

DUE DILIGENCE IN MORTGAGE OR LOAN TRANSACTIONS

Mortgage fraud is a serious and growing problem in Ontario. In many cases, mortgage fraud involves the use of false identities (title fraud) and the artificial inflation of property values (value fraud). Title fraud occurs when a property is fraudulently transferred from its true registered owner and/or a fraudulent mortgage is registered on the property. In these types of transactions, a fraudster usually misappropriates the identity of the true registered owner. Value fraud occurs when the value of a property is inflated to deceive a mortgage lender in order to obtain a higher mortgage amount than would otherwise be available.

For consumers, the purchase of a home often represents their single largest investment. Over the course of the past year there have been a number of court cases dealing with the rights of innocent homeowners to have title restored to their names and fraudulent mortgages set aside. In the recent case of *Rabi v. Rosu*, the Ontario Superior Court of Justice commented on the impersonal nature of mortgage lending and borrowing in this day and age and stated that in the circumstances of that case more care should have been exercised in advancing a sum in excess of one quarter of a million dollars.

The completion of a real estate transaction usually involves the participation of a number of parties in the transaction such as a lawyer, a lender and its agents, a real estate agent or broker, a mortgage agent or broker and others. In order to properly protect the public, the Law Society maintains that it is imperative that all of the parties involved in the transaction exercise care to detect and deter fraud at all stages in the transaction and particularly at the early stages of the transaction when the borrower first makes contact with the lender or its agent to obtain mortgage financing or executes an agreement of purchase and sale to buy or sell property. It is essential that there be checks and balances throughout the entire process of the transaction.

The Law Society has prepared this document to outline the steps required of a lender to ensure that adequate care is exercised in the funding of mortgage or loan transactions and the steps required of a lawyer acting for a lender in such transactions.

LENDER DUE DILIGENCE

The following is a list of the steps required of a lender in a mortgage or loan transaction to detect and deter fraud.

Checking Identification

Prior to instructing the lawyer to act in a mortgage or loan transaction, the lender or a licensed mortgage broker or agent on behalf of the lender should:

- meet personally with the borrower(s) and obtain two pieces of original identification for each borrower, one of which must be government issued photo identification;
- examine the original identification obtained for irregularities and retain photocopies or document particulars of the identification; and

- check the information contained in the mortgage loan application using other sources such as credit reporting agencies and employer references.

If there are irregularities or suspicious circumstances that cannot be adequately explained, the lender must not proceed with the transaction.

Verification of the Transaction

Prior to instructing the lawyer to act in a mortgage or loan transaction, the lender or its agent must:

- take steps to verify that the registered owner is in fact selling or mortgaging the property. These steps should include at a minimum an on-site visit of the property or an on-site appraisal. Other steps that may be taken, depending on the circumstances, would include obtaining utility or realty tax bills, reviewing the MLS listing of the property or a phone call to the owner using the 411 listing;
- satisfy itself as to the value of the property. Depending on the circumstances, these steps could include reviewing the agreement of purchase and sale for discrepancies, reviewing the MLS listing of the property, attending at the property or conducting an on site appraisal; and
- review the application and supporting documentation such as the agreement of purchase and sale and amendments. If there are suspicious circumstances that cannot be adequately explained, the lender must not proceed with the transaction.

When instructing the lawyer to act in a mortgage or loan transaction, the lender must:

- provide the lawyer with a copy of the agreement of purchase and sale and all addenda and amendments obtained by the lender in the course of its decision to finance the transaction so that the lawyer may compare these documents to the documents or information in the lawyer's file;
- provide the lawyer with the name and contact information of an individual at the lending institution who can provide the lawyer with informed instructions on short notice.

Timely Registration of Discharge of Mortgages

Where the lender does not instruct the borrower's lawyer to register the discharge of mortgage after the mortgage has been paid out, the lender must register on title the discharge of mortgage document no later than 60 days after the mortgage has been paid in full and provide particulars of the registration to the lawyer for the borrower or to the borrower directly if the borrower is not represented by a lawyer.

