

# SPEAKERS' NOTES

MORTGAGE FRAUD SEMINAR, 30<sup>TH</sup> APRIL 2009



**ARUN CHAUHAN**  
JOINT HEAD,  
FRAUD & ASSET  
RECOVERY DEPARTMENT

## Evolution of Challinors' Fraud & Asset Recovery Department:

- Formalised in March 2009
- Aimed at the commercial market
- Jointly headed by Arun Chauhan and Mark Kenkre, both specialist dispute resolution lawyers
- Growing profile and volume of instructions, recognised by Challinors' appointment to the Treasury Solicitor's panel for litigation and investigation services in 2008
- The Treasury Solicitors represent 180 Government departments and publicly funded bodies; Challinors is one of two firms advising on fraud investigations for the Central England and Mid-Wales regions.

## Regional Focus:

- Challinors has researched the provision of dedicated teams in commercial fraud in Birmingham and nationally
- The majority of specialist teams are based in London
- Many commercial litigation departments are based in Birmingham, Challinors believes it has the only department set up to provide a dedicated service on commercial fraud
- Challinors has identified a real need for this in Birmingham and across the Midlands
- Challinors' first-ever Fraud & Asset Recovery Survey worryingly revealed that only 25% of respondents believed fraud to have increased in the Birmingham and Midlands area
- The recent KPMG fraud survey revealed the Midlands has seen the highest increase nationally for fraud in 2008 costing the region's economy £380m last year.

## The issue of fraud:

- Is a national problem
- Professional advice in Birmingham is proving to be a financially efficient alternative to London, without forgoing the expertise once believed only to exist there
- Fraud is a growth area – cyber fraud, banking fraud or mortgage fraud
- Challinors' Fraud & Asset Recovery Survey revealed 50 percent of businesses and professional services believe fraud will increase this year
- There has been an alarming increase in cases proceeding through the High Court on Fraud in 2008
- This is the tip of the iceberg, with many of these cases relating to fraud committed in the past 1 to 5 years
- The current climate of financial constraint is causing more people to undertake fraud
- Challinors predicts an increase in commercial fraud cases.

## Mortgage Fraud:

- Mortgage Fraud is a big problem, a recent report from the Council of Mortgage Lenders suggests 11.74 million mortgages exist in the UK with loans worth over £1.2 trillion
- The mortgage lending process has become a significant target for serious criminals, to acquire property as well as to steal money

## Fraud in the mortgage market takes two forms:

- **Fraud for Property** – borrowers inflate earnings or deceive on their intended use of a property to obtain a mortgage
- **Fraud for Profit** – mortgage funds are lent and then stolen, something common with an organised fraud.

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## Areas at the heart of a mortgage fraud are:

- **Professional Corruption** – where mortgage lenders are the victims
- **Insider Corruption** – where loan facilities are increased after underwriters' approval
- **Due diligence and internal control failures** – money laundering checks need to be tighter
- **Procurement process weaknesses** – lenders are exposed where cash-back arrangements have not been declared.

## Commercial Lending Fraud:

- Involves larger amounts of money than residential fraud
- Lenders that are keen to take a share of the commercial market boom have taken less due diligence and assessment on risk
- Areas of protection should cover:
  - **Alert system** – to flag any changes to the lenders' normal debenture structure
  - **Monitor** – all referrals and fees and check.



**MARK KENKRE**  
JOINT HEAD,  
FRAUD & ASSET  
RECOVERY DEPARTMENT

## Mortgage Fraud:

- Lenders have historically avoided large exposure to mortgage fraud, relying on the upward trend of the market to recoup any losses if they were duped
- With the market much changed, lenders are well aware of their high exposure to fraud
- The Law Society (15th April 2009) has introduced a Practice Note on Mortgage Fraud for solicitors
- It is not only solicitors who should be aware of the dangers of mortgage fraud.

## The fraudster's avenues:

### Valuation fraud:

- Most common is when a surveyor overvalues a property
- Often through bribery or collusion, the surveyor overvalues a property for a client
- The client has already arranged to sell the property to an accomplice
- The accomplice will arrange for a mortgage application that provides false information about income, credit ratings and references, to obtain an inflated mortgage and then default on it
- The property seller, who set up the deal with the surveyor, vanishes with the cash, leaving the lender with an asset worth substantially less than it was valued at.

### Property clubs:

- Fraudsters choose these as private sources of funding
- Lenders have lower safeguards than institutional lenders, leaving them more susceptible to organised fraud
- Losses to lenders include shortfall claims, valuation fees paid to rogue surveyors and revaluations costs of housing stock
- Mark and Challinors recently concluded a case involving a network of more than 150 individuals, alleged to be part of a scam against lenders who had employed a surveyor to overvalue properties; full recovery achieved, but only after undercover investigation and piecing together transactions and individuals.

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## Broker fraud:

- An emerging area
- The most common way involves a broker acting on behalf of a property investor who essentially secures a mortgage deal for the investor at the resident homeowner rate by submitting the application, liaises with the lender and is paid commission for his services
- Losses to the lender could be:
  - 2 percent over the 25-year term of the mortgage
  - The fee paid to the broker
  - Shortfall claim if the investor cannot service the mortgage or if the tenants default as a result of the downturn
- Brokers are desperate to maintain commission rates and business levels prior to the current financial climate
- They may see this as an innocent exploitation, but the ramifications for lenders can be devastating.



