Mortgage Fraud: Risk and Prevention in 2021

Mortgage fraud is moving to a professional level both in the home and in respect of investment properties, the risks to lenders are increasing. But there is some practical advice for prevention.

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There is a melting pot of issues that are likely to come to the boil in 2021. Some issues are obvious, such as the devastating impact of the pandemic on the economy and rising unemployment, both of which are inevitably resulting in financial difficulties for many individuals and businesses.

Others may be less so. For example, interest rates are likely to be low for some time; property values have been historically high and there has been a further upward rise in property prices as a result of recent, temporary stamp duty changes. Taxation reforms also represent a squeeze on landlords. The latter costs are likely to be passed on to tenants, many of whom may be in the lower income category and already facing significant post-Covid financial pressure.

The move towards working from home involves reduced interaction in person and greater reliance on documents. This results in a reduction in the ability to discuss a transaction and raise queries that might then lead to a potential fraud being picked up. Taken alongside the increase in conveyancing transactions occasioned by the stamp duty holiday – perhaps being processed by fewer employees due to furlough leave and job losses – that will create a perfect storm with the risk of checks, balances and details being missed.

Financial hardship, depression/stress/anxiety, declining property values, and decreased due diligence are all known contributors to fraud – hence the likelihood that 2021 will see an increase in the commission of new mortgage frauds.

Add to that the fact that current credit-risk modelling and scenario-planning may not take account of risks associated with 'little white lie' frauds[1] which have already been committed and which might have been camouflaged as performing loans in more favourable economic and property market conditions, and 2021 is also likely to result in many such frauds (and consequential under-performing accounts) coming to light.

Mortgage fraud at the professional level: What are lenders up against?

According to an October 2019 report from Onfido (a London-based vendor of AI-driven Fintech fraud solutions), incidence of fraud data demonstrates that many fraudsters are actually making a profession of it, working Monday – Friday and taking weekends off.

At this 'professional' level, a key risk for lenders is 'property hijack fraud'. This generally involves one fraudster posing as the owner of the property and pretending to sell it or to re-mortgage it, and often another fraudster posing as a purchaser and applying for a mortgage. The fraudsters employ increasingly sophisticated identity theft schemes, and state-of-the-art tech and systems expertise, to dupe innocent conveyancing solicitors, financial advisers/ intermediaries and mortgage lenders in order to circumvent due diligence and underwriting processes.

Associated techniques adopted by 'professional' fraudsters include impersonation of conveyancers, intermediaries, lenders and/or parties to a transaction; 'phishing'; and soliciting personal data via specific Covid-related scams, such as fraudulent e-mails, calls, texts from fraudsters posing as banks/lenders, charities, government officials, landlords etc. offering lower rates, lower rent, loan modifications, payment holidays/arrangements and other post-Covid relief or benefits etc.

Following completion, the fraudsters in a property hijack fraud disappear with the mortgage advance and often the fraud is not detected until days or weeks after it has been carried out – often meaning that the funds themselves can no longer be located or recovered.

Mortgage fraud within the home

Frauds in the home and spouse frauds often involve one partner borrowing against a property without the knowledge and consent of the other. In times where small and medium-sized businesses are feeling the strain, desperate and ill-judged decisions to "borrow against the house" will likely flourish if it is the only way to save the business from failure.

Such frauds also typically involve the provision of false or exaggerated (AKA 'staged') income, applicants reducing declared expenses to inflate apparent net profit; and credit abuse such as the non-disclosure of adverse credit, typically by failing to reveal a former address associated with defaults/CCJs.

Mortgage fraud involving investment properties

Investment property fraud typically involves buy-to-let properties. These are often 'no money down' transactions, and there are a number of dishonest mechanisms which fraudsters can deploy.

For example, sub-sales, back-to-back sales and gifted deposits – all common within the buy-to-let scenario – are designed in such a way as to facilitate a fraudster not disclosing to the lender the true purchase price that is being paid, with a view to the fraudster borrowing 100% of the true purchase price and, in doing so, not putting their own funds at risk. That can result in underwriting decisions, mortgage offers/advances and loan to value ratios being misconceived, and lenders ultimately suffering a shortfall if, at a later date, the property has to be repossessed.

Scheme abuse – that is, where borrower misrepresents purpose behind their loan (such as renting out a property purchased with a residential mortgage without the lender's consent) – can also be a particular risk associated with investment properties.

These types of frauds often come to light in an economic downturn, when defaults increase and re-mortgaging proves difficult or impossible due to negative equity.

Prevention is better than cure

There are a number of legal options by which a lender can attempt to recover lost funds/security but prevention of fraud will be more cost- and time-effective than any such cure.

So, what steps can lenders take to prevent mortgage fraud in 2021?

In respect of mortgage fraud at the 'professional level', within the home and in relation to investment properties, fraud risk management can be proactive (for example, putting into place systems, processes, checks etc when customer data is collected and stored – often as part of the on-boarding/account-opening process); and reactive (where fraud is suspected and/ or detected).

Being aware of the risks can help lenders and their advisers to spot potential indicators of fraud; adopting rigorous Know Your Client (KYC) due diligence in spite of changed working practices and related post-Covid challenges; and investigating/applying suitable Fintech solutions can all contribute to effective fraud prevention.

In particular, the following practical pointers may assist:

- **Staff education is crucial** – Lenders should ensure that their own colleagues are fully trained to be aware of fraud risks, to understand why risks are in fact risks, to spot indicators of fraud, and to follow mandatory processes and procedures to mitigate against and/or to react to incidences of potential fraud.

- **Due diligence on applications** – As a point of general good practice, really probing a loan application to get to know and understand the people and purpose behind it can be crucial.

