

## E&O claims continue upwards putting pressure on insurance premiums

**FACT:** In 2008, lawyers reported 2,175 E&O claims to LAWPRO – more claims than in any year since 1995.

**FACT:** This increase cannot be explained solely by the increase in the number of lawyers in practice. Since 1995, both the number of claims reported and the claims frequency (the number of claims per 1,000 lawyers) has increased annually. In 2005, there were 90 claims reported per 1,000 lawyers; in 2008 that claims frequency had increased to 100.2.

**FACT:** The cost of resolving these E&O claims continues to climb steadily, to \$83 million in 2008 from \$70 million in 2005. Based on current trends and early results for 2009, we project that our 2009 claims costs will be even higher. This increase is driven not only by increased numbers, but also by the growing complexity of law practice: More complex files give rise to more complex claims that inevitably cost more to resolve.

*This deteriorating claims picture is not a new phenomenon at LAWPRO. In our annual report, in presentations and in magazine articles (such as those on fraud), we've been alerting lawyers to disconcerting claims trends and to the pressure that these trends put on insurance premiums.*

*In our next issue of the magazine, due out in late August 2009, we'll examine claims numbers and trends in more detail.*

*In this issue we look at one specific concern: the increase in fraud claims despite a concerted effort by LAWPRO and the Law Society to inform lawyers about the common types of fraud, the red flags of fraud and how they can avoid being a victim of fraudsters.*

### Fraud claims: 10 per cent of all claims costs

Based on the most recent analysis, lawyers reported 136 claims with a fraud component in 2008. The anticipated cost to resolve those claims as of May 2009: \$8.7 million. In 2007, lawyers reported 107 fraud claims at a cost to the insurance program of about \$8.5 million. Real estate fraud continues to account for the majority of fraud-related claims, accounting for about 63 per cent of claims reported and 54 per cent of costs.

But that's not to say other practice areas are immune to fraud claims. What fraudsters are looking for is someone with a trust account and/or access to Ontario's e-reg<sup>®</sup> system. To be successful, they need to find a lawyer who is disinclined to listen to his or her instincts and ask questions if some aspect of the transaction or client does not quite pass the smell test.

### The many faces of fraud

The following are examples of fraud claims that LAWPRO has resolved, or composite scenarios based on trends in fraud experience in specific areas of practice.

#### REAL ESTATE FRAUDS

- **Fraudulent discharges:** Typically, a borrower approaches a lawyer to assist with a mortgage loan. The lawyer's search reveals that a previous mortgage had been discharged; he registers a new mortgage, apparently in first position. The discharge is fraudulent and had been registered by someone in cahoots with the borrower. In a post Bill-152 environment, once it is discovered that the discharge was fraudulent, the old mortgage is put back into priority so that there is not enough equity to cover anything but the first (and possibly a portion of the second) mortgage. On one such file we saw at LAWPRO, there had been a lot of recent activity on the title with large mortgages being registered and discharged in short order, and the lawyer had failed to advise the mortgage client of this kind of activity.
- **Oklahoma rings/value frauds:** These are the standard value frauds in which there is an artificial increase in the value of a property through a series of phoney sales to "straw" buyers for the purpose of obtaining higher value mortgages than can be supported by the true equity in the property. The more interesting of these are the organized rings in which the fraudster borrowers will work with a crooked broker, appraiser and "mortgage specialist" (i.e. bank employee) to run a series of these frauds. LAWPRO has seen this type of activity in both big city and small town environments.

**Risk management tips:** *If you see frequent activity on title in a short period of time, ask questions. Pull some of the deleted instruments and look at the history of trades on the property; watch comparables in a neighbourhood. And let the lender know what you are seeing – because chances are the lender's mortgage instructions state that you are to do just that. If the lender then opts to proceed and advance the mortgage funds, confirm in writing with the lender that s/he has decided to proceed.*

- **Identity theft:** Usually targeting elderly individuals, the fraudsters find homes that are unencumbered, prepare false identification and transfer the property to a co-conspirator who obtains a mortgage. The more creative fraudsters will divert the victim's mail, set up fake entities to confirm employment credentials of the new borrower and run a series of frauds at the same time to increase amounts obtainable before they start to attract attention.

