Consultation paper

Confirmation of identity
Sections 56C and 117 of the *Real Property Act 1900*

LPMA response to submissions

Land and Property
Management Authority

Background

Section 56C of the *Real Property Act 1900* ('the Act') requires that a mortgagee must take reasonable steps to ensure that the person who executed the mortgage is, or is to become, the registered proprietor of the land to be mortgaged.

Section 117 of the Act requires that a witness to a land dealing or caveat must have known the person signing the dealing or caveat for more than 12 months, or must have taken the reasonable steps to ensure the identity of that person.

Sections 56C and 117 have not yet commenced. This is because the "reasonable steps" have not yet been determined. Once they are determined, they will be prescribed in the *Real Property Regulation 2008*. Once prescribed, sections 56C and 117 of the Act will commence operation.

In order to assist the Land and Property Management Authority ('LPMA') to determine what the "reasonable steps" will be, a consultation paper titled *"Consultation Paper – Confirmation of Identity"* was prepared and released in December 2009. The paper sought comment and submissions from the public and industry to the proposed requirements by the LPMA.

To summarise, the "reasonable steps" proposed by the LPMA were:

1. A face-to-face interview with the mortgagor(s)
2. Document based verification rather than electronic based verification
3. Minimum of two, preferably three, identification documents, at least one of which should include a photograph
4. Original documents to be sighted, rather than certified copies.

The LPMA received seven submissions in response to the paper. The majority of the submissions did not support the proposed requirements. The main issue which was consistent amongst the responses were that the provisions of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* ('AML/CTF Act') were sufficient to combat fraud and that mortgagees were already required to satisfy those provisions. Also, the proposed requirements would impose increased costs and delay in the mortgage process.

Most significantly, the submissions expressed concern that there was no consistency with the proposals for identification verification in the forthcoming National Electronic Conveyancing System (NECS). The requirements for customer identification in NECS are unknown at this time, and the proposed requirements may inadvertently result in two different systems, one for paper based and one for the NECS environment.

The problem with the AML/CTF Act and mortgages

The paper explained why the provisions of the AML/CTF Act were not appropriate. The primary purpose of section 56C of the Act is to reduce the incidence of mortgage fraud. The way the section addresses this purpose is to ensure, as reasonably as can practically be, *that the person signing the mortgage, is the same person who is to be the mortgagor*.

The objectives of the customer identification obligations of the AML/CTF Act are quite different from the objectives of section 56C of the Act. The purpose of AML/CTF legislation is to protect businesses from being misused for money laundering and terrorism financing. This is achieved by placing obligations on reporting entities to collect information on their customers ("know your customers"), and put in place risk-based systems and controls. These are designed to identify, mitigate and manage money laundering and terrorism finance risk that may reasonably be faced in providing the services.

The "know your customers" component is primarily focused on the relationship of the person providing the designated service, and the customer, and the risk that the relationship may have in terms of money laundering or terrorism finance. For example, reporting entities should take into account risk factors such as whether the customer is based overseas, or whether the customer has access to offshore funds, or if the customer makes or accepts payments to or from offshore accounts.

Although there may be crossover in the effect of both pieces of legislation, the purpose and focus are quite different. The AML/CTF legislation lacks mechanisms to ensure *that the person signing the mortgage is the same person who is to be the mortgagor*.

The clear majority of compensation claims received by the LPMA arise from fraud by either a family member, or a friend or associate of the victim. It is rare for a claim on the Torrens Assurance Fund to involve criminal gangs targeting unknown victims. Similarly, to date, the LPMA have received no compensation claims that can be identified as involving money laundering or terrorism funding.

Several of the submissions pointed out that fake documents such as drivers licence and passports can be easily produced by crime syndicates. However, the claims received by the LPMA rarely involve fake documents. The fraudsters are relying on the lender not pursuing more vigorous checks as to who is actually borrowing the money, and who will actually be on the mortgage as mortgagor.

It should also be pointed out that a clear majority of claims on the Torrens Assurance Fund are from lo-doc "short term" money lenders. As Justice Young observed in *Vella v Permanent Mortgages Pty Ltd* [2008] NSWSC 505: *"I should add to this that the impression that I formed in this case is that the "industry" involved in low document short term loans at high interest appears to depend more on good luck than good management and that there are quite a number of people involved, at least in the lower echelons who do not have profound ideas of the ethics of the situation and who are prepared to "cut corners" in order to earn a quick commission."*

The provisions of the AML/CTF are lacking in combating the types of fraud that the LPMA are experiencing. For example, how would the AML/CTF provisions reduce the incidence of fraud where a husband fraudulently signs his wife's signature on a mortgage to fund his gambling debt? (*Perpetual Trustees Victoria Limited v Peter Van den Heuvel* No 2 [2009] NSWSC 483). Or where a wife fraudulently signs her husband's signature on a mortgage? (*Perpetual Trustees Victoria Ltd v. Cipri* [2009] NSWSC 335). Or to a situation where a son assists a fraudster to forge his parent's signature on a mortgage? (*Chandra v Perpetual Trustee Victoria Limited* [2006] NSWSC 1046).

These examples are only a very small sample of the types of claims the LPMA pay out of the Torrens Assurance Fund each year: the majority of the claims are dealt with administratively. In most of those claims, there is always a "missing step" that the mortgagee could have taken to prevent a mortgage fraud from occurring: the verification that the person applying for the loan will be the same person who signs the mortgage. This is why face to face verification is important.

Current situation

Currently the Act is silent on the obligations that mortgagees have to identify their mortgagors. It is important that sections 56C and 117 commence as soon as possible so that a standard of verification of identity may be applied. These sections are essential to assist the LPMA, and more importantly the taxpayers of New South Wales, to combat mortgage fraud.

In coming to our decision, we are also mindful of the identity requirements in other states. We believe that once the standard of customer verification for conveyancing being considered within the NECS roadmap is known, then it is likely that other states will adopt that standard as part of a commitment to adopting nationally consistent practices.

However, in the meantime there is a need to ensure that landowners are protected from the growing threat of identity fraud. Accordingly it is proposed to commence the remaining provisions of the *Real Property and Conveyancing Legislation Amendment Act 2009*.

Section 56C - reasonable steps

The reasonable steps under section 56C of the Act will be closely based on the document based safe harbour provisions of the AML/CTF, that is, verify the customer's name, residential address and date of birth from an original or certified copy of a primary photographic identification document, or two original or certified copies of a secondary document. The categories and documents will be more fully described in the Regulation.

Because mortgagees currently have to comply with the AML/CTF provisions, the reasonable steps required under section 56C of the Act do not impose significant further obligations on them.

This will enable mortgagees to implement practices to comply with the requirements of section 56C using an interim standard that they are familiar with.

Section 117 - reasonable steps

The reasonable steps for the purpose of section 117(4)(c) will be one original or certified copy of a primary identification document or two original or certified copies of secondary documents.

The categories and documents will be more fully described in the Regulation.

The future

It is expected that the conveyancing standard being developed through the NECS consultation initiatives will be known by December 2010. Once it is known, LPMA intends to review the Regulation implementing sections 56C and 117 of the Act with a view to tightening the requirements and obtaining consistency with the conveyancing standard.

The LPMA thanks everyone for their participation and input in this issue, and look forward to working together again in the future.

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