Identify the borrower or risk a cancelled mortgage

Lenders affected by real property amendments

By MATTHEW BRANSGROVE

Matthew Bransgrove is senior partner at Bransgroves Lawyers, and co-author of The Essential Guide to Mortgage Law in NSW (LexisNexis, 2008).

THE *Real Property and Conveyancing Legislation Amendment Act 2009* (NSW) has introduced changes which require additional borrower identification requirements, and will potentially affect indefeasibility of title and compensation from the Torrens Assurance Fund.

The changes dilute the state guarantee of title under the Torrens Systems, although the extent of the dilution will remain unclear until case law beds down. What is immediately clear is that the intent of parliament was that claims on the Torrens Assurance Fund will be radically reduced.

Prudent lenders must now very seriously consider the need for title insurance.

Borrower identification requirements

Reasonable steps

Lenders are now required to take "reasonable steps" to ensure the person who signs the mortgage is the mortgagor. The legislation envisages that regulations will be published that will guide lenders on what is sufficient. The fact that no regulations have as yet been proclaimed does not in the meantime relieve lenders of their obligations. According to a recent speech of the Attorney General the identification procedures will likely follow the 100-points ID scheme.

Record-keeping

The lender must keep records of the steps taken to verify the mortgagor's identity and copies of the identification documents must be retained for seven years from the date of registration.

Identification requisitions

The Registrar-General (RG) has been empowered to make requisitions of the lender to determine whether or not the identification requirements have been complied with. These requisitions can be made before or after registration.

Refusal of registration

If a lender fails to answer requisitions the RG may "refuse to register, or reject, the mortgage". One anomaly of the drafting is that the power to refuse to register a mortgage does not arise if no identification check was made, but rather only if requisitions are not answered. Nevertheless, as will be seen, this will gain the mortgagee little if the mortgage was indeed forged.

Cancellation of a registered mortgage

The biggest innovation introduced by the amending Act is the power of the RG to cancel the registration of a mortgage. Up until now, once a forged mortgage was registered, the lender was safe. Nothing but actual fraud on the part of the lender could dislodge the mortgage or impede its enforceability except if it was an all monies mortgage. If the fraud was discovered after registration there was nothing the RG, or anyone else could do about it. Now, under the changes, the RG can under two circumstances cancel the registration of a forged mortgage.

Cancellation for failure to take reasonable steps to identify

The first ground upon which a mortgage can be cancelled is if the lender has failed to comply with the identification requirements. This significantly dilutes indefeasibility so far as it applies to imposter fraud.

Cancellation where there is 'constructive notice' of fraud

The second basis upon which the registration of a forged mortgage can be cancelled is where the lender had "constructive notice" of the forgery. Arguably, with the wisdom of hindsight, virtually every fraud could have been detected. For example, if a fraudulent letter on the application file had a false ABN number, arguably that put the lender on constructive notice of the fraud. Its inclusion seems to have been intended to create a de facto negligence standard, but what rules will be applied is unknown. Constructive notice is of course a concept borrowed from equity, but its application in equity depends very much on the equitable principle to which it is being applied – each one having developed its own case law.

Queensland has recently passed similar legislation which introduced the requirement on lenders to take steps to identify mortgagors but without the constructive notice element. This is therefore new and unique territory. It seems clear the Parliament's intention was to reduce claims on the Torrens Assurance Fund, but as drafted it will ultimately be up to the courts to decide how tightly the faucet is closed on the flow of money out of the fund.

Transferee tainted

One of the key elements of indefeasibility was the protection it gave to a lender who took a transfer of a mortgage, without actual notice of a fraud by the transferor. Under the changes, this has been done away with, and a transferee now suffers any consequences, which would otherwise attend the original lender. This has a significant impact on the market for mortgages. Arguably, it would no longer be prudent to take a transfer of a mortgage without either mortgage insurance or taking steps to have the mortgage affirmed in some way by the mortgagor.

Limits on amount recoverable from the Torrens Assurance Fund

The new s.129B is headed "Limits on amount recoverable in respect of mortgage obtained by fraud". It might be thought that this section has the potential to impact on the rights of lenders. However, assuming a forged mortgage is not cancelled under the new provisions, it is not the lender who makes an application for compensation in the event of a forged mortgage, it is the registered proprietor. As drafted, the only occasion on which the new s.129B will come into play is when a fraudulent discharge of mortgage has been registered. The most significant element in the new s.129B is that the maximum interest that can be recovered by the lender is the official cash rate plus two per cent.

Duty of care when exercising power of sale

The amending act also inserts into the *Conveyancing Act* a new s.111(A)(1), which reads:

"A mortgagee in exercising a power of sale in respect of mortgaged land, must take reasonable care to ensure that the land is sold for:

a) if the land has an ascertainable market value when it is sold – not less than its market value, or

b)in any other case – the best price that may reasonably be obtained in the circumstances."

This brings the law in relation to the sale of land owned by an individual into line with

the law in relation to the sale of land owned by a corporation. This is governed by s.420A (1) of the *Corporations Act*, which contains near identical wording:

"In exercising a power of sale in respect of property of a corporation, a controller must take all reasonable care to sell the property for:
a) if, when it is sold, it has a market value – not less than that market value; or
b) otherwise – the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold."

The previous common law duty was a duty to act in good faith. This meant that so long as the lender was not fraudulent, or behaving with reckless indifference, then the mere fact that the property was sold at less than market value was irrelevant.

Under the statutory regime, however, the focus is on the price actually obtained. As worded, it imports a strict liability on the lender to get the market value or the best price available. However, Whelan J in *Irani v St George Bank Ltd* (No 2) [2005] VSC 403 at [142] took a different view: "Both limbs of s.420A are concerned with the process of exercise of the power of sale. On the one hand, breach of the duty provided for is not established merely because market value or the best price reasonably obtainable is not achieved. On the other hand, breach may be found to have occurred even where it is established that market value or the best price reasonably obtainable was achieved."

This seems to be at odds with the literal wording of the legislation. Whelen J's formulation seems to suggest that what is important is the steps that were taken. This in turn amounts to an analysis of the lender's bona fides, and that in turn can be seen as a return to the common-law good faith test.

A different approach was taken last month by Bryson J in *Winters v H G & R Nominees* [2009] NSWSC 467 when he said: "It is essential to the borrowers' case to establish that there was a serious discrepancy between the market value of the property at the time it was sold and the sale price. Unless there was a serious discrepancy, criticisms of the lender's conduct cannot affect the outcome."

This seems to show a deference for the literal construction of strict liability, although with the addition of the qualification of "serious", where none exists in the legislation. However, later his Honour seemed to back away from this: "This document shows careful consideration and review of factors relevant to a decision to sell and to the price, going through the information and advice available and supporting the decision to recommend it with careful reasoning. This rebuts any view that the defendant acted with any extraneous or improper motive, or with indifference or lack of appropriate attention to the business in hand and its importance."

It might be that his Honour only meant to address the common-law duty of good faith which arguably applies in parallel with the statutory duty. ❑