**Risk management tips:** Check ID – know your client. Confirm referral sources. Make sure the terms in the Agreement of Purchase and Sale are legitimate and genuine – don't help create a misleading situation for the lender. Consider reviewing or discussing the transaction with another lawyer in a way that protects client confidentiality. Seek advice from Practice Advisory Services at the Law Society. Work with other professionals who are being equally careful. Avoid having documents executed outside your office.

For more, see the extensive list of real estate fraud articles at [www.practicepro.ca/fraud](http://www.practicepro.ca/fraud).

- **Bogus bank drafts on mortgage deals:** A variation of the bogus bad cheque/draft scams (described more fully below), fraudsters in these schemes get real estate lawyers acting on mortgage deals to run bad bank drafts through their trust accounts. In some instances, the supposed fraudster has used the identity of a major national financial institution as the actual lender in the transaction.

A new client or lender contact allegedly from a major bank asks the lawyer to act on a mortgage matter; mortgage instructions and/or a bank draft drawn on a major bank look legitimate. In some instances, the fraudsters have stolen the identity of a real property owner. The instructions and the draft turn out to be counterfeit.

**Risk management tips:** Use the title search, telephone book, Internet and other sources to make an independent cross-check of client and bank names, addresses, phone numbers and other information in the documentation provided to you. Carefully examine all cheques and bank drafts for authenticity, and never let your client directly deposit cheques or bank drafts into your trust account.

Protect yourself when dealing with the bank. Don't rely on oral confirmation from your bank at time of deposit that the bank draft is good. Don't disburse funds immediately – even if your client is pushing! Wait until the second bank-to-bank verification before issuing funds from your trust account. For branches in major centres this often will take one or two banking days, and for branches in more remote locales as long as a 8-10 calendar days.

For more, see **Show Me the Money** article for more information on funds transfers (Summer 2008 *LAWPRO Magazine* at [www.practicepro.ca/magazinearchives](http://www.practicepro.ca/magazinearchives) ).

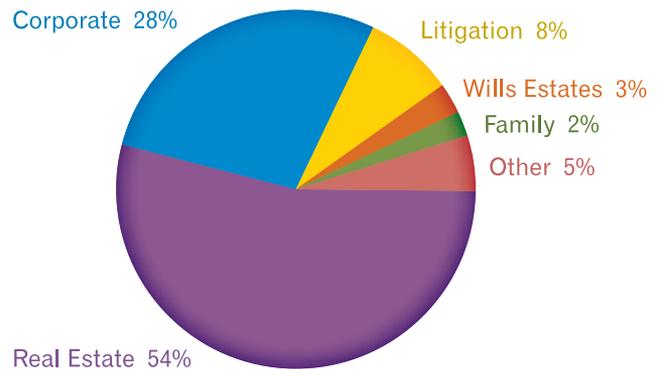
### CORPORATE IDENTITY THEFT

Much like personal identity fraud, corporate identity fraud involves the wrongful taking of the identity of a corporation – with an added level of sophistication. Fraudsters in these instances often enlist someone with expertise to create and falsify corporate minute books, or adopt the personal identity of one of the corporation's controlling individuals, or create a new rogue identity to act as the controlling mind of the target company.

In one such case that cost *LAWPRO* the full \$1 million per claim policy limit, a lawyer acted for an individual who had filed the required form under the *Business Corporations Act* that, among other things, named the individual as a director of a numbered company. The lawyer relied on that form in acting on the subsequent multi-million dollar mortgage on a property owned by the company – and the fraudster promptly disappeared with the funds.

**Risk management tips:** If you're acting for the lender, ask for a corporate opinion from another lawyer. If you're acting for the borrower, get an updated corporate profile and status certificate.

### Fraud claims (2004-08) by cost



Watch for recent changes in directors, officers or addresses. You want to ensure the corporation is properly constituted. Ask to see the minute books. Ensure that the party signing for the corporation is an authorized signing officer and that all formalities with respect to the execution of a document on behalf of a company are taken and adhered to, particularly the requirement for multiple signing officers as per the by-laws of the company.

For more, see the article **Corporate Fraud: Identity Theft with a Difference** by Neil Smiley at [www.practicepro.ca/fraud](http://www.practicepro.ca/fraud).

### BOGUS CHEQUE SCAMS

In the last year we have seen numerous such frauds. Whether they involve collections or business loans, these scams have a common goal: to run a fraudulent certified cheque or bank draft through your trust account. You disburse funds relying on the bad cheque – on instructions from the fraudster. The fraudster gets real funds from your account, and when the bad cheque bounces there is a shortfall in your trust account.

Debt collection frauds often involve new clients from outside Canada who seek your help on a debt collection, often with the promise of a hefty fee for your services. Surprisingly, the debtor pays up quickly after you send your demand letter and sends a cheque payable to your firm in trust. As instructed, you promptly send the funds offshore – and discover later the shortfall in your trust account.

On a business loan fraud a new client (often offshore) retains you to help with a small business loan. The client's documentation looks real; background checks seem to check out. After you deposit the certified cheque (which also looks authentic) that you receive from the supposed lender and disburse funds as instructed, you learn the cheque was fraudulent.

### PLEDGE OF FRAUDULENT SECURITY

In a variation of the loan fraud scheme that *LAWPRO* saw recently, the client provided a retirement savings plan and a life insurance policy as security for loans. The letterheads of the financial institutions used to evidence the existence of the account and policy contained a number of grammar and syntax errors; documents were also allowed to leave the lawyer's office, ostensibly to have them signed by the financial institutions. Neither the account nor the policy existed. The cost to the insurance program: More than \$560,000.

The article, *Anatomy of a fraud alert* on page 5 details the most recent loan frauds.

**Risk management tips:** *Look for grammatical errors, misspellings, unusual sentence construction and the use of cellphone numbers as the only contact number for a financial institution: They are among the many red flags that should prompt you to dig deeper.*

For more tips see the extensive list of articles on these types of fraud at: [www.practicepro.ca/fraud](http://www.practicepro.ca/fraud).

#### EMPLOYEE THEFT OR FRAUD FROM THE INSIDE

LAWPRO has seen several cases in which long-serving, trusted employees masterminded stealing money from trust accounts and/or setting up phoney deals in order to scoop mortgage money. In many of these situations, the lawyers abdicated responsibility for running their law offices to law clerks and other employees who could not resist the opportunity to access the lawyers' trust accounts. In some instances, lawyers had given their employees authority to meet with and sign up clients, sign cheques and register documents through Teranet Inc. The employees often had

the lawyer's e-reg® passwords in order to close transactions – in breach of Teranet security protocols and the Rules of Professional Conduct.

**Risk management lessons:** *Clerks must not be allowed to sign trust account cheques unless there are exceptional circumstances and special arrangements are made regarding bonding in accordance with By-Law 9. Nor should you leave blank trust account cheques available; only partners should have the authority to sign trust account cheques. Clerks must not have access to your e-reg password. Also ensure every member of your staff takes at least one full week of consecutive vacation days each year – people who love their work so much that they never take a vacation could well be trying to hide fraudulent activity.*

For more see the following articles:

- **Fraud on the inside: What to do when partners, associates or staff commit fraud;**
- **Fraud: The threat from within; plus Screening new staff during the hiring process;**

at [www.practicepro.ca/fraud](http://www.practicepro.ca/fraud).

# fraud

## Can you keep a secret?

### Identity theft and the dangers of posting personal and professional information on social networking sites

More and more people are using social networking sites. And although they offer all sorts of interesting new ways to interact with people in both personal and business spheres, they also expose you to hidden risks, including identity theft.

How can this happen?

Your FaceBook, LinkedIn or other social networking site profiles can include information such as your birth date, where you went to university, your mother's maiden name, or where you articulated and when. In the pre-Internet era only your family, close friends and co-workers might have been privy to this information. Social networking sites make it freely accessible to anyone.

Someone intent on stealing your identity will visit social networking sites and gather information about you. They then use it to create a new identity for themselves – your identity. For example, they can use it to bypass the standard challenge questions that banks, credit card companies and others use to verify your identity. What

is your mother's maiden name? When did you graduate from university? Do these questions sound familiar?

Having your identity stolen can have severe consequences. It's not only stressful to have to restore your true identity, but also takes time and money and can leave you – even temporarily – with a bad credit rating. This is not only a personal issue; situations in which fraudsters have assumed a lawyer's professional identity have occurred in Ontario.

The lesson is clear: You want to do everything you can to avoid identity theft. And you certainly don't want to do anything to help someone steal your identity. Be careful about how much personal and professional information you post in social networking site profiles, especially where that information might be used to verify or establish your identity.

Also look for a more detailed discussion of social media – the pros, the cons, and how you can best navigate through this new world to benefit your law firm – in an upcoming issue of LAWPRO Magazine.