Introduction to Title Insurance

1. What is title insurance and how is it different from other kinds of insurance?

   Title insurance is a uniquely American product which is used primarily (but not exclusively) in the United States. Every jurisdiction in America maintains public real estate records—a recording system whereby title to and matters affecting real property interests are memorialized to provide notice of such interests and matters to the public.

   Up until the late nineteenth century, when, for example, a buyer wanted to purchase real estate, he would (if he was smart) engage an attorney to locate and review all matters recorded against the subject property and issue an opinion letter at closing assuring (not insuring) the buyer as to all title matters. Identified open mortgages, judgments and liens would be satisfied (or otherwise released) prior to the payment of consideration and the conveyance of the deed. However, there was a downside. If the attorney failed to identify a title defect, the buyer's only remedy was to bring a tort action against the attorney for malpractice. To prevail, the plaintiff would have to prove that the defendant attorney failed to exercise the proper standard of care in the community for real estate title examinations. If the plaintiff successfully proved negligence, he would be awarded a judgment against the attorney or, more and more frequently, against the attorney's malpractice insurance carrier. If he could enforce that judgment, he could collect his money damages. The process was time consuming and uncertain, which led to the evolution of title insurance. Far easier to bring a strict liability contract claim against a deep-pocketed insurance company, than to litigate a negligence claim against an individual who may or may not have the resources to pay it should the plaintiff prevail.

   Property, casualty, auto and life insurance all protect against harm arising out of *future* events such as theft, fire, collision and death. Recurring annual premiums are based on statistical probabilities of these occurrences or, in the case of life insurance, actuarial tables. Title insurance is different. It insures against damages arising out of *past* events. It is a guarantee—"insurance" is a misnomer—that the legal risk analysis performed by the title underwriter against the property which is the subject of the insured transaction has identified all judgments, liens, taxes and agreements affecting the property and that the transaction has been duly authorized. As anticipated, property, casualty, auto and life insurance claims arise whenever the future events the policies insure against occur. Title insurance claims arise much less frequently (also as anticipated), because they arise out of past events which, in a perfect world, would all have been identified prior to policy issuance. It is only when, for whatever reason, a title underwriter overlooks potential liability that a claim may arise. Accordingly, there is no correlation between the value of title insurance and the infrequency of title insurance claims. The one-time premium is paid with the expectation that there will never be a claim (which expectation is usually met).

There are two prongs to title insurance: defense costs and loss payment up to the insured amount on the face of the policy. If a claim arises, the title insurer will either pay the cost of defending (or settling) the claim or it will pay the insured the amount of the loss in value to the insured property attributable to the claim (not to exceed the policy amount). Put another way, a title insurance policy provides (1) litigation insurance, and (2) a guaranty that, subject to (a) the Schedule B-1 exceptions (and no others) and (b) the exclusions from title set forth in the preprinted form jacket , the insured estate (fee, leasehold, mortgagee or leasehold mortgagee) is vested as described on Schedule A of the policy and the subject transaction has been duly authorized.

In the United States, it is customary to order a title report whenever an interest in real estate is to be purchased or mortgaged. In most other countries where title insurance is available, it is usually only purchased to insure over a specific title concern.

2. Ordering a Title Report.

In order to begin, the title insurance company will need (a) the name of the owner of the property interest, (b) a legal description of the property or at least a street address and/or block and lot description, and (c) copies of any prior title reports or policies. So-called “back title” can significantly speed the search and examination process and every effort should be made to locate any such reports or policies. A survey can also be helpful as can copies of recent tax bills. Make sure the title insurance company has a thorough understanding of the nature of the transaction and the roles of each party. The better the company understands the transaction structure, the less chance of its searching the wrong estate or the wrong parcel.

The cost of and time to complete a title report varies by jurisdiction and size/area of property to be searched. As a general rule, where a recent back title policy is provided, the process will be faster and, often, less costly.

The issuance of a title insurance policy is a three step process: First, a searcher searches the record pertaining to the subject property. In large urban centers like New York City or Atlanta, this is a computerized database search. In more rural areas, this will involve a visit to the local recorder’s office or courthouse for a physical review of the record books. The searcher then makes photo copies of all instruments recorded against the property and gives them, along with her notes, to a reader/examiner. Second, the reader/examiner reviews the recorded materials and prepares a summary of matters affecting title, which, depending on the jurisdiction where the property is located, can be called a title report, a title commitment or a title certificate. For the purposes of this article, these terms are interchangeable. Third, counsel for the party to be insured negotiates the title report with the assigned title insurance company underwriter. More about this third step shortly.

The most comprehensive title insurance for an owner's policy can only be obtained in conjunction with a current survey. Counsel for the proposed insured should determine whether a current survey exists and, if not, whether the transaction will support the cost of ordering