

Fighting fraud: tips for lawyers

What can be done when fraudsters continue to refine their schemes? Obviously the financial institutions should be more diligent in researching and reviewing the proposed transactions before agreeing to lend money. But the lawyer acting for the financial institutions also has an important role to play.

Obtain photo identification

The examples listed on the previous pages emphasize the need for lawyers to obtain photo identification of borrowers to protect themselves from negligence claims.

In *Yamada v. Mock*, the court clearly said that lawyers cannot prevent fraud but can make it a little more difficult for the fraudster and should at least obtain identification from the borrower. This seems to be the current standard of care for lawyers. Failing to do so will no doubt bring a claim against the lawyer in a fraud or impostor case.

The proliferation of identity theft today means you must be on guard. Lawyers should ensure that they keep copies of the identification in the file and ensure that it is legible. It is critical to proving that you met the standard of care that you have the evidence in your file of your confirmation of the borrower's identity.

Keep the lender informed

If the vendor on the Agreement of Purchase and Sale is not the same as the person listed as the last registered owner on the search,

questions should be asked. If there is a flip involved, advise the financial institution of this information. If the price from one sale to the next has escalated significantly, the lawyer should also consider advising the financial institution, so that the final decision as to whether or not to proceed with the loan transaction is made on the basis of all relevant information.

Question unusual directions

As well, the lawyer should carefully scrutinize and critically assess any directions he/she receives to determine whether persons seemingly unrelated to the transaction (other than a recognized creditor) are to receive significant amounts from the mortgage proceeds. If a large percentage of the mortgage proceeds are to be paid out to the borrower themselves, or to parties other than a financial institution or recognized creditor, questions should be asked.

Consider title insurance.

Most title insurance policies insure against fraud. Discuss the title insurance option with your clients, so they fully understand the scope of coverage that title insurance provides. At the same time, appreciate the impact of these frauds on title insurers. Follow all of their procedures carefully to be certain that a policy is issued and coverage is available.

– Based on contributions from S. Troister, R. Potts and M. Selznick

What if you suspect a fraud?

The Law Society advises that lawyers become familiar with the indicators of fraud in real estate transactions to avoid becoming the tool or dupe of their clients.

Lawyers should also know that the Law Society can help answer questions about lawyers' ethical obligations should they be acting in a transaction where a client is or may be committing a fraud. For example, the Society's Practice Advisory department can give guidance to lawyers on their obligations regarding disclosure of confidential client information to third parties, obligations when acting on a joint retainer for both the lender and the borrower in a transaction, and withdrawal of their services.

The *Rules of Professional Conduct (Rules)* specifically prohibit lawyers from assisting in any dishonesty or fraud. Subrule 2.02(5)

provides that a lawyer shall not 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. The commentary to the subrule warns lawyers to guard against becoming the tool or dupe of an unscrupulous client or persons associated with such a client.

Lawyers with questions about their ethical and regulatory responsibilities can access practice tips, the *Rules* and other resource materials on the Law Society's Web site at: www.lsuc.on.ca. The Practice Advisory department is also just a phone call away at 416-947-3315 or toll-free at 1-800-668-7380, ext. 3315.



Fighting fraud:

build a better checklist

The first thing Stephen Shub did when he learned of the proliferation of real estate frauds was to beef up his already-extensive intake form/checklist guide to include a series of fraud flags.

"It might take an additional minute or two to ask a few more questions in my initial conversation with our client when we're doing a purchase or refinance transaction – but in my mind, that's time well spent," says Shub, a sole practitioner based in North York. "Because in the long run, these flags save us time. We don't end up spinning our wheels on garbage or nonsense transactions. We don't end up doing all our searches and documentation only to find out that there's a real issue here.

"I think that's the problem in so many situations: The lawyer cranks up the file too quickly only to find out too late – when the pressure to close is tremendous and he's invested a lot of time and effort – that there's an issue that could come back to bite him.

"Our view is that we want to take the time to identify these potential issues before we do a whole lot of work on the file. I don't want to end up the duped lawyer – because even if you are totally innocent, the consequences are huge: The investigative process exacts a huge toll on your practice and on you personally."

