUD required a Direct Endorsement lender, such as Franklin American, to submit a statement to HUD that it was unable to so certify and to explain why it could not execute the certification.

8. To qualify as a Direct Endorsement underwriter an underwriter must satisfy several requirements. The Direct Endorsement underwriter "must have a minimum of three years full-time recent experience (or equivalent experience) reviewing both credit applications and property appraisals." HUD Handbook 4000.4, REV-1, CHG-2, ch. 2-4.A.3; *see also* HUD Handbook 4155.2 ch. 2.A.4.a. The underwriter must also be a "reliable and responsible professional skilled in mortgage evaluation" and "must be able to demonstrate his or her knowledge and experience regarding the principles of mortgage underwriting." HUD Handbook 4000.4, REV-1, CHG-2, ch. 2-4.A.1; *see also* HUD Handbook 4155.2 ch. 2.A.4.a.

9. HUD considers the Direct Endorsement underwriter to be "the focal point of the Direct Endorsement program." HUD Handbook 4000.4, REV-1, CHG-2, ch. 2-4.C. The Direct Endorsement underwriter must assume the following responsibilities: (1) compliance with HUD instructions, the coordination of all phases of underwriting, and the quality of decisions made under the program; (2) the review of appraisal reports, compliance inspections and credit analyses performed by fee and staff personnel to ensure reasonable conclusions, sound reports and compliance with HUD requirements; (3) the decisions relating to the acceptability of the appraisal, the inspections, the buyer's capacity to repay the mortgage, and the overall acceptability of the mortgage loan for HUD insurance; (4) the monitoring and evaluation of the performance of fee and staff personnel used for the Direct Endorsement program; and (5) awareness of the warning signs that may indicate irregularities, and an ability to detect fraud, as well as the responsibility that underwriting decisions are performed with due diligence in a prudent manner.

10. With respect to each mortgage loan submitted or endorsed by Franklin American for FHA insurance, either a Franklin American mortgagee representative or a Franklin American Direct Endorsement underwriter was required to certify that the mortgage "is eligible for HUD mortgage insurance under the Direct Endorsement program." For each loan that was approved using AUS, a Franklin American mortgagee representative was required to certify to the "integrity of the data supplied by [Franklin American] used to determine the quality of the loan [and] that a Direct Endorsement Underwriter reviewed the appraisal." For each FHA loan that Franklin American approved using manual underwriting, a Franklin American Direct Endorsement underwriter was required to certify that he or she "personally reviewed the appraisal report (if applicable), credit application, and all associated documents and ha[s] used due diligence in underwriting the[e] mortgage."

11. For every mortgage loan approved by Franklin American, whether through manual underwriting or the use of an AUS, a Franklin American Direct Endorsement underwriter was required to certify that:

> I, the undersigned, as authorized representative of Franklin American at this time of closing of this mortgage loan, certify that I have personally reviewed the mortgage loan documents, closing statements, application for insurance endorsement, and all accompanying documents. I hereby make all certifications required for this mortgage as set forth in HUD Handbook 4000.4.

12 When a borrower defaults on an FHA-insured loan underwritten and endorsed by a Direct Endorsement lender, such as Franklin American, the lender, or if the mortgage or servicing rights were transferred after closing, the mortgage holder or servicer, has the option of submitting a claim to HUD to compensate the lender for any loss sustained as a result of the default. As such, once a mortgage loan is endorsed for

FHA insurance, HUD insures the risk of the borrower defaulting on that mortgage, which is realized if an insurance claim is submitted.

13. The Department of Justice has investigated Franklin American with regard to its origination, underwriting, quality control, and endorsement practices, as well as its submissions of certifications, related to certain FHA-insured single-family residential mortgage loans originated between January 1, 2006, and December 31, 2012, and for which claims for FHA insurance benefits were submitted by July 10, 2015 (the "Released Loans"). The following statements apply to the Released Loans only.

14. Between January 1, 2006, and December 31, 2012, Franklin American certified for FHA mortgage insurance pursuant to the Direct Endorsement Program certain Released Loans that did not meet certain HUD requirements and therefore were not eligible for FHA mortgage insurance under the Direct Endorsement Program.

