

LawPRO Alert

ATTENTION

October 7, 2014

[Send this to a friend](#)

You may be exposed to a claim if you release a private mortgage advance to a third party

LAWPRO has become aware of a new exception to coverage in certain title insurance policies which could expose real estate practitioners to claims from their private lender clients.

The issue has recently arisen in connection with private residential mortgage transactions, and in particular where the lender and borrower are separately represented, as required, because the loan is more than \$50,000. This is the basic scenario: After the lender's and borrower's lawyers conduct their respective work and due diligence, the lender's lawyer provides the mortgage advance to the borrower's lawyer, in trust. The borrower's lawyer accepts a direction from his/her client as to how the mortgage advance is to be paid out. The direction provides for funds to be paid to one or more third parties. Typically, the lender's lawyer would not see this direction. The lender's lawyer purchases a title insurance policy. It turns out that a fraud has been perpetrated (i.e., the borrower has been impersonated). The lender files a claim with its title insurer as a result of the fraud. The title insurer denies the claim as a result of an exception in the policy dealing with distribution of the mortgage proceeds.

The typical wording of this exception provides that, notwithstanding the coverage offered by the policy, the company may deny coverage and has no liability to the insured in the event the proceeds of the insured mortgage are paid to any person or entity other than the registered title holder, the holder of a prior registered encumbrance, execution creditor or other specified, limited types of payees. LAWPRO has only very recently become aware of this exception, but already we have seen it in E&O claims against lawyers involving residential lender policies from three different title insurers active in Ontario. Sample clauses that have been involved in claims filed with LawPRO appear [in this post on the AvoidAClaim blog](#).

If the lender's lawyer is not aware of or does not alert a lender client to the existence of this exception, and highlight the potential for a denial of coverage if the mortgage proceeds are paid to parties other than those permitted in the exception, the lender's only likely recourse will be a negligence claim against the lender's lawyer in the event the lender's title insurance claim is denied. We have recently seen several claims arising out of this exact scenario, including some involving substantial dollar amounts.

Note that in transactions where a lawyer is permitted to act for lender and borrower (e.g., under \$50,000 or when non-arm's length parties) and payments are made to third parties, the lawyer will be taken to know that the exception applies if a fraud is perpetrated. Why? Because the lawyer will have both undertaken the distribution of funds in contravention of the exception and negotiated or accepted the policy with the relevant exception.

From a claims prevention point of view, the above scenario highlights the

Online community

[AvoidAClaim Blog](#)

[Follow us on Twitter](#)

[LAWPRO on Facebook](#)

[TitlePLUS on Facebook](#)

Quick links

[File online](#)

[Address change](#)

[Report a claim](#)

[Order materials](#)

lawyer's duty to carefully review the terms of a title insurance policy and explain them to a client. As lenders will expect fraud coverage to be in place, LAWPRO encourages lawyers acting for lenders to be aware of these exceptions and where applicable based on the presence of the exception, to advise lender clients that there may not be coverage where there has been a fraud and mortgage funds are paid to one or more parties other than those permitted in the exception.

This exception is not being added to TitlePLUS policies as a matter of course, although TitlePLUS underwriting requires the subscribing lawyer to advise if funds are going to non-permitted payees. Failure of the lawyer ordering the policy to comply with the underwriting requirement does not affect the lender's coverage under the policy, although it could result in review of a lawyer's status under the TitlePLUS Subscription Agreement. If you have any questions concerning the TitlePLUS underwriting requirements, contact the TitlePLUS Customer Service Centre via email at titleplus@lawpro.ca or call 1-800-410-1013.

If you have any questions about the exceptions discussed in this communication, please contact your title insurer. If you have acted for a lender in the scenario described above and there has been a fraud, there is the potential for a claim and the circumstances of your matter should be reported to LAWPRO – see the [How to report a claim page](#) on our website.

[Subscribe](#) | [Unsubscribe](#) | [Contact us](#)

About LAWPRO Alert:

LAWPRO Alert is distributed to LAWPRO insureds and other contacts (on request) to keep them up to date on the LAWPRO insurance program, risk management information and other news.

This publication includes techniques which are designed to minimize the likelihood of being sued for professional liability. The material presented does not establish, report, or create the standard of care for lawyers. The material is not a complete analysis of any of the topics covered, and readers should conduct their own appropriate legal research.



Lawyers' Professional Indemnity Company (LAWPRO)
3101 - 250 Yonge Street, Toronto, ON M5B 2L7, Canada
416-598-5899 or 1-800-410-1013
www.lawpro.ca

This email was created and delivered using [Industry Mailout](#)