The fraud flags he's incorporated into both a form he completes as part of his initial conversation with his clients, and into his refinancing pre-closing checklist, are based on common indicia of fraud that he learned about from readings and attending various seminars on the subject of real estate fraud. The fraud flags used on his refinancing intake form/initial conversation with the client are reproduced on this page. To see the complete opening checklist Shub uses, go to www.practicepro.ca/refinancechecklist.

Fraud Flag Questions:

- | | | |
|-----|----|---|
| Yes | No | Client not known to us before |
| Yes | No | No existing first mortgage to discharge |
| Yes | No | Client wants \$\$ paid to unsecured 3rd party by us |
| Yes | No | 411.ca does not confirm that residence telephone connects to address given |
| Yes | No | Client appears to have problem providing documents |
| Yes | No | Financing is based on a concocted purchase agreement |
| Yes | No | Property is vacant or tenanted |

Total number of "yes" answers: _____

If there are two or more "yes" responses, staff are instructed to check with Shub after obtaining a copy of register showing deleted documents to check for any recent mortgage discharge or title transfer, and before opening the file and "before leaving initial conversation in a prospective client filing system which is alphabetical by surname."

Shub also must sign an internal acknowledgement on his own pre-closing checklist acknowledging that if there were two or more "yes" responses to the fraud flag questions, he has been consulted and has given permission for the transaction to proceed.

Reproduced courtesy of Stephen Shub.

Fighting fraud:

protect security of PSPs



PSPs – personal security packages – issued under a lawyer’s Teraview account – are key to accessing Ontario’s electronic registration (e-reg™) system. Their security is vital to the integrity of the e-reg system. Recognizing this, the Law Society in June 2002 approved additions to the *Rules of Professional Conduct* and new practice guidelines for the electronic registration of title documents.

Subrules 5.01(7) and (8) to rule 5.01, impose obligations on a lawyer regarding the use of PSPs issued under the lawyer’s Teraview account:

- Each user under a Teraview account, that is, each person in a law firm that accesses the e-reg system, must obtain a PSP (a personalized, specially encrypted diskette and corresponding pass phrase) to access the system.
- Subrule 5.01 (7) provides that a lawyer shall not permit others, including a non-lawyer employee, to use the lawyer’s personalized specially encrypted diskette and shall not disclose his or her personalized e-reg pass-phrase to others.
- Subrule 5.01(8) provides that when a lawyer has a non-lawyer employee who has a personalized, specially encrypted diskette and personalized e-reg pass-phrase to access the system, the lawyer shall ensure that the non-lawyer employee does not permit others to use the diskette and does not disclose his or her personalized e-reg pass-phrases to others.

These subrules aim at preserving the integrity and security of the e-reg system which is achieved, in part, through Teranet maintaining an audit trail of all transactions and the parties who performed them identified by the pass phrase used.

They also emphasize to lawyers the importance of maintaining and ensuring the security and the exclusively personal use of the lawyer’s PSP. The e-reg system permits only lawyers in good standing to make statements professing compliance with law without the registration of supporting documents.

Commentaries to subrules 5.01 (2) and (3) provide that a lawyer not delegate the signing for completeness of any document that requires compliance with law statements, and that a lawyer who approves the electronic registration of title documents by a non-lawyer is responsible for the content of any document that contains the electronic signature of the non-lawyer.

A commentary to subrule 6.03(8), the rule dealing with undertakings given by lawyers, provides that in real estate transactions using the system for the electronic registration of title documents, lawyers acting for the parties (with their consent) will sign and be bound by a Document Registration Agreement that will contain undertakings.

When entering into a Document Registration Agreement, a lawyer should have regard to and strictly comply with his or her obligations under subrule 6.03(8). This subrule provides that a lawyer shall not give an undertaking that cannot be fulfilled and shall fulfill every undertaking given.

For the full text of the Rules and commentaries, go to www.lsuc.on.ca/services/RulesProfCondpage_en.jsp

(e-reg is a registered trademark of Teraview Enterprises Inc.)

Fighting fraud:

implement appropriate internal controls

*Ed note: The following is excerpted from **Managing the Finances of Your Practice**, the sixth in a series of booklets published by practicePRO, LAWPRO's risk management initiative, to help lawyers more effectively manage the risk associated with law practice. The booklet is available in PDF format at www.practicepro.ca/financesbooklet.*



Ideally, your office should have clearly established internal controls for handling and documenting all types of financial transactions. These internal controls are really just policies and procedures that direct what steps should be taken when various financial transactions occur. Although a lack of internal controls does not necessarily constitute a breach of the Rules of Professional Conduct or By-laws, you may consider implementing internal controls to assist your efforts to comply.

