

Did you know that some title insurers include exceptions to fraud coverage for private lender transactions where the mortgage funds are not paid to acceptable parties?

Title insurance for private mortgage lender clients: don't get caught on a technicality

In light of the commonly held view that real estate is a safe investment, many individuals use mortgage investments to supplement income or as a means of saving for retirement. Unfortunately, a reality of the current real estate landscape is that private lenders are often the target of identity frauds.

A title insurance policy generally includes coverage for identity fraud and although most real estate lawyers are familiar with the standard exclusions, title insurers often include transaction-specific “exceptions” to coverage. It is a lawyer’s failure to identify and consider these “exceptions” which have been a source of E&O claims for LAWPRO. It is important to review the exclusions and exceptions with your private lender client before advancing mortgage funds.

Some title insurers, but not TitlePLUS, routinely include exceptions to fraud coverage for private lender transactions **where the mortgage funds are not paid to acceptable parties**. With this exception, if the funds are paid to the borrower’s lawyer in trust or to any third party (other than those specifically set out in the exception), the title insurer may deny coverage for fraud.

This exception goes against the standard practice of the lender’s lawyer disbursing payments to the borrower’s lawyer in trust (where the borrower is represented by separate counsel). The requirement imposed by the wording of the exception, that payment be made directly to the “registered title holders,” is inherently challenging since the lender’s lawyer would not generally deal with the borrower directly.

As a result of the changing nature of title insurance underwriting in relation to private mortgages – when acting for a private lender – it is imperative to carefully review the coverage details to determine whether specific steps need to be taken, which might not otherwise be standard practice, and to obtain the client’s instructions. Warn the client of the risks associated with waiving the requirements set out in the exception, and document the discussion and client’s instructions. This will protect you in the event that issues are discovered after closing.

What to do:

Title insurers who use the private mortgage fraud exception may permit the lender’s lawyer to pay the borrower’s lawyer in trust **as long as the borrower’s lawyer provides a personal undertaking** that they will pay the balance of funds to acceptable parties (after payment of property taxes and prior registered encumbrances).

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Identity fraud and mortgages

An identity fraud occurs when a fraudster uses fake identification to assume the identity of an existing property owner (or director/officer of a corporate owner) for the purpose of granting a mortgage. The fraudster then absconds with the mortgage funds (after perhaps making a few mortgage payments) and the true property owner usually learns about the fraudulent mortgage upon receiving correspondence regarding the default.

In these situations, the true property owner may pursue a court proceeding to have the mortgage discharged without payment. Alternatively, the Director of Titles may hold a hearing, pursuant to subsection 57(16) of the *Land Titles Act*, R.S.O. 1990, to rectify the register by deleting the mortgage if it is found to be a fraudulent instrument. This process is usually known as a “Caution Hearing.” In either case, the lender is left with an outstanding

loan with no security and, in many cases, authorities are not able (or do not have the resources) to track down the fraudsters. Often a private lender’s only meaningful avenue of recourse is to submit a claim through title insurance. ■

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