

## Preventing Fraud at the Closing

By: Adam Leitman Bailey, Esq.

At the start of this new millennium, the most effective means to rob a bank no longer includes the use of a gun. The real estate closing table has replaced the gun and mask as the most favored and effective tool of theft from financial institutions.

As the New York Times reported on October 19, 2008, the Federal Bureau of Investigation (“FBI”) declared its inability to properly investigate the number of property and mortgage fraud claims, due to inadequate staffing,<sup>1</sup> noting that there is “no central way to track the total extent of the problem,” the number of mortgage fraud reports filed with the FBI totaled 46,717 in 2007 compared with 6,936 reports filed in 2003—a 674% increase.

Mortgage fraud has taken the lead as our country’s fastest growing white collar crime, accounting for more than twenty percent of all fraud in the United States. Federal, state, and local prosecutors have had to expand their resources in order to deal with this crime wave sweeping the nation. In New York City alone, for example, the FBI, two branch offices of the United States Attorney’s Office, and the Manhattan District Attorney’s Office have all restructured to open specialized mortgage fraud bureaus.<sup>2</sup>

No industry has been stung more by property and mortgage fraud than the title insurance industry. Notwithstanding that a major function of the process of issuing a title insurance policy is to resolve title defects prior to closing, this past August, an executive officer at one of the nation’s largest title companies remarked at an annual title insurance industry convention, “We used to have to justify its premiums. ‘How can your prices be so high and your claims so low?’ they used to ask me. Now, we have really shown them!” (NYLTA Convention,

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<sup>1</sup> Eric Lichtblau, F.B.I. Struggles to Handle Financial Fraud Cases, N.Y. Times, October 19, 2008 at A1.

<sup>2</sup> *Mortgage Fraud is Top White Collar Crime*, Organized Crime Digest, ¶13 (December 15, 2005), at [http://findarticles.com/p/articles/mi\\_qa4441/is\\_200512/ai\\_n16065739](http://findarticles.com/p/articles/mi_qa4441/is_200512/ai_n16065739).

August 26, 2008). In 1996, the title industry reported paid title claims equaling \$271.1 million. In 2005, claims reached \$916.4 million, followed by paid claims of \$870.3 million in 2006. Alarming, in 2007, paid title claims reached just under \$1.3 *billion*, which, notably, is a 149 percent increase from 2006, and a 480% increase (or almost a *quintupling*<sup>3</sup>) in paid claims over the span of a decade.<sup>4</sup>

Practitioners explaining to purchasers the importance of purchasing title insurance no longer rely on the old adage of an owner reclaiming land transacted as a result of a peace treaty hundreds of years ago. After a generation of protecting clients from property fraud or theft, for the first time in their careers, many practitioners now find themselves also assisting their clients in filing title insurance claims and sitting at depositions explaining the anatomy of the fraud at the closing.

The fact patterns giving rise to the thousands of real estate fraud claims are remarkably similar, most falling into a handful of categories. Taking advantage of lenient due diligence and lax lending standards, four common scenarios have emerged:

- an imposter posing as a property owner and selling or refinancing the land's equity, while collecting the proceeds at the closing;
- a family member refinancing or selling another family member's interest in a property;
- a real estate professional selling a property to a straw buyer without significant, if any, consideration to collect the proceeds of mortgage or sale;
- an owner fraudulently selling or refinancing a property multiple times to cash out all the equity from the property even beyond the true value of the collateral.

<sup>3</sup> None of these figures are adjusted for inflation.

<sup>4</sup> A.M. Best Research 2008 Special Report Data visually depicted by chart for ALTA and reported to ALB PC by Stephen Brown Klingler, Senior Business Analyst at A.M. Best.

## Imposter Fraud

Governmental authorities, prosecutors, and title litigation attorneys mostly agree that real estate fraud can be prevented by conducting a degree of due diligence at the closing, and by a more careful read of the closing and mortgage application and documents.

Many times, imposter fraud can be eliminated by collecting a valid governmentally-issued identification before the closing, or, at a minimum, requesting that identification be available for inspection at the actual closing. Some attorneys, banks and at least one title agency now collect identification upon signing the contract of sale or ordering title insurance.

A New York State driver's license, as with many other state driver's licenses, can be run against a readily available website that enables a determination of its validity. If an electronic search is not feasible, however, a driver's license from almost any state or country in the world can be checked for validity through the *I.D. Checking Guide by the Drivers License Guide Company, Redwood City, California*, which provides tips for identifying counterfeits. For example, on a New York State driver's license that was issued before July, 2008, the first two black letters on the far right bottom corner of the license should be the applicant's birth year.