LAWYER DUE DILIGENCE

The following is a list of the steps that a lawyer must or should take when acting for a lender in a mortgage or loan transaction to detect and deter fraud.

Duty to avoid becoming the Tool or Dupe of an Unscrupulous Client

When advising a client, a lawyer has a duty not to knowingly assist in or encourage any dishonesty, fraud, crime or illegal conduct, or instruct the client on how to violate the law and avoid punishment.

A lawyer should be alert to and avoid unwittingly becoming involved with a client engaged in criminal activity such as mortgage fraud.

Before accepting a retainer or during a retainer if a lawyer has suspicions or doubts about whether he or she might be assisting the client in dishonesty, fraud, crime or illegal conduct, the lawyer should:

- make reasonable inquiries to obtain information about the client, and about the subject matter and objectives of the retainer;
- make a record of the results of these inquiries; and
- disclose his or her concerns to all of the clients in the retainer.

Despite having taken these steps, in certain circumstances the lawyer may have to withdraw completely from representing the client.

Checking Identification

The lawyer should undertake steps to verify that the person retaining the lawyer and/or signing documents under the lawyer's supervision has reasonable identification to substantiate that he or she is the named client/party and should retain details or information in the file about the identification obtained.

Title Search

When doing a title search of the property, the lawyer should review:

- all documents on title affecting the client's interest in the property;
- the values revealed by arms-length transfers in the recent past, to determine if there have been any suspicious changes in value; and
- the pattern of inactive or deleted instruments on the parcel register and inquire about any suspicious patterns of transfers or discharges.

The lawyer should retain notes on the search of title with respect to every real estate file and should report the results of the title search and due diligence process and in particular

any suspicious patterns of transfers or discharges and/or any suspicious changes in values revealed by the due diligence process to the purchaser/borrower if the lawyer is acting for the purchaser/borrower, the lender if the lawyer is acting for the lender and the title insurer.

Disclosure to the Clients on Joint Retainers

Where the lawyer acts for both the borrower and the lender in the mortgage transaction, the lawyer must disclose to the borrower and lender in writing, before the advance or release of the mortgage or loan funds, all material information that is relevant to the transaction.

Depending on the circumstances of the transaction, this information might include:

- the fact that there is a flip (the property is being re-sold the same day or within a short period of time at a higher price);
- the fact that there are amendments to the agreement of purchase and sale, either formal or otherwise, changing the terms of the agreement upon which the lender has based its mortgage transaction. Examples include purchase price reductions, extra deposits payable, renovation or other credits, cash-backs or other credits to the purchaser, changing the parties to the transaction, changing the purchase price, adding subsequent mortgages, changing the amount payable on closing and changing the manner of taking title;
- the fact that the mortgage documentation is to be executed under a power of attorney where this fact is not apparently known to the lender;
- information about the circumstances of the agreement of purchase and sale upon which the lender has based its mortgage transaction and which could affect the lender's ultimate decision to advance funds. Examples include: the vendor named in the agreement of purchase and sale is not the registered owner of the property at the time of the agreement of purchase and sale, the use of counter cheques and identification irregularities;
- information about the transaction or purchaser that is inconsistent with the information shown in the mortgage commitment such as changes in the mortgagor's economic circumstances, changes in the mortgagor's employment, changes in the mortgagor's marital status and evidence of inaccurate appraisals;
- the fact that the mortgage advance exceeds the balance due or actually paid on closing; and
- the direct payment of the deposit or down-payment to the vendor.

Execution of Documents

Prior to registering electronic documents, the lawyer should obtain and retain in the lawyer's file the client's written authorization.

Timely Reporting to the Lender Client

A lawyer who acts for a lender in a mortgage transaction must provide a final report on the transaction together with the duplicate registered mortgage to the lender within 60 days of the registration of the mortgage or within such other time period as instructed by the lender.