

# Fraud: How You Can Avoid Being Its Next Victim

A complimentary webinar sponsored by LAWPRO

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## Agenda



- Why fraud is a concern
- The numbers
- The common scenarios
  - Commercial loan
  - Collection matter
  - Real estate
- The red flags
- How to protect yourself
- Getting more info
- Questions

## Today's speakers

- Dan Pinnington
  - Director, practicePRO, LAWPRO



- Rosanne Manson
  - Claims Counsel, LAWPRO



- Lisa Weinstein
  - Director, National Underwriting Policy, TitlePLUS



## Fraud claims: a growing concern

- 2008 E&O program
  - 136 fraud claims
  - \$8.7 million in costs (actual + reserves)
  - In 2007 107 claims costing \$8.5 million
- TitlePLUS program since inception
  - 2% of claims are fraud-related
  - 35% of claims costs
    - \$2.7 million in 2007, only \$27,000 in 2008



## Organized fraud targeted Ontario lawyers this month

- Contrived small business loan matters
- Set to close last week
- 17 matters averaging \$305,000
- Total: \$5.2 million
- Lawyers caught red flags or dug deeper on suspicious looking matters after seeing our e-blasts



## Bad cheque fraud



## Basics of bad cheque fraud

- Contrived matter that gets you to run fraudulent certified cheque or bank draft through your trust account
- You disburse funds on the bad cheque
- Fraudster gets real money from your account
- When the bad cheque bounces there is a shortfall in your trust account
  - Some fraud-related claims will not be covered under the LAWPRO policy

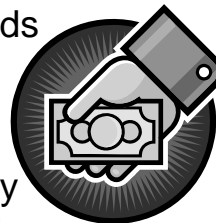
## Commercial loan fraud scenario

- Solo/small firm lawyers targeted
- Commercial loan transactions to buy small business equipment or inventory
- Will be new client to firm
- Documents in client's file will look real (invoices, letters etc.)
- Lawyer to act for lender and borrower
- Certified cheque from "lender" comes to firm
- Funds disbursed by lawyer



## Collection matter fraud scenario

- Litigators targeted
- New client outside Canada contacts counsel seeking help on debt collection
- Contingent payment from collected funds
- Lawyer sends demand letter
- Debtor pays up after only one day!
- Debtor sends sizeable cheque (typically \$250,000) – payable to law firm in trust
- Lawyer sends money offshore



## Protecting yourself: dealing with the bank



- Don't rely on oral confirmation from your bank at time of deposit that cheque is good
- Don't disburse funds immediately  
– EVEN IF CLIENT IS PUSHING!!!
- Wait until second bank-to-bank verification before issuing funds from your trust account  
– Wait at least 2-3 banking days
- See *Show Me The Money* article on funds transfers Summer 2008 LAWPRO Magazine

## Watch for the red flags



- New client (often offshore)
- E-mail and phone contact (even in person too)
- In a rush
- Before long weekend/bank holiday
- Client insists certified cheque goes through your acct and quickly gets wired to offshore bank
- Higher than usual fees on contingent basis
- Agreeable debtor pays after one call/letter
- Instructions change at last minute
- Cheque looks flawless but phone and transit numbers, addresses etc. are wrong

## Protecting yourself: digging deeper

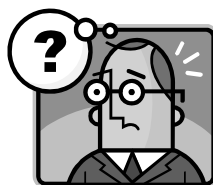
### if there are **red flags**



- Check drivers license on MTO site
  - [www.dlcheck.rus.mto.gov.on.ca](http://www.dlcheck.rus.mto.gov.on.ca)
- Google the bank or "company" issuing the cheque
  - Don't just rely on calling them as fraudsters will have someone to answer the specified phone number
  - Cross-check phone and transit numbers, address etc.
- Ask your bank to call the bank that issued the certified cheque to confirm the details on the cheque
- Call recipients of cheques issued from your trust account to confirm they are in fact expecting payment and are familiar with your client

## If you're still uncomfortable

- If red flags make you uncomfortable and you have dug as deep as you can
- Ask client for more information
- Call LAWPRO to get our take on it
- Refuse to act any further and terminate your retainer



## Real estate fraud



## Real Estate Fraud in the News



- “Two men in real estate fraud appear in court”: Vancouver Sun, March 3, 2009
- “Suspected mortgage fraud up 42% in 2007”: Inman News, April 7, 2008
- “Real estate fraud costs millions, groups warn”: Ottawa Citizen, March 16, 2007
- “Nominees and real estate fraud”, Radio-Canada program “La Facture”, March 28, 2009 (Montreal)

## Is it just us? No way!

- “Valley couple probed for alleged real estate fraud”: The Arizona Republic, March 9, 2009
- “Mortgage Fraud Case: Former real estate agent pleads guilty”: The Delaware Gazette, March 3, 2009
- “2 arrests in NY real estate scam”: Newsday, March 3, 2009
- “Real estate fraud growing in Polk and across Florida”: The Ledger, February 27, 2009
- “Real estate agent fined for fraud, has license revoked”: BYU Newsnet, February 23, 2009



## Real estate fraud: Types

- Identity Theft (i.e. forgery, impersonation)
  - Individual or corporate
  - Owner-occupied or tenanted
- Power of Attorney Fraud
- Equity Theft
- Value Fraud



How is fraud categorized?