For purchasers and sellers without a driver's license, most states issue a non-driver photo identification card through its Department of Motor Vehicles or some other state agency. With few, if any, exceptions, non-governmental identification papers do not effectively verify identities.

In the event of a purchaser, who is not a United States citizen, proper identification can include a foreign passport with a valid I-551 stamp, a permanent residence card (Form I-551), and/or a foreign passport with a visa and form I-94.

Fake or altered death certificates have also figured into a number of title litigation cases. In all of these cases, a search to see if the owner's death has been

“greatly exaggerated” can be run through a free internet search of the Social Security Death Index on *Ancestry.com*.

One can also require a certified copy of the death certificate prior to closing. In some cases, it may even be appropriate to call the funeral home for verification, although extreme caution should be exercised when making such calls out of state. Anyone who has gone to the trouble of faking the existence of a letter from a non-existent distant funeral home may well furnish an equally phony telephone number.

### **Power of Attorney Fraud**

The United States has no greater enemy in its fight against property and mortgage fraud than the power of attorney. A disproportionate number of title litigation cases have resulted from a spurious power of attorney. Many and perhaps almost all, of these cases could have been prevented by a diligent attorney contacting the issuer of the power and confirming some of the basic identifying data. These would include the power giver’s social security number and personal data as reported on the credit report or mortgage application.

Furthermore, the person granting the power of attorney should be contacted at the phone number listed on reliable documents. A credit report or a *Google* search may also be able to produce a reliable phone number. During the ensuing conversation, the issuer should be asked about the instant transaction and details surrounding the sale. The inquirer should also ask the issuer to fax, or send in Portable Document Format (PDF), identification documents immediately after the telephone call. Any delay in the receipt of that data should arouse suspicions.

Where there are persons holding powers connected with a guardianship proceeding, the investigator should review the guardianship order to ensure both that the guardian has the power to transfer real property, and that the order and commission have been duly authenticated by the issuing court, most typically with a raised seal.

## **Forgeries**

Fraudulent transactions arising from forgeries are exceedingly difficult to prove. The author's review of over 25 cases involving a deed or a power of attorney with a forged name revealed that the forgers either spend a lot of time perfecting the victim's signature, or use some type of tracing device with capabilities to fool even handwriting experts.

Many of these forgeries can be blamed on a notary, who fails to require the forger to produce verifiable identification before signing. In fact, many of the notaries in these cases sign his or her verification without even being in the presence of the transgressor or without asking for identification. With this kind of fraud so rampantly climbing, attorneys and real estate professionals must diligently require notaries to make copies of proper identification and supply such copies to all financially interested parties.

The irony of this is that the office of the notary was designed centuries ago to provide routine and ready fraud prevention, but is now regarded as an outmoded formalism. Nowadays, clear thinkers realize that insistence upon the notary's performing the duties of the office can diligently lead to the prevention of deception. Once such due diligence again becomes the norm, the real estate industry will have recovered a hoary, but inexpensive, means of fighting fraud.

### **Inter-spousal and other family member transfers**

By far, the most common form of closing fraud involves inter-spousal and other family member transfers. The motives are usually self-evident: one disgruntled spouse may attempt to cut off the other from the value of the equity, or a judgment debtor may attempt to transfer assets to a family member to avoid a creditor.

Many title professionals assert that all family transfers should be treated as suspect. When very little or no consideration changes hands, an even higher alert should be signaled, as fraudsters usually attempt to retain assets and, therefore, make sure only a small amount of transfer taxes are paid at closing. Like all of us, even fraudsters do not like paying taxes.

## Satisfaction of Mortgage Fraud

A close companion to the unmasked and gunless bank robber comes in the form of a satisfaction or payoff of a mortgage. Fraudsters have been attending closings with self-created bank letters indicating false prior mortgagees. One method involves fraudulent pay-off letters from a fake service agent pretending to act on behalf of a lender collecting the proceeds to pay off an existing loan.

Another form of fraud evolved with the creation of the Mortgage Electronic Registration Systems, popularly known as "MERS." Under the system, this central organization, MERS, appears on all papers as the nominee of the holder of the mortgage in question. However, the right to "service" that mortgage, such as collecting payments and monitoring compliance with various mortgage requirements, or to be the holder in due course of the debt can be freely passed around from one institution to another like the baton in a relay race.

