Conveyancing and property

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TORRENS CEASES TO ASSURE: A WAKE-UP CALL FOR LENDERS

Australian mortgage lenders have long reclined beneath the shield of Torrens title. Mortgage fraud was a troubling, but not overly worrying, spectre. As long as mortgagees were not actually complicit, their title was indefeasible and the State would provide the funds necessary to redeem their mortgage. Like a well-insured motorist, for whom the prospect of car theft causes little alarm, the Australian mortgage lender could afford to be indifferent to the risk. This complacency was understandable, given the reverence with which the courts treated indefeasibility. Rothman J provided an example in *Perpetual Ltd v Barghachoun* [2010] NSWSC 108 at [25]:

> Indefeasibility of title is the most fundamental feature of the land registration system in Australia. Under it, the State guarantees the title of those with a registered interest in land, to the extent of that interest. The foregoing is trite. But the principle is so important, and adherence to it so essential, that registered title is able to be challenged, under the legislative provisions in each of the States, only in the most exceptional circumstances. The Torrens system has enabled conveyance with certainty in Australia and, even though there may be occasions where notions of comparative justice may seem to have been transgressed, it is essential that indefeasibility of title is not undermined.

All this has changed. Several factors have combined to erode indefeasibility and make lenders in Australia, for most practical purposes, no better off than lenders in a system of title by deeds. The problem is that, like a frog in slowly warming water, the practices of lenders and their solicitors are not adjusting to this new reality. The new reality is that lenders now face loss of all their capital unless they, and their solicitors, take active and earnest steps to prevent impostor-fraud. In many cases the commercial realities of high volume loan processing make this impossible – pointing to a clear requirement for title insurance.

The first of these erosive factors was the emergent judicial view that forged "all moneys mortgages" – which is to say, mortgages that secure obligations contained in contracts extraneous to the register – while technically indefeasible, secured nothing. This is because forged documents extraneous to the register are nullities. Although the roots of this line of authority lie in a 1992 decision, no one seemed to notice until during the credit boom, when invocations of it began to come thick and fast: examples were *Perpetual Trustees Victoria Ltd v Tsai* [2004] NSWSC 745, *Printy v Provident Capital Ltd* [2007] NSWSC 287, *Chandra v Perpetual Trustees Victoria Ltd* [2007] NSWSC 694, *Yazgi v Permanent Custodians Ltd* [2007] NSWCA 240, *Vella v Permanent Mortgages Pty Ltd* [2008] NSWSC 505 and *Provident Capital Ltd v Printy* [2008] NSWCA 13. Notwithstanding this string of authorities, lenders continue to use "all moneys" mortgages for reasons of convenience. But they do so now in the full knowledge that their security does not benefit from indefeasibility. If the lender is not aware of this, then their solicitor may be found to be negligent (see *Vella v Permanent Mortgages Pty Ltd* [2008] NSWSC 505).

The second of these erosive factors, at least in New South Wales, is the existence of the "registration stopper". This was explained by an officer of Land and Property Information (LPI) when giving evidence in *Challenger Managed Investments Ltd v Direct Money Corp Pty Ltd* (2003) 59 NSWLR 452 at [25]:

> A so called "Registration Stopper" is an electronic flag that may be entered into the titling data base operated by the Registrar-General and known as the Integrated Titling System (ITS) so as to ensure that dealings with that land are referred to the person directing the notification for further investigation, and possibly for requisition, prior to registration. This notification is used as an administrative tool where the Registrar-General has concerns about possible transactions but does not have the evidence to warrant the placement of a Registrar-General's caveat under s 12(1)(e) of the *Real Property Act 1900*. A Registrar-General's caveat would prohibit the registration of any dealings with the land whereas the "registration stopper" requires that dealings be further investigated prior to being registered. A "registration stopper" does not appear on a search of the Register folio.

The problem with registration stoppers is that they make the face of the register unreliable. This undermines a key plank of the Torrens system, which together with indefeasibility, used to make mortgage lending a safe pastime. Today a lender, relying on the face of the register, can settle a loan, hand over the money, but then find the LPI will not accept the document for registration because (for example) a fraud investigation is underway. Although this risk can be met by settling at the LPI, and not handing over the advance funds until the mortgage is actually registered, commercial realities make this, for the most part, impractical.