Fraud for profit

vs.

Fraud for shelter

## Why is it occurring?

- Part of global trend
- Long-term changes in “know your client”
- Theft of ID and credit card information is common; many of us have been affected
- Availability of fraudulent ID via websites
- Organized crime – real estate frauds may have links to money laundering, terrorist financing and other illegal activities
- Increasing sophistication of some fraudsters

## Know the warning signs!

- If it's too good to be true...it probably is!
- We will highlight some common indicators
- Apply the “smell” test - use your instinct



## Real estate Identity Theft Fraud

- Client uses fake ID to assume identity of existing property owner (or director/officer of corporate owner)
- Client sells or mortgages the property, or discharges mortgage from title, then gets new (often high-ratio) mortgage from other lender, and repeats, using different lenders and lawyers each time
- Paperwork looks in order; may be no encumbrances on title, but one or more recently discharged mortgages
- Or existing mortgage may be for substantially less than new one
- Client in a hurry: may not be interested in house inspection, or discourage on-site appraisal
- Transaction closes, you pay proceeds to client who makes a few mortgage payments, then disappears

## Real Estate Value (“Flip”) Fraud

- Client says s/he is a real estate agent or in business of buying and selling
- Client promises high fees, lots of business for quick turnaround on deals (short turn-around means lawyer has little time to think about deal)
- Once transaction closes, client flips property to accomplice for much higher value
- Lender issues mortgage on inflated property value.
- Client uses mortgage proceeds to pay initial purchase price, splits excess funds with accomplices
- Client makes a few payments, then disappears with funds
- Lender sells property under power of sale, is out of pocket for excess/inflated value of mortgage.

## Red flags: The client



- Referral source new, strange or doesn't check out
- Use of power of attorney: Do you know the family? Is it a reasonable explanation?
- No interest in price, mortgage rate, legal/brokerage fees
- No title docs, survey, reporting letter, utility bills
- Unfamiliar or unconcerned with property
- Client "out of sync" with property
- Refuses to allow contact with prior lawyer
- Funds directed to one or more unconnected third parties
- Unusual financial provisions wanted in agreement
- Amendments to agreement lowering purchase price

## More red flags: The client

- Stranger to transaction seems to be calling the shots, may attend with client to sign documents
- Client asks for documents to be signed outside your office
- Property owned by family member, who may be elderly or vulnerable
- Client wants to give cell phone only for contact
- Deposit not personal cheque of client
- Tenant paying more than one month's rent up front

## Red flags: The transaction

- Repeat activity on single property or by single client on different properties
- Rush deals, promise of more if this one closes fast
- Small deposit relative to purchase price, or no deposit
- No amendments to agreement



## More red flags: The transaction

- Municipality, utilities have no record of client's ownership
- Unusual adjustments in favour of vendor, or large vendor take back mortgage
- Unusual restrictions on access to property
- "Private" sale – no agent named in agreement
- Or real estate agent named in agreement has no knowledge of transaction
- Mortgages discharged and replaced within short period of time

## Equity theft

- Attempt to strip out equity from property by placing new line of credit or conventional mortgage
- May be associated with spousal issues or crumbling business relationship
- Or can be ordinary ID fraud where value of property exceeds existing mortgage

## Power of attorney fraud

- Example: Reviczky v. Meleknia et al., (2007) 88 O.R. (3d) 699 (Superior Court of Justice)
  - Tenant of rented property forged owner's signature on Power of Attorney to imaginary grandson, then sold property to good faith purchaser who mortgaged it to HSBC Bank Canada
  - Lawyers overlooked defective execution of Power of Attorney
  - Court held transfer and mortgage invalid, stated lender could have avoided the fraud

## Protecting against power of attorney fraud

- Follow LSUC Guidelines
- Meet lender's requirements re transactions under power of attorney
- Review power of attorney document carefully
- If suspicious, consult with other lawyers
- Discuss with title insurance underwriter

## Protect yourself

- Read ID and compare with client
- Follow lender's instructions – they may have their own ID requirements
- Confirm referral sources
- APS terms must be legitimate & genuine – don't help create a misleading situation for lender
- Search deleted instruments
- Work with other professionals who are being equally careful and know warning signs of fraud

## Protect yourself (2)

- Fraudsters seek lawyers perceived as vulnerable – want lawyer's e-reg capability and trust account facility
- Lawyers recently called to Bar, doing few real estate deals, changing practice areas or gearing down for retirement may be at risk
- Consider market trends in the property area
- Be wary of unusual business relationships between lawyers and non-lawyers

