MORTGAGE FRAUD: DEFEND YOUR TITLE

By Paul Watkins

National statistics indicate that 21 per cent of all serious fraud offences committed in Australia and New Zealand involve mortgage fraud, with most frauds committed against financial institutions, according to a report by the Australian Institute of Criminology and PricewaterhouseCoopers.

Lenders and brokers are facing fraudsters who are increasingly using forged documentation and fictitious identities in carrying out mortgage fraud attacks. Mortgage Professional Australia, has pointed to organised crime syndicates being involved in targeting the mortgage industry and taking advantage of the rise of intermediaries in the mortgage market such as mortgage brokers, originators and aggregators.

Financial crimes committed by fraudsters are costing financial institutions significant sums and consumers are generally bearing the brunt through higher fees, interest rates and insurance premiums. Credit unions and mutual building societies have a range of weapons to use in defending themselves against fraudsters, but one option to manage the potential costs to members of mortgage fraud is title insurance. Title insurance can be utilised to effectively manage mortgage fraud risks.

"The re-allocation of risk through using title insurance ensures that losses incurred by lenders as a result of mortgage fraud are not passed back to credit union or building society members."

Paul Watkins, Manager of Legal & Underwriting, Stewart Title

WHAT IS TITLE INSURANCE?

Title insurance may de described as a contract of indemnity whereby the title insurer, for a one-time premium, indemnifies the lender for the life of the loan against actual loss incurred by the insured as a result of any unknown title defect or other risk covered in the policy as at the policy date (the date of settlement). An example of other risks is registration gap cover. For credit unions and building societies, the key component of title insurance is protection that the mortgage is:

> valid and enforceable; and;

> enjoys the required priority.

THE TITLE FIGHT

In addition to indemnifying the insured from actual loss arising from a risk covered in the title insurance policy, a title insurer will also defend the insured's title as represented in the policy and cover the costs incurred in that defence, such as legal costs and expenses. These costs are in addition to any liability the insurer may have in respect of the indemnity amount contained in the policy.

The policy amount will normally be the principal amount of the mortgage, which will automatically increase to a maximum of 125 per cent of the loan amount.

TITLE INSURANCE AS A RISK MANAGEMENT TOOL

Title insurance minimises risk in the lending transaction by delivering protection against losses incurred by mortgage fraud. It is this re-allocation of risk that makes title insurance such an effective risk management tool. Title insurance protects the lender in two ways:

> Firstly, title insurance protects the validity and enforceability of a mortgage, which might be challenged in circumstances where the borrower's identity has been stolen by a fraudster. A common scenario is that a third party obtains false identification in the name of the true owner of the property and obtains funds from the lender by way of a mortgage. The fraudster obviously does not meet the repayments under the loan and loan falls into default. The true owner disputes the validity of the mortgage.

> Secondly, title insurance protects the validity and enforceability of a mortgage that might be challenged in circumstances where a mortgage broker or loan originator has committed fraud and the borrower claims the mortgage contract to be 'unjust'. The borrower commences action under the Contracts Review Act or the Uniform Consumer Credit Code to have the mortgage varied or set aside entirely. In most cases, the borrower will join the lender to the proceedings, requiring the lender to incur substantial legal fees.

THE BENEFITS – NO FAULT POLICY

One of the key benefits of title insurance is that in circumstances where there is a challenge to the enforceability or validity of a mortgage by a borrower, the insured lender would be entitled to make a claim on its title insurance policy on a 'no fault' basis and the title insurer would be obligated to cover all legal costs and expenses associated with upholding the enforceability of the mortgage. The title insurer would also be obligated to compensate the lender for its loss, ie, the outstanding principal amount of the loan, in the event that the mortgage is found be invalid or unenforceable as a result of fraud.

This re-allocation of loss and risk ensures that losses incurred by lenders as a result of mortgage fraud are not passed back to credit union or building society members.

Title insurance enhances the lending process and complements existing risk management strategies employed by credit unions and building societies, such as Lenders Mortgage Insurance because a claim against a mortgage insurer will be unsuccessful where the mortgage itself is invalid or unenforceable. ■

Paul Watkins is Manager, Legal & Underwriting with Stewart Title.