The following are some suggested internal controls you may consider implementing at your office¹:

Cheque requisitions

When dealing with cheque requisitions for both your general and trust accounts, consider the following:

- All cheque requests are accompanied by a signed cheque requisition evidencing approval.
- Only certain designated lawyers may authorize trust account payments.
- Only certain designated individuals may authorize general account payments.

- Firm personnel responsible for preparing cheques are instructed not to prepare cheques unless the requisition includes a signature of approval.
- Supporting documentation (such as an original invoice, reporting letter, statement of receipts or disbursements) accompanies the cheque requisition, where possible.
- Original copy of the invoice is stamped paid (to prevent an individual from using an invoice more than once to obtain funds).
- Photocopies of invoices are not generally accepted as support for cheque requisitions.

Cheque signing policies

When dealing with cheques requisitions for both your general and trust accounts, consider the following:

- Cheques in excess of a threshold amount require the signatures of two partners.
- Cheques are never to be signed in blank.
- Cheques made payable to financial institutions include details of the transaction.

- Cheques are in numbered order and the sequence is checked.
- At least one of the individuals signing the cheques always reviews the request for payment to determine if the request relates to trust funds and reviews the client file, to determine:
 - validity of the request for payment;
 - reasonableness of the amount requested;
 - if sufficient funds are available to pay the amount of the cheque; and
 - that an accounting to the client for receipts and disbursements is completed.

Trust records

Trust accounts are an essential part of the practice of law. When dealing with trust accounts and trust records consider the following suggestions:

- Monthly reconciliations and adjustments are reviewed and signed by someone other than the individual who prepared the reconciliation.
- Reviewer of the reconciliation ensures that:
 - reconciliations are prepared on time;
 - reconciled items are cleared promptly;
 - all unusual items are questioned and an adequate explanation is given for the unusual nature of the item and noted in the firm records and client file.
 - a list of trust balances is periodically reviewed for closed or completed matters including trust balances that have not changed in the past twelve months.
- Trust transfer requisitions are prepared to transfer funds from one client's trust ledger account to another trust ledger account; and:
 - written authorization from the client to transfer funds to another trust ledger is always obtained prior to the trust transfer;
 - the trust transfer requisition is signed by the responsible lawyer and an explanation is provided; and
 - the accounting department, or personnel responsible for accounting, has been instructed to process trust transfer requisitions only if the criteria for signatures and explanations has been met;
- A senior partner or office manager periodically reviews the client's trust ledger accounts for unusual items.
- Blank trust cheques should be kept in a secure manner.

Staffing policies and procedures

Law firm staff are an essential part of getting all work done in a law office. The following are some suggested staffing policies that can operate as internal controls:

- The firm has a policy respecting an individual's need to take regular holidays.
- The firm conducts periodic reviews of lawyers' work.
- Periodic reviews of client files are conducted by a senior partner or office manager to ensure:
 - the client receives an accounting for trust receipts and disbursements;
 - the details of the accounting to the client match with the trust ledger; and
 - the file is maintained in an orderly fashion.
- Lawyers are required to consider whether their outside interests may put them in a conflict of interest situation.

The firm should also be aware of indicators of potential problems which may result in inappropriate activities or conduct, including:

- a lawyer who is consistently too busy to take holidays;
- a lawyer who appears to be living beyond his or her means;
- sudden and significant increases in advances for entertainment expenditures;
- large increases in unbilled disbursements;
- a lawyer whose production has fallen off for no apparent reason;
- a lawyer who appears withdrawn or nervous;
- a lawyer who continually makes last-minute requests for funds.

Segregation of duties

Lawyers should segregate firm duties so that the same individual does not have complete control over the management of funds. Consider the following suggestions:

- The individual who opens the mail is different from the individual responsible for preparing a listing of all cash and cheques received.
- All cheques received are stamped "deposit only."
- The firm issues receipts for all cash or cheques received to:
 - provide client with proof of payment;
 - help prevent funds from being redirected to another client's account; and
- The numerical sequence of receipts is checked to ensure that all funds receipted are also recorded in accounting records and deposited into the bank.