## How can you help protect clients?

- No absolute way to prevent fraud
- Advise clients to be careful if renting property or leaving it vacant
- Clients should not assume mortgage on title prevents fraud – it can be fraudulently discharged
- Clients can check own credit reports -- may indicate an identity theft in process



## How does title insurance help?

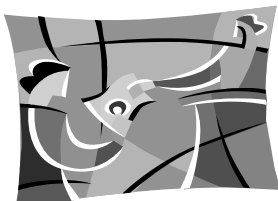
- Cannot prevent fraud
- But compensates if:
  - purchaser's or lender's interest invalid because of fraud; or
  - property is later a target of fraud, after buying/lending
- Duty to defend also applies
- Existing owner policies are available

## Internal fraud



## Beware fraud inside the firm

- 2 major multiple frauds by long-serving and most trusted law clerks
- Losses: \$6 million
- How:
  - Lawyer duped
  - Lawyer abdicated responsibility to monitor files and trust account to clerk



## The mechanics of internal fraud

Internal frauds happen because three things come together:

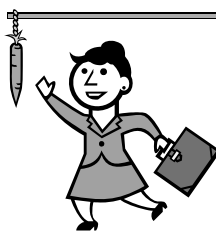
- Motive
- Opportunity
- Character



From David Debenham's article *When the unthinkable happens: What to do when partners, associates or staff commit fraud* in Winter 08/09 LAWPRO Magazine

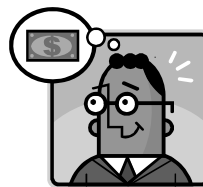
## Motive

- A need for cash:
  - Financial stress due to personal factors (divorce, business reversals, gambling)
  - Financing an unrealistic lifestyle expectation
  - Feels overworked and underpaid and is “setting things right”



## Opportunity

- Partners:
  - Work in “silos”
  - Only staff know what they are doing
  - Can override internal controls
  - Direct client contact lets them head off any client suspicions or complaints
  - Often use shell companies to divert funds
- Staff:
  - Will take advantage of flaws in accounting and internal control systems
    - E.g. bypass cheque requisition process because “emergency”
  - Most danger in ‘informal’ procedures
    - E.g. assistants forging lawyer’s signatures



## Character

- Will usually be person in position of trust
- Last person you would expect
- Long term and most trusted person
  - They have ability to circumvent normal procedures and processes



## How to spot internal fraud

- Most often practices with large cash flow through trust accounts
  - Wills, litigation, real estate
- Look for overly keen employee
  - Works long hours and never takes holiday or sick days
  - Hiding fraud is time consuming
- Change in lifestyle or personality
- Mail for corporation that has no client file
- Past due account notices
- Altered (handwritten changes) documents or cheques
- Original documents are missing



## Pro-active internal fraud prevention

- Separation of duties
- Do surprise audits
- Rotate staff
- Scrutinize shell companies
- Check that clients and suppliers are receiving payments issued by firm
- See practicePRO's *managing the finances of your practice* booklet for detailed list of internal controls
  - [www.practicepro.ca/financesbooklet](http://www.practicepro.ca/financesbooklet)



## Digging deeper if you think you have an internal fraud

- Respond with tact and care
- Keep in mind Rules of Conduct, employment law, LAWPRO policy
- Assume there is innocent explanation
  - Look for it and gather information/evidence
- Keep in mind *Rule 6.01(3)* – misconduct involving trust funds must be reported to Law Society



## Taking action on an internal fraud

- See David Debenham article *When the unthinkable happens: What to do when partners, associates or staff commit fraud*
- Checklists:
  - How to respond to and investigate a suspected fraud
  - What do after the fraud suspect has left the building



## Your marching orders

- Be aware of common fraud scenarios
- Watch for red flags
- If something doesn't add up
  - Ask extra questions
- And remember:
  - *If it sounds too good to be true, it probably is*



## Getting more information

- LAWPRO Fraud page
  - [www.practicepro.ca/fraud](http://www.practicepro.ca/fraud)
- Articles from LAWPRO Magazine
  - [www.practicepro.ca/magazinearchives](http://www.practicepro.ca/magazinearchives)
- LAWPRO Fraud Fact Sheet
  - [www.practicepro.ca/practice/pdf/FraudInfoSheet.pdf](http://www.practicepro.ca/practice/pdf/FraudInfoSheet.pdf)
- *Real Simple Real Estate Guide*™
  - [www.titleplus.ca](http://www.titleplus.ca)
- LSUC fraud page
  - <http://rc.lsuc.on.ca/jsp/fightingRealEstate/index.jsp>



## Call for more help

- Another lawyer
- Law Society Practice Advisory Service
- LAWPRO or TitlePLUS Customer Service  
1-800-410-1013 or (416) 598-5899



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Thanks and Questions  
Please!!