**JOHN RANDALL QC**  
BARRISTER,  
ST PHILIPS CHAMBERS



## Mortgage Fraud: there's a lot of it about

Nine cases profiled - of which, six cases are 2007 or more recent.

- Cheshire BS v (1) Dunlop Haywards & (2) Cobbetts [2008] EWHC 51 (Comm) David Steel J and Nationwide BS v (1) Dunlop Haywards & (2) Cobbetts [2009] EWHC 254 (Comm) Clarke J
- Paragon Finance v DB Thakerar & Co [1999] 1 All ER 400 (CA)
- Shuttari v Solicitors' Indemnity Fund [2004] EWHC 1537 (Ch) Jules Sher QC
- Pulvers v Chan and ors [2007] EWHC 2406 (Ch) Morgan J
- St Paul Travelers Insurance v Okporuah and ors [2006] EWHC 2107 (Ch) HHJ Hodge QC
- Drakes v Abbey plc (2008) 18 January (EAT)
- Olupitan and anor v Director of the Assets Recovery Agency [2008] EWCA Civ 104
- Serious Organised Crime Agency v Olden [2009] EWHC 610 (QB) Holdroyde J.

## Nationwide BS case:

- A striking case involving significant values of fraud
- Based on commercial property in Aston, Birmingham
- Demonstrates the importance of carrying out due diligence on all mortgages
- If mortgage fraud is suspected, then sue and do it quickly!
- The fraud began in September 2004, with three valuations on the same property on the same day
- These valuations put the market value of the property at £10.5 million, but if three proposed leases on the property were completed, this would rise to £16 million
- One recipient organisation carrying out its due diligence read the file papers which revealed that someone was actually purchasing the property for £1.4 million, so it raised a query about this and the transaction did not proceed
- In February 2005 the same valuer produced a draft valuation letter in respect of the same property putting its market value at £4.75 million
- That draft letter enabled the claimant building society to prove dishonesty on the

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- documents, and so to obtain a quick judgment based on deceit, not just negligence
- The main losses recovered by The Cheshire Building Society – the original lenders – for deceit included the advance itself, the loss of interest on alternative advances it would otherwise have made, the loss of managerial and staff time investigating all related matters, the loss of retail deposits, the additional cost to the building society of borrowing capital on the financial markets, the loss of opportunity to make as many mortgage loans as it otherwise would have done, and other resultant restrictions on its financial freedom of action. The total losses awarded against the valuers were over £15.5 million
  - Solicitors Cobbetts settled the claim against them for just over £5.5m, and in subsequent contribution proceedings accepted that they would (subject to questions of contributory negligence and contractual limitations of liability) have been held liable in negligence for the advance itself and the loss of interest on alternative advances
  - In the contribution proceedings, Cobbetts was awarded a sum equivalent to about 80 percent of the sum they paid in settlement against the valuers
  - The Cheshire has subsequently merged with the Nationwide.

#### Other cases:

- Demonstrate that the timing for suing for fraud is important – the Court of Appeal has said that the six year rule does apply *Paragon Finance v DB Thakerar & Co*
- Sometimes fraud can go undetected due to the incompetence of a solicitor, which was the basis on which the case of *Shuttari v Solicitors Indemnity Fund* was decided
- Fraud can also be facilitated by the failure of individual employees of the lender to abide by set procedures. Compare the facts of *Drakes v Abbey plc*, involving the branch manager of the Notting Hill branch, whose summary dismissal for the manner in which he dealt with mortgage identity verification on applications referred by a non-regulated introducer was upheld as being gross misconduct, and not merely negligent.
- Regrettably the role of the professionals can be to aid the crooks – or even that they have acted dishonestly themselves, as was held to be the case in *St Paul Travelers Insurance v Okporuah* and in respect of the part-qualified legal executive in *Pulvers v Chan*
- The case of *Serious Organised Crime Agency v Olden* originally involved 20 different properties, mortgage and remortgage fraud, and one man with three different identities; a slip in the police investigation resulted in all evidence being deemed as inadmissible in the criminal proceedings against him. However, SOCA brought civil proceedings against the individual, in which all the evidence was held admissible and SOCA succeeded in its claim for a civil recovery order in respect of two of the properties.

**Time is precious, so talk to advisors as soon as possible.**

IF YOU WOULD LIKE MORE INFORMATION ON OUR FRAUD AND ASSET RECOVERY SERVICES, PLEASE CONTACT:

#### **Arun Chauhan**

*Joint Head of Fraud and Asset Recovery Department*

T: 0121 204 2666

E: [arun.chauhan@fraud.challinors.co.uk](mailto:arun.chauhan@fraud.challinors.co.uk)

#### **Mark Kenkre**

*Joint Head of Fraud and Asset Recovery Department*

T: 0121 204 2665

E: [mark.kenkre@fraud.challinors.co.uk](mailto:mark.kenkre@fraud.challinors.co.uk)

Edmund House 12-22 Newhall Street, Birmingham B3 3EF

T: 0121 212 9393 F: 0121 212 3422 E: [enquiries@fraud.challinors.co.uk](mailto:enquiries@fraud.challinors.co.uk)

<http://fraud.challinors.co.uk>

WE WOULD LIKE TO THANK OUR GUEST SPEAKER:

**John Randall QC** *St Philips Chambers*

T: 0121 246 7000 E: [jrandall@st-philips.com](mailto:jrandall@st-philips.com)

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