- **Be wary of empty, high value properties** – The most attractive properties for hijack fraudsters to target are high value, empty and unencumbered. A simple but effective 'hack' is to write to the actual property address in question (and not to communicate solely via, say, e-mail or mobile phone) and to ensure that you receive a genuine response before proceeding with any transaction.

- **In-person valuer checks** – Mortgage valuers should visit any high value/high risk properties in person. When doing so, they should be asked to ensure that they meet the genuine owner – for example by comparing the 'owner' that they meet with the ID/photograph on the lender's file.

- **Obtain consent from all joint owners** – When dealing with jointly owned properties – and in particular where any party is self-employed – lenders/conveyancers should ensure that both/ all proprietors are aware of and consent to the proposed transaction [2]. If it is not possible to meet all owners to conduct such tests face-to-face, phone calls or (even better) audio-visual options such as Zoom, Teams, FaceTime and the like, should be utilised.

- **Purpose of loan** – Lenders/conveyancers should also satisfy themselves as to the purpose of any requested loan. In the post-Covid world, for example, someone who has been furloughed or relied on other government support would be less likely to apply for a large loan for home improvements.

- **Be alive to investment property risks** – Prevention of investment property fraud can be more difficult as lenders will often be wholly reliant on their various professional advisers: solicitors, valuers, brokers. The best option is therefore to be alive to the most typical scenarios in which such frauds are conducted; and then to be extra vigilant with every aspect of

the transaction and underwriting when applications are made in such scenarios. As well as sub-sales, back-to-back sales and gifted deposits, lenders and advisers should be aware that investment property fraud often targets multi -accommodation, such as blocks of flats or new-build developments. It often occurs where multiple loans are requested in a development or by a group of borrowers over a short period of time.

- **Query applications and advice** – Lenders should also not be shy in raising issues or querying applications, transactions or advice they receive from solicitors, valuers or brokers. Such individuals will be at the forefront of the transaction and, as such, better placed to spot mortgage frauds. Concerns over the quality standards and compliance with service level agreement terms should be raised early and resolved before proceeding with further transactions involving such parties.

Fintech

In today's market, Fintech solutions also abound, but they are not a silver bullet or impenetrable shield that will protect lenders from mortgage fraud; rather they should be considered to be part of the lender's arsenal in combatting fraud.

Proactive Fintech solutions, many of which can be deployed in real time include (non-exhaustively): multifactor authentication and identity verification tools, biometrics, tokens, enforcing complex password requirements, anti-malware, firewalls, and network analytics and dynamic scoring[3].

Key reactive Fintech solutions can perform millions of fraud checks within seconds, include (non-exhaustively): data enrichment/aggregation and data mining/pattern recognition[4] and the use of Artificial Intelligence.

The best advice is for lenders and their professional advisers to combine a stringent human-led KYC approach with suitable digital safeguards.

Comment

If you would like to discuss any of the issues covered in this article, if you are interested in Walker Morris fraud prevention training, please do not hesitate to contact Louise Power or Sandip Singh.

Reference

1 An Equifax survey carried out in Canada in 2017 found that 8% of respondents admitted to making material misrepresentations on mortgage applications and 13% saw no issue with telling white lies on applications

2 https://www.walkermorris.co.uk/publications/undue-influence-etridge-and-mrs-browns-boys/

3 leveraging a user interface to reduce the time it takes to gather intelligence and to investigate and assess risk and generating scoring networks created from underlying data to drive insights, uncover hidden relationships/risks.

4 the process of combining third party data from an external, authentic source, with data held internally and the classification, grouping and segmenting of data to search through up to millions of transactions to find patterns and detect fraud.

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Louise Power has a varied practice which in recent years has focused on financial litigation involving secured lending. Louise is instructed on cases ranging from multi-jurisdictional frauds to surveyor's negligence via non-standard possession actions and has become a trusted advisor to the financial institutions with whom she works. Clients comment on her integrity and the way she takes the time to understand their business needs and objectives.

Louise also specializes in real estate litigation and acts for developer clients on disputes relating to issues of construction quality and consumer complaints. Following the repeal of the Property Misdescriptions Act Louise has presented to the housing industry in conjunction with the Home Builders Federation and has devised an e-learning training programme for developers in relation to the Consumer Protection Regulations 2008 to allow desk top training on this complex area of law.

A member of the Property Litigation Association, the Professional Negligence Lawyers Association, Louise is regularly invited to speak at training events and conferences where comment is often made about her down-to-earth, approachable style as well as the obvious depth of her knowledge.

Louise's experience is wide-ranging, but the common element throughout all her work is her professional, client-focused, tenacious approach.

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Sandip Singh has experience of acting for a number of lending institutions on a wide range of disputes including complex and high value frauds, elaborate and multi-party frauds and the misappropriation of funds by solicitors, borrowers and third parties. He also acts in cases where the intended security has not been obtained.

He is experienced in claims against solicitors for fraud, breach of fiduciary duty, negligence, breach of retainer and breach of trust. He also acts in valuer claims in negligence and breach of retainer. He acts in cases involving identity theft for lenders and property hijacks by fraudsters. He also has experience of applications and claims to the Land Registry for indemnity payments, rectification, alteration of the register and dealing with wrongly discharged mortgages.

Sandip acts in relation to non-standard title defect claims and non-standard repossession claims including claims where vesting orders or declaratory proceedings are required. He also acts where repossession claims have become complex or sensitive.

He has previous experience as a Real Estate Litigator with a commercial, landlord and tenant and residential property litigation background and so is able to provide pragmatic and cost effective solutions to a wide range of issues affecting lenders.