15. Since 2006, Franklin American underwrote and endorsed FHA-insured loans primarily through two business channels: retail and wholesale. In the retail channel, Franklin American employees worked directly with prospective borrowers to prepare mortgage applications and gather the relevant supporting materials. The employees then transmitted the materials to Franklin American's underwriting department to be underwritten. If the application was approved, Franklin American would then fund the loan and endorse it for FHA insurance. In the wholesale channel, mortgage brokers who were not employed by Franklin American worked with borrowers to prepare mortgage applications and relevant materials. Those brokers then transmitted those materials to Franklin American for underwriting, funding, and endorsement for

FHA insurance if the application was approved.[2] Franklin American considered loans originated through the wholesale channel to present greater risk than those originated through the retail channel.

16. From 2006 through 2010, Franklin American's FHA loan production grew substantially. Most of this growth occurred through the origination of loans in the wholesale channel. After 2010, Franklin American's FHA loan production decreased and leveled off.

17. Franklin American employed Direct Endorsement underwriters who would receive and review a loan application and the supporting documentation submitted by a broker or account executive. The Direct Endorsement underwriter could then approve the loan, approve the loan with conditions, suspend the loan, or reject the loan. The documents initially received by Franklin's Direct Endorsement underwriters frequently did not suffice to approve a loan. In those cases, the Direct Endorsement underwriter could approve the loan with conditions, meaning that additional documentation was required before the loan could be fully assessed and endorsed. The conditions set by the Direct Endorsement underwriter could involve issues directly affecting the creditworthiness of the borrower (*i.e.*, the borrower's ability to repay the loan) and the eligibility of the loan for FHA insurance. Such conditions required documentation related to income, employment, assets, liabilities, credit, and collateral.

18. Between 2006 and 2010, Franklin American established a position called a junior underwriter or junior government underwriter. Junior underwriters were not required to be Direct Endorsement underwriters. When the Direct Endorsement

[2] Franklin American also had a "correspondent" channel. In that channel, it purchased FHA-insured loans that had been originated, underwritten, and endorsed by other lenders. Franklin American generally did not underwrite or endorse the FHA-insured loans it purchased through the correspondent channel.

underwriter reviewed and conditionally approved a loan for FHA insurance, the junior underwriters were tasked with reviewing certain conditions. This included obtaining and reviewing documentation to determine if the condition had been satisfied. Among other things, some junior underwriters at times cleared conditions related to income, employment, assets, liabilities, credit, and collateral.

19. Franklin American also set goals that its Direct Endorsement underwriters review a certain number of loan applications each day (generally four to five loans during most of the relevant period, but sometimes more during periods of particularly high demand). These goals would be communicated to Franklin American's Direct Endorsement underwriters by Franklin American management. For example, during one period of particularly high demand when Franklin American was experiencing a backlog of loan applications, an assistant vice president and government underwriting manager wrote to several underwriters that "[t]he requirement for new loans used to be 5-6 per day when you still had your [resubmissions] and appraisals to review. Those shifted to another team and your daily requirement became a minimum of 9 per day. Some of you are constantly hitting this number each and everyday and the company is paying you a bonus for your achievements. EVERYONE needs to be hitting this number each and everyday not just a day here or a day there and we need to be consistent. Some of you come in early, stay late, take things home, etc to get the job done….some of you work the regular hours with minimal extra….and this will not work."

20. In some instances, internal communications also reflect that sales and production managers discussed terminating the employment of underwriters if they consistently did not review the number of loans set by management. For example, a vice

president of wholesale production noted in a May 18, 2007, email to an executive vice president and senior vice president: "Were [sic] is the accountability? I have put 4 [sales] people on Produce or Perish this month. We need to replace those underwriters who can't get with the program and produce. No more excuses." An executive vice president wrote to a government underwriting manager in a January 15, 2009, email discussing a daily goal that underwriters review eight loan files that "[t]he people that are doing the bare minimum will need to be made aware that their services are about to be terminated. We cannot accept the minimal performance any longer. I will give them one week or they will be looking for another job."

21. Franklin American also sought to incentivize the processing of loan applications by offering bonus programs to underwriters based in part on the number of loan files reviewed. For example, Direct Endorsement underwriters were eligible for a bonus in 2009 if they reviewed an average of 5 loans a day and met other requirements, including as to quality. In 2010, Direct Endorsement underwriters were eligible for bonuses for each loan over 100 that they reviewed in a particular month. The top tier of the bonus plan contemplated the possibility that Direct Endorsement underwriters could underwrite from 201 to 225 loans per month. In announcing an updated bonus plan in 2011, Franklin American noted that "[a]s with prior Bonus Plans, the primary component to achieve bonus will be meeting production goals which tie into goals of the division and company."