This practice enables the trading and assigning of massive amounts of debt *without* having to record new mortgage ownership documents on every transfer of a mortgage. The weakness of the system, from a fraud point of view, is that, at many closings, the actual pay-off holder in due course cannot be determined from the face of the mortgage itself or its accompanying documentation. This enables thieves, for example, to supply fictitious letterhead with instructions for the payoff of the loan into a fraudulently created account.

In all of these cases, a simple phone call to MERS, or use of its public website ([www.mers-servicerid.org/sis](http://www.mers-servicerid.org/sis)) to determine the actual owner of the mortgage, would unmask the fraud.

Because lenders normally return the original stock pertaining to a cooperative unit upon the satisfaction of the obligation, owners should expect these documents to be present at a closing where the payoff is being made. Otherwise, a copy of the stock or mortgage, as recorded, should be requested to be brought to closing with the cancelled check matching the payoff amount that can be confirmed with the bank. In any event, if the payoff letter is issued by MERS or a servicing agent, as opposed to being issued by the lender of record, the

lender must confirm the identity and proper allocation of monies to be transferred.

Suspicion has become a closing professional's best friend, as it goads a closing professional to look more deeply into the finer parts of the transaction. Aside from the intensity it gains from any other irregularity, such suspicion should always be heightened when large amounts of money are being transferred to parties other than the buyer, seller, or the prior mortgagee, or where the prior lender is not listed as the payoff entity.

Whenever a loan is not satisfied or paid off from the funds transferred in the closing transaction, suspicion should also be aroused. The diligent closing professional should see to the authentication and verification of any satisfaction or release presented at closing.

### **Recording Office Indolence**

As one reads the literature on fraud cases, it becomes quickly apparent that many of them stem from someone assuming that, just because a document is actually genuinely recorded, it represents a legitimate transaction. However, the main things that the recording stamps of the county clerks and other recording officers ensure, are that the document, whatever it may be, with all its faults and flaws: (1) exists, (2) is recorded, (3) is signed in original ink, and (4) was paid for – nothing more.

This may change at some future time. At the time of this writing, there are recording officers, who are contemplating potential procedures that will ensure some level of validity to recorded documents they are recording. Until such procedures are implemented, however, no justifiable sense of security can arise from the existence of a recording stamp, beyond confirming that the document was recorded, signed in original ink, and paid for.

Recording offices do not generally check the validity of the transaction, do not inquire into the credentials of the notary, do not inquire as to whether the notary was properly satisfied of the identity of the signatories, and do not inquire into the identities of the parties involved in the transaction. The recording

officers, for the most part, see their duties as largely ministerial, complete after simply checking for a properly created Cover Page and recording the transaction.

### **Timely Recording Deeds**

Selling the same property to more than one person also joins the list of common types of fraudulent practices. States that call for recording a deed within minutes of the transfer are the least vulnerable to this kind of fraud. But in other states, like New York, where the practice is more lax, the vulnerability to fraud heightens because documents can be recorded weeks, or even months, after a closing.

In such states, a clever thief will use the gap between transaction and recordation to give another mortgage on the premises to a different bank that also thinks the lien is in first priority. The thief flees with the proceeds of the two “sales”, and the hapless multiple lenders are left to battle out the question of which bank won the race to the recording office.

Just because a State does not have “walked in” deeds as the usual methodology, however, does not mean that a recording office will refuse to accommodate a filer who does, in fact, walk-in a deed. This is an inexpensive way to ensure the priority of a transaction, even if it is at the expense of other purchasers and mortgagees, who are less vigilant.

### **Freezing Credit Lines**

To prevent a borrower from illegally squeezing extra money from a line of credit, the lender must obtain all instruments that would enable such a theft and destroy them at the closing. A letter from the lender acknowledging that the line of credit has been frozen should be included with the payoff letter at closing.

### **Outside of the Closing: Various Preventive Measures**

Closers need to be motivated to want to uncover fraud. One such motivation the author has titled the “Fraud Buster Bonus”, which would involve the title company giving the closer a money reward for uncovering a fraud in an

amount equal to the commission the closer would have gotten had the deal gone forward.

In addition, some real estate professionals have created internal private lists of unethical bank attorneys, real estate brokers, appraisers, and title companies. These lists set forth the names of persons, who have proven unethical, and persons with an acquired reputation for committing and/or facilitating ethical breaches.

Finally, as many fraudsters are repeat offenders, a shared database of these names should be maintained with banking and title insurance companies, as well as with interested governmental agencies. Real estate professionals must balance the utility of fraud prevention measures against the utility of efficient transaction of business. There is undoubted trouble and expense involved in protecting one's business, but it does not even begin to approach the expense of not protecting that business in the shark infested waters of real property fraud transactions.