Understanding lender attitudes towards mortgage fraud

Introduction

In the modern age of property transactions, what is the biggest risk to mortgage lenders and what impact does this have on their relationship with the conveyancing profession?

This whitepaper summary presents and analyses the results of a survey of 28 CML members, including directors, heads of department and compliance managers at some of the largest and most influential mortgage lenders in the UK.

Conducted by TM Group, the survey was designed to offer insight into the mind-sets of these decision makers by asking questions about managing risk within the property transaction.

Since the financial crisis, sales of homes have understandably reduced in frequency, providing lenders the time necessary to assess threats to their profession and enforce tighter controls to help mitigate the threat of solicitor and other third party fraud within the mortgage chain.

So where exactly do mortgage lenders feel that the biggest risks originate from? Furthermore, what is the impact of these risks and how can they be managed?

Questions were also posed that were designed to gain an understanding of lenders' attitudes towards what methods could help reduce the risk of mortgage fraud and role that technology has to play.

Ultimately, the report offers valuable information for conveyancers, particularly those on lender panels where the lender is ultimately their client, providing a powerful insight into the mindsets of mortgage lenders as well as helping solicitors formulate strategies to help manage the hotspots throughout the property transaction.

Risky Business

Mortgage fraud is one of the most significant risks to lenders. In its 2013 Annual Fraud Indicator report, the National Fraud Authority estimated the annual loss attributed to mortgage fraud at £1bn and not only can financial crime prove extremely expensive for a lender but it can also pose a threat to their credibility with the public.

Steps have been taken by both the CML and FSA to reduce the risk of mortgage fraud, but in 2013, The Financial Times reported that mortgage fraud is more rife than ever before. Indeed, it was revealed in a report by Experian that attempted mortgage fraud rose to 38 cases in every 10,000 applications in 2012, up from 35 per 10,000 in 2011. [1]

Fraud can manifest within the transaction in a number of different ways but we wanted to gain an insight into which areas the lenders perceived the biggest risk of fraud. The respondents could choose from the options below or provide their own suggestion by choosing 'other'.

Survey question: Which type of fraud do you consider to be the biggest risk to your business?

More than a third of lenders, thirty-seven percent, answered that they are most concerned with solicitor negligence. Do the tiny minority of negligent or criminal solicitors colour the view of the profession for lenders, or do the lenders' fears have some merit? Interestingly, Lockton Companies, the world's largest privately owned, independent insurance brokerage firm, state that 70% of PII claims against solicitors relate to property transactions and it's certainly the case that conveyancing is amongst the riskiest sectors within the legal profession.[2]

Negligence can come in different forms however, as pressure on residential conveyancing fees has seen a tendency for conveyancing work to become increasingly driven by processes and be at risk of commoditisation.

The profession has, at the same time, been targeted to a greater extent than ever before by petty fraudsters and organised criminal gangs who have spotted the opportunity for rich pickings in property transactions.

And with thirty percent of lenders answering that they're most concerned with identity fraud which, allied to the fact that the answers we received for 'Other' made mention of fake income documentation or fraud committed by intermediaries, potentially highlights the ease with which one can conceal their identity in the modern age.

Indeed, it was reported recently that the SRA received 549 reports of bogus firms in 2013, a 57 percent increase on the number from 2012.[3] So with criminal activity on the rise and with strains on the time and resources available to law firms, it's increasingly vital to carry out thorough checks when processing property transactions.

The issue for solicitors is that fraud will not always be immediately apparent. Fraudsters will often use at least one professional within the transaction whether that professional is cognizant or not but, as the Law Society explains in their anti-'mortgage fraud' guidance note, "Courts will assume a high level of knowledge and education on your part. They will often be less willing to accept claims that you were unwittingly involved if you have not applied appropriate due diligence."