¹ This section is based in part on the Financial Management Guideline prepared by the Law Society of Upper Canada (www.lsuc.on.ca/services/pmg_summary.jsp).

Fighting fraud: organizations collaborate

If there's one thing all parties concerned about real estate fraud agree on, it's that there is no silver bullet with which to fight fraud. Instead, it will take a multi-faceted effort on the part of all players in the mix – lawyers, lenders, real estate agents, mortgage insurers, industry associations and provincial ministries and agencies – to address the problem.

To this end, the Ministry of Consumer and Business Services (MCBS), Teranet Enterprises Inc., and LAWPRO, have joined together on a committee to examine how to work together in dealing with and preventing fraud. This committee consists of representatives from the lending and legal communities, title insurers, mortgage insurers, provincial ministries, law enforcement agencies and others.

The committee's existence is a first, acknowledges Kate Murray, Director of Titles for Ontario's land registration system of MCBS and one of the key committee organizers, and reflects a recognition that a collective effort is needed to combat fraud.

"We are working on many fronts: What reforms, for example, might be needed to existing regulatory and legislative frameworks that deal with the reporting, monitoring and action on real estate fraud allegations. How do we best share information among committee members and organizations? What do we need to do to educate all participants in a real estate transaction – from realtors and financiers to lawyers, regulators and government – about the issue and how do we best deliver these educational initiatives?"

Individually, organizations are also taking action. The Canadian Institute of Mortgage Lenders and Brokers (CIMBL) for example, has issued a revised draft of its best practices document – a standard of practice guide that is aimed specifically at mortgage originators, both independents and those still working within financial institutions.

"In the late 1990s, the independent mortgage originator channel accounted for about 10 per cent of mortgages; today, this channel accounts for more than 25 per cent of all mortgages," reports Mark Webb, CIMBL's Senior Director of Professional Affairs. And with the incidence of fraud on the rise, lenders, insurers and brokers recognize the need to set a practice standard for this source of business. "The mortgage community is concerned about the deals they are seeing and the losses they are experiencing. Fraud is no longer just a cost of doing business – its scope is such that action needs to be taken."

The new standards suggested in CIMBL's "Origination Standards for Fraud Avoidance" document significantly raise the bar when it comes to the mortgage originator, requiring documentation, identification and investigation. The document reflects a new set of higher expectations that, Webb believes, are an inevitable

outcome of fraud. "The lenders, insurers and brokers all have an increased awareness of the need to raise expectations – of themselves, of lawyers and all other parties to a mortgage transaction." Similarly, he points out, there are signs that the Office of the Superintendent of Financial Institutions, which oversees the financial sector, is likely to tighten the standards to which the lenders are held accountable. "I think we're going to see stricter standards all around."

CIMBL and the Canadian Mortgage and Housing Corporation (CMHC) are working individually to train lenders and brokers on the issue of fraud, adds Marie Dyck, Senior Advisor – Fraud for CMHC's Insurance Servicing Division.

"The entire mortgage industry – lender, insurer, agent, broker, lawyer – need to act together to address this problem. Fraud will always target the weakest link: So if only one of us implements anti-fraud controls, fraud will simply move to another segment of the industry where the controls are weakest."

For its part, the Real Estate Council of Ontario (RECO) – the regulatory body through which real estate salespeople and brokers are registered – is stepping up its member- and consumer-oriented educational efforts, as well as its investigative/reporting activities.

RECO currently publishes the names and disciplinary proceedings of those who are subject to internal disciplinary action by the Council as a result of violations of RECO's Code of Ethics. RECO will publish the particulars of revocation proceedings and the names of those who have breached the Real Estate and Business Brokers Act (REBBA), the legislation governing the real estate industry in Ontario. A new newsletter to be launched this fall will focus on fraud as part of the Council's effort to raise agent and broker knowledge of mortgage fraud.

RECO also aims to better educate consumers about what to expect in a real estate transaction, and to inform consumers about the services already available to help them check out their real estate agent or broker.

The RECO Web site, for example, lets anyone do a real-time search of its 39,000-member database – enabling any member of the public to verify the identity and credentials of individuals who hold themselves out to be licensed real estate professionals. Plans are to highlight this service to the public, as well as enlist consumers in helping spot fraud by educating them about the details of a real estate transaction.