The third, and most significant, of these erosive factors has been recent statutory curtailments to indefeasibility within the Torrens Acts themselves in Queensland and New South Wales. These require lenders to take reasonable steps to identify the mortgagors. The provisions are ss 11A and 11B of the *Land Title Act 1994* (Qld) and s 56C of the of the *Real Property Act 1900* (NSW). To illustrate the issue, consider the New South Wales provision. Under s 56C(1), before presenting a mortgage for lodgment, the mortgagee must take "reasonable steps" to ensure that the person who executed the mortgage as mortgagor, or on whose behalf the mortgage was executed, is the same person who is, or is to become, the registered proprietor of the land. Under s 56C(4) the Registrar-General may ask questions of the mortgagee as to the steps taken to confirm the identity of the mortgagor, or may inspect records of the steps taken. Failure by the mortgagee to comply with such a request may lead to refusal to register or rejection of the registration of the mortgage (s 56C(5)). Under s 56C(6) the Registrar-General can cancel any recording with respect to a mortgage if the Registrar-General is of the opinion that the execution involved fraud against the registered proprietor, and that the mortgagee failed to comply with s 56C(1), or had actual *or constructive* notice that the mortgagor was not the same person as the person who was, or was about to become, the registered proprietor of the relevant land.

The formulation "reasonable steps" sounds eminently reasonable. Also, reg 11A(1) of the *Real Property Regulation 2008* (NSW) assures lenders that a "mortgagee is to be considered as having taken reasonable steps" to check the identity of the person who executed the mortgage, if the mortgagee "has taken the steps set out in this Part". Nevertheless, lenders cannot reassure themselves that traditional indefeasibility will flow merely by following a checklist. The devil is in the detail, and in particular in s 56C(6)(b)(ii) of the Act which empowers cancellation of registration if the lender had "constructive notice of the fraud"

The reference to "constructive notice" of fraud is a significant departure from traditional Torrens principles. The foundation case which established the parameters of the "fraud" exception to Torrens indefeasibility was *Assets Co Ltd v Mere Roihi* [1905] AC 176, where the Privy Council stated (at 210):

> by fraud in these Acts is meant actual fraud, ie, dishonesty of some sort, not what is called constructive or equitable fraud … The mere fact that [the person now registered as proprietor] might have found out fraud if he had been more vigilant, and had made further inquiries which he omitted to make, does not of itself prove fraud on his part.

Thus s 56C(6)(b)(ii) represents a revolution in one of the key aspects of indefeasibility. Whereas lenders previously need not have concerned themselves with facts that might put them on constructive notice of a fraud, now they must make all inquiries suggested by facts known to them. Constructive notice is also embedded in the regulations, which prescribe the reasonable steps to be taken by a mortgagee. Regulation 11B(3)(b) of the *Real Property Regulation 2008* (NSW) states:

> In verifying the information from the relevant document, the mortgagee must be reasonably satisfied that … there is no apparent discrepancy between the information collected from the mortgagor and the information contained in the document.

Lenders might console themselves that, if their loan underwriters are alert and their solicitors on their toes, indefeasibility will continue to flow as before. Unfortunately, the cases show that when a fraud has taken place everyone's conduct is examined under a microscope – and, like it or not, the wisdom of hindsight is often applied. Busy loans officers and solicitors, who might have dozens of loans crossing their desk daily, are being grilled in the witness box about why they did not notice tiny disparate details on documents they received weeks apart.

To a very large extent lenders and their solicitors should expect something akin to res ipsa loquitur to apply: if there was a fraud and they did not detect it, they will likely to be found not to have taken reasonable steps. The case of *Perpetual Trustee Co Ltd v CTC Group* [2012] NSWCA 252 (special leave to appeal dismissed: *CTC Group Pty Ltd v Perpetual Trustee Co Ltd* [2013] HCASL 16) is demonstrative. The lender alleged that CTC did not take reasonable care to identify the mortgagor. The trial judge was sympathetic to the duped originator, finding that even though CTC obtained a photocopy of the mortgagor's passport, the possibility remained that a family member with a resemblance to the mortgagor impersonated him. Thus, the trial judge was not satisfied that there was any breach of duty. In the Court of Appeal, Macfarlan JA (with whom Meagher and Barrett JJA agreed) essentially applied res ipsa loquitur to overturn the trial judge's finding ([2012] NSWCA 252 at [26]):

> The primary judge's unchallenged findings were that [the mortgagor] did not sign the application … If [the officer of CTC] did not make the requisite comparison between the signatory of the application and the original passport photograph, he failed to act with reasonable care … The fact that the application was submitted despite [the mortgagor] not having signed it, strongly suggests that he did not.

In conclusion, lenders and their solicitors need to consider that much of the efficacy of indefeasibility has been removed. The duty to detect impostor-fraud, and the risk if they fail, has now fallen on them. They need to make changes to procedures to increase their vigilance, and solicitors need to advise their lender clients of the new realities, and the potential need for title insurance.

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