A recent case evidencing this was Santander UK v R A Legal Solicitors in which now-defunct law firm RA Legal were found to be negligent in unwittingly paying £150,000 of Santander's money to a bogus law firm. Tracey Carr of Santander said: "The practical implications of the Court of Appeal's Judgment on the lending industry are significant and it will act as a welcome confidence booster. It will also encourage the residential conveyancing sector by its placing of a great deal of importance on the maintenance of high standards within that sector - in particular, to prevent, as far as possible, fraudulent activity from taking place." [4]

It's therefore increasingly vital to check the actual solicitor you're dealing with, even if you are aware of the firm. A modern trend emerging is for fraudsters to invent fake branches for a real law firm – even going so far as to clone their website - in order to trick you into handing over your client's money. A quick check of the Law Society's website is no longer sufficient and doesn't take this threat into account.

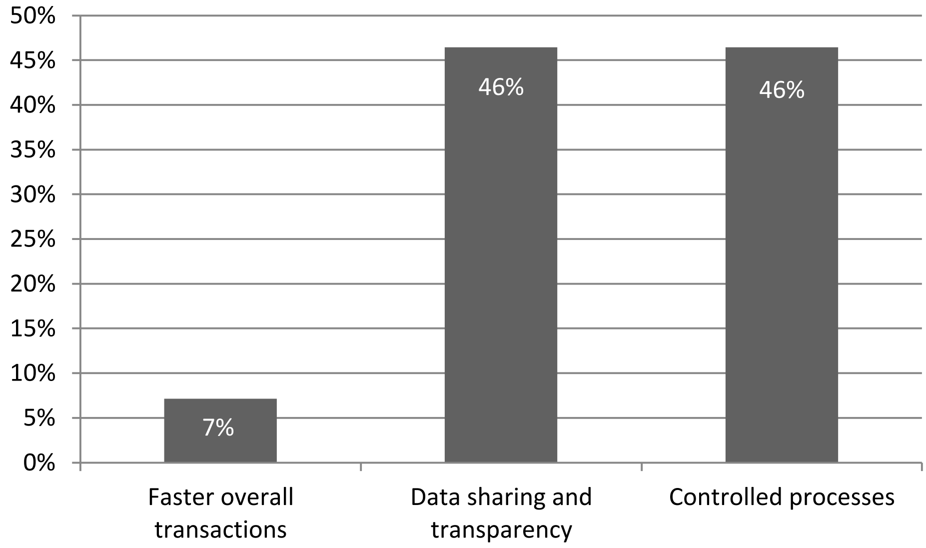
There are tools available to help counter this threat, amongst which is Lawyer Checker: a system that carries out a number of identity and fraud checks on the firm you're dealing with. So if your firm is experiencing pressures on time and resources putting in a series of procedures now, that work for each and every transaction, allows for sustainable protection as case volumes increase.

With so much money at stake for lenders it's understandable, and perhaps healthy, to be cautious towards the process in which substantial capital is transferred to applicants.

On the other hand, do the responses to this question demonstrate a lack of trust in solicitors? If so, how exactly should the industry deal with this lack of trust?

We asked the lenders what they felt were the best methods or tools to help reduce the risk of fraud in a property transaction.

Survey Question: Which of the following do you think could make the most significant contribution to reducing the risk of fraud in the transaction?