22. In 2006, a third party was performing quality control reviews of closed loans underwritten by Franklin American. Franklin American later changed its outside vendor before bringing the quality control review of closed loans in house. Although the

quality control reviews varied over time, those reviews generally assigned a rating to particular deficiencies and the quality of a loan as a whole. For example, many of Franklin American's quality control reviews that it performed in-house would categorize a deficiency as critical, major, moderate, or minor. Franklin American defined a deficiency as "critical" if it "affects the decision, collectability, insurability, and salability of the loan," and "major" if it "affects the decision, quality, and insurability of the loan and could affect the salability." Based on the quality and quantity of the deficiencies, Franklin American would then rate the loan as good, acceptable, fair, or poor.

23. After the loans were reviewed, Franklin American or a third party would then prepare "management reports" that were submitted to the vice president of quality control or a quality control manager as well as to managers of Franklin American's three business channels. The management reports were also occasionally provided to higher-level management, such as executive vice presidents.

24. The management reports prepared by Franklin American or a third party identified substantial numbers of loans with serious deficiencies. For example, a third party audited 89 of Franklin American's closed loan files from its retail and wholesale business channels that were originated in March 2006. Those audits revealed over 40 deficiencies in the loan files that were labeled "serious." The quality control report from December 2008 indicated that year-to-date between 15 percent and 28 percent of the loans underwritten by Franklin American in its wholesale and retail business channels were rated poor. The report states that a significant number of loans underwritten by Franklin American had serious deficiencies. The December 2009 quality control report indicated that year-to-date 13 to 19 percent of the loans Franklin American underwrote in

its wholesale and retail business channels were rated poor. By 2010, those averages had increased to between 22 and 30 percent.

25. From 2006 until around 2010, Franklin American inconsistently conducted EPD reviews. Those reviews that were conducted identified a significant number of loans that were rated poor and that contained “serious” underwriting deficiencies.

26. The quality control reports also show certain deficiencies related to junior underwriters. For example, Franklin American underwrote a property that closed in May 2009. The post-close quality control review of that property noted several “major” deficiencies related to inadequate documentation of gift funds and a failure to address overdrafts on bank statements, large deposits, and debts. When the Direct Endorsement underwriter was questioned about these deficiencies, she responded that they were all errors by the junior underwriter. Similarly, Franklin American’s quality control review of a loan originated in May 2010 identified a “critical” deficiency related to income not being entered into the AUS in the proper category. The Direct Endorsement underwriter responded to the finding by noting that the junior underwriter made the mistake and stating that this finding made “a good case for [the] reasoning behind [the] junior [underwriter] position going away.”

27. A letter from HUD to Franklin American’s president dated March 17, 2006, provided that “[w]e would like to note that the Neighborhood Watch Early Warning System allows mortgagees to report serious deficiencies, patterns of non-compliance, or suspected fraud, to HUD in a uniform, automated fashion. Mortgagees shall use the ‘Reporting’ feature of the Neighborhood Watch Early Warning System

menu in lieu of submitting a written report to the Quality Assurance Division. As stated in Mortgagee Letter 05-26, use of the Neighborhood Watch Reporting tool became mandatory in November 2005 . . . ." In addition, Franklin American's quality control plans consistently recognized its duty to make such self-reports.

28. Franklin American did not make any self reports until 2009. Franklin American's assistant vice president of government credit policy noted in February 2008 that "since 2005 we've been required to self-report in Neighborhood Watch, any fraud or serious deficiencies that we discover on FHA loans. . . . [O]ur reporting history is blank." Franklin American reported 4 loans in 2009, 50 loans in 2010, 26 loans in 2011, 21 loans in 2012, and 21 loans in 2013.[3] Very few of these self-reported loans were reported for containing serious underwriting deficiencies.

29. As a result of Franklin American's conduct and omissions, HUD insured hundreds of loans approved by Franklin American that were not eligible for FHA mortgage insurance under the Direct Endorsement Program, and that HUD would not otherwise have insured. HUD subsequently incurred substantial losses when it paid insurance claims on those Released Loans.

30. The statements herein apply only to certain mortgages which are the subject of the release in this Agreement. This document is not an admission as to any conduct related to any mortgage not released in this Agreement, nor is it an admission of any legal liability. Franklin American reserves the right to contest the use or application of this document in any future litigation.

[3] Thirty-nine of the self-reported loans in 2010 and eighteen of the self-reported loans in 2011 were related to fraud at a single broker.