"The key message we want to get out is that registrants who participate in mortgage fraud not only face the prospect of being charged criminally but could lose their registration," says Prendergast. "We also recognize that no one organization alone

can solve this problem. We know from experience that fraud often happens when many players in the mix are complicit. There is no single solution that will work for each of us.

To address the problem, the many organizations that have a stake in this issue – lenders, lawyers, insurers, agencies such as ours and others – have to work together to fight fraud.”

Law Society initiatives: CLE, training, resources

The Law Society of Upper Canada is developing a range of informational resources for lawyers, and is working with other organizations as part of a collaborative approach being taken to deal with and help prevent mortgage fraud.

In addition to the guidance available to lawyers through the Law Society's Practice Advisory department, the Law Society is developing reference materials and continuing legal education (CLE) programs to help lawyers involved in real estate transactions avoid becoming the tool or dupe of unscrupulous clients.

The Law Society is currently developing CLE programs on the topic of fraud that will be presented in Fall 2004. The Law Society previously presented a CLE program titled “Real Estate Fraud: Protecting Your Practice from the Brazen New Breed of Fraudster” on January 26, 2004. Materials from the program are currently available on the Law Society's e-Transactions site at: <http://ecom.lsuc.on.ca> or by calling the Law Society's Member Resource Centre at 416-947-3315 or toll-free at 1-800-668-7380, ext.3315.

The Law Society is also working with other organizations as part of a multi-faceted approach to dealing with and preventing fraud.

“All institutions, lenders and regulatory bodies touched by this issue must work together to attack the problem and to develop safeguards against future occurrences,” says Zeynep Onen, Director of Professional Regulation for the Law Society.

In April 2002, the Law Society created a special mortgage fraud team in its Investigations department to concentrate its full-time focus on complaints of alleged mortgage and real estate fraud involving lawyers. In the course of its work, Law Society staff have developed expertise on the issue which has been shared with various lending institutions and regulatory bodies.

“The Law Society has presented seminars to share the learning coming out of our investigations,” notes Onen. “Our hope is that together we can develop methods that will help better identify possible fraudulent transactions before they are completed.”

The Law Society is currently coordinating additional workshops, and will include seminars for Crown Attorneys and police officers.

Online reference materials for lawyers will include:

- Fact scenarios, which will provide examples of how frauds may occur in the context of a mortgage transaction, including identity fraud.
- A list of potential fraud indicators.
- Useful practice tips.
- References to the *Rules of Professional Conduct*, including some of the lawyer's ethical obligations when acting in a transaction where a client may be engaged in a fraud.
- Questions and answers (Qs and As), which are being developed based on a sample of the questions received from lawyers by the Law Society's Practice Advisory department and from the experience gained by the Law Society during its investigation of mortgage fraud-related disciplinary matters.

These reference materials will be available on the Law Society's Web site at: www.lsuc.on.ca/services_en.jsp. The online materials will be supplemented with links to additional resources available on the Web sites of other partners in the fight against fraud, such as the Ministry of Consumer and Business Services, LAWPRO and the Canadian Institute of Mortgage Lenders and Brokers. The Law Society is also publishing information and promoting the online resources in a special section of its July/August 2004 issue of the Ontario Lawyers Gazette. In addition, the Law Society's Practice Advisory department is available to provide assistance to lawyers with ethical questions on the topic and can be contacted at 416-947-3315, or toll-free at 1-800-668-7380, ext. 3315.

For continuing updates and resources related to this issue, visit the Law Society's Web site at: www.lsuc.on.ca.

Heather MacDonnell is a communication advisor with the Law Society.

TitlePLUS fraud measures

The increased attention being paid to fraud has prompted LAWPRO to increase its scrutiny of applications for TitlePLUS coverage.

This additional fact-checking will happen automatically and in an automated fashion to all TitlePLUS applications submitted

over the Web. The application system now will run a number of fraud prevention checks which may increase by a few seconds the time it takes to obtain a pre-approval on a TitlePLUS application; in some instances, the application may trigger the need for a manual review by one of the TitlePLUS underwriters. Additional anti-fraud measures are being contemplated.