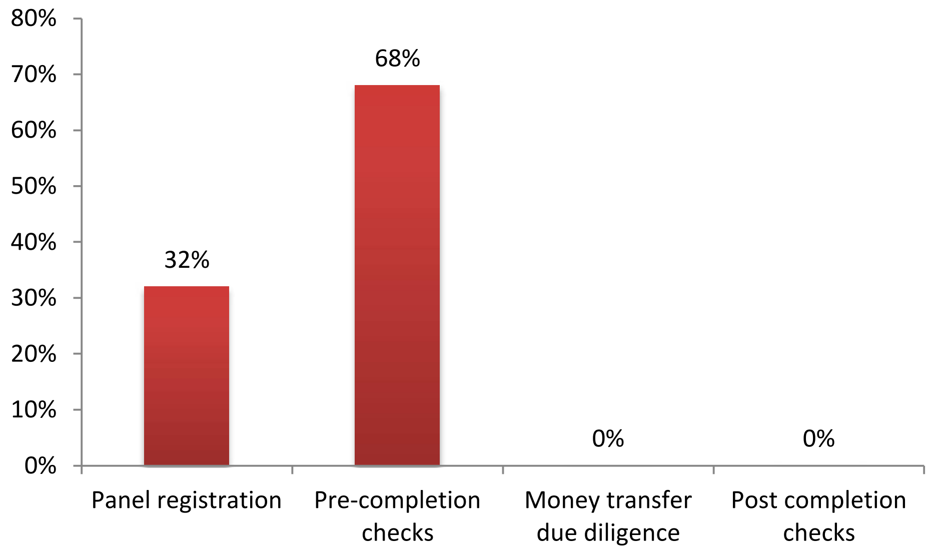
The lenders surveyed clearly think that there are two main drivers to help reduce the risk of fraud in property transactions. Forty-six percent of those asked were looking for data to be shared and transparency to be maintained throughout the process; an equal proportion answered that they believed controlled processes to be the most significant method in combating fraud. Just seven percent of those asked felt that faster overall transactions were an important factor in adding security.

Sharing data better and employing consistent procedures are ideal practises which make sense for the industry to adopt. Improving the visibility of the transaction for all parties would help keep everyone better informed and identify any potential problems as they arise. It would also help foster better communications between mortgage lenders and conveyancers and, in doing so, work to bridge any perceived lack of trust within the industry.

Additionally, the adoption of strict procedures that would be applied for each case would help ensure consistency and reduce potential for errors. The key question this provokes for solicitors: What systems do you have in place to make sure that you are actively safeguarding your firm from fraudsters?

We've established that lenders consider transparency and consistency to be two key tools in the war on fraud but where exactly in the process would these measures have the biggest impact in order to help head-off risks before they arise? We asked where tools might be enforced within the transaction to ensure that solicitors comply with lender requirements.

Survey question: With emerging products now providing tools for ensuring compliance, where are you most likely to enforce them?



The results demonstrate that around two thirds intend to implement compliance tools during pre-completion checks compared with just a third interested in stiffening the panel registration process. It's no surprise to see that lenders consider post-completion checks to be of little use as it is seemingly the case of shutting the gate after the horse has bolted.

Nor is it a surprise to see that a significant number of lenders are keen on improving the panel registration process which has been a hot topic in recent years. Given the chance, most lenders would dramatically reduce their panels down to solve this issue. However, in light of the HSBC's efforts to reduce their panel to 43 firms being met with significant opposition, tightening up the process of registration seems to be the most effective contingency.

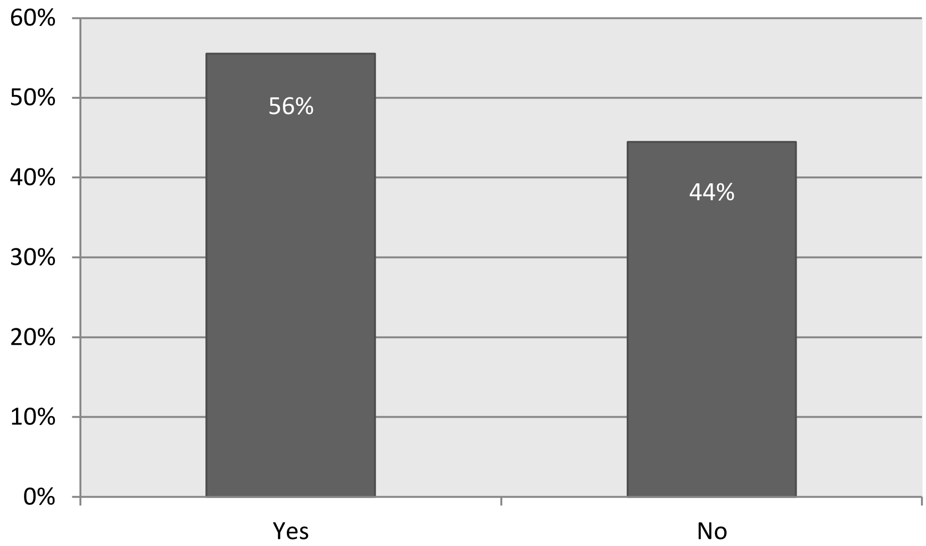
With lenders now allowing firms that are part of the Conveyancing Quality Scheme (CQS) to complete their work, it makes sense that a significant portion of lenders are more concerned with pre-completion checks than with panel registration.

So the question to consider is: What other barriers might be raised in the future that conveyancing firms could be preparing for now? With the housing market increasingly buoyant, transactions are on the increase but there remains a shortage of skills within conveyancing. Therefore, it's essential to prepare processes: establish procedures now which can be scaled sustainably in the future. For example, manually checking both parts of the CML handbook online and printing them off is no longer a viable option, nor a worthwhile use of time.

With the modern generation frequently clamouring for instant results, a major impact of technology on the transaction means that vendors expect greater efficiency and for their transaction to be completed within a shorter time period.

However, we wanted to discover whether lenders felt that technology had at least enhanced the process and helped all parties keep up with this increasing consumer demand, as well as helping to combat any threats that might hinder the transaction. So we asked the respondents: Has technology helped the transaction over the last two years?

Survey Question: Has technology helped the transaction over the last two years?

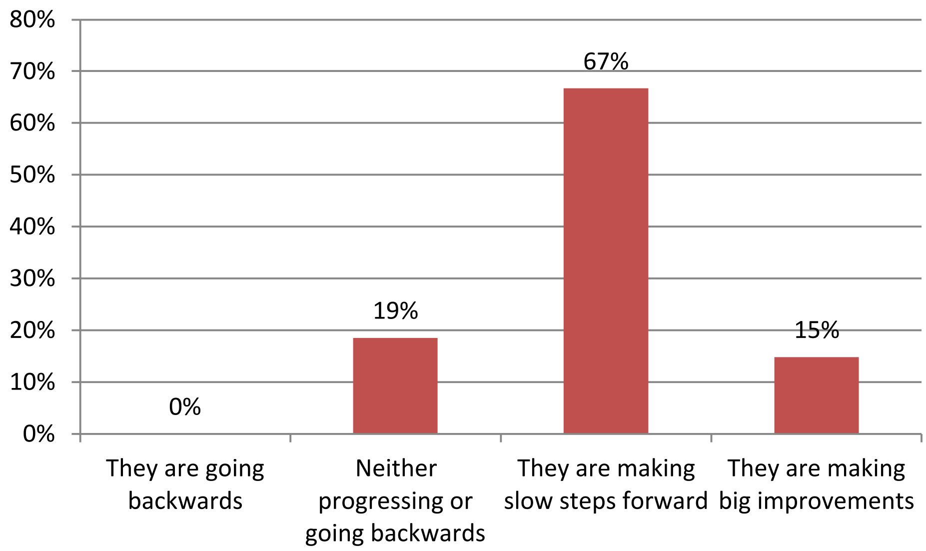


The results show that more than half of the lenders surveyed (fifty-six percent) believe that technology is improving the process. Those who answered 'yes' were prompted to explain further and most of the responses centred around the proposition that technology helps produce speedier transactions, thereby reducing the risk of fraud. It is also thought that technology helps automate a lot of the tasks involved, thereby reducing inconsistencies and the potential for human error.

However, if 56 percent believe that technology has helped the transaction recently, we are still left with forty-four percent that think the opposite. This shows that there is still work to be done and perhaps even suggests that lenders see solicitors as reticent to move with the times and adopt new technology?

Within the next two years, what would need to be done for all lenders to think that technology has helped the property transaction? Certainly it would require all parties within the industry to pull together towards the same goal, in recognising and minimising the risk of fraud but do the lenders think that this is happening already?

Survey Question: Do you feel overall that the steps being taken by lenders and conveyancers to prevent fraud are sufficient?



More than four fifths of those surveyed (eighty-one percent) feel that progress is being made in some form, whilst the remaining respondents (around one in five) thought that there was neither progression nor regression.

This is clearly a positive response as none of the lenders feel that the situation is deteriorating but perhaps more needs to be done in the coming months to convince two-thirds of lenders that ‘slow steps’ have become ‘big improvements’.

How can this be achieved? With fraudsters employing ever more sophisticated, measures do need to be employed by all parties, not only to keep up but, to remain watchful and stay one step ahead. Undoubtedly it is in both parties’ interests to improve trust and compliance in order to negate fraud and it is surely within the adoption of set procedures that can be managed and automated with technology that can help reduce the risk of error and deception.

Equally, it is important to increase awareness of fraud, and the fact that more solicitors are being targeted as unwitting accomplices, so that warning signs are spotted early and acted upon.

Summary

It is only within the last year or so that we have emerged from the recession that rocked the financial industry but we are still seeing caution from the mortgage lenders and this is a trend that is unlikely to be reversed.

Despite the economic downturn and subsequent reduction of property transactions, we have witnessed a rise in criminals seeking to commit mortgage fraud and this has only been abetted by developments in technology that enable fraudsters to mask their true identity and intentions. Conversely, technology has a substantial role to play in countering the threat of mortgage fraud but it requires co-operation from all parties within the property transaction to make its use effective.

The survey of 28 decision makers from some of the most largest mortgage lenders in the UK revealed that most lenders consider solicitor negligence to be the biggest type of fraud risk to their business. In dealing with this, the lenders surveyed felt that if property solicitors adhered to controlled processes and shared data more regularly, these would be positive steps to help counter the risk of fraud. The majority of lenders agree that the use of technology is helping the property transaction but that more could be done by both lenders and conveyancers to combat mortgage fraud schemes.

With recent legal cases showing that solicitors can be held liable for negligence even for historical transactions, the question for conveyancers is: What processes do you have in place to protect your business? Ensuring and proving compliance with mortgage lender requirements should be major considerations. Furthermore, remaining vigilant to the methods employed by criminals and conducting your own identity checks on clients and other firms will help to ensure that you know who you are dealing with at every stage of the property transaction.

To learn more about tools to counter mortgage fraud or to discuss how you could be involved on working with TM Group please call us on 0800 249 9200 or email marketing@tmgroup.co.uk

TM Group

TM is the largest provider of property searches to the conveyancing sector. Operating across England, Scotland and Wales, TM offers services to all professionals involved in a property transaction and provides a collaborative environment in which the entire purchasing process can be managed from start to finish, allowing all invited parties involved to easily share documentation with each other.

Our knowledge makes a real difference. With unrivalled expertise in managing property searches and transactions, we continue to evolve and shape the conveyancing landscape of the future. TM continues to lead the way in the creation of technology and standards to deliver greater transparency, efficiency and certainty to the UK housing market.

To find out more about how TM Group can help you and your business, please visit our website: www.tmgroup.co.uk

References:

[1] Financial Times – The Rise in Mortgage Fraud

[2] TM Group – Property Claims Drive Law Firms' Risk Profiles

[3] SRA Risk Resource - Spiders in the web: The risks of online crime to legal business

[4] Legal Futures - Overturning of ruling highlights urgent need to prove CML compliance

Further resources:

CML Policy - Fraud: awareness and prevention

The Law Society Guidance Note – Mortgage Fraud

FSA Thematic Review – Mortgage Fraud Against Lenders

CML Policy - Fraud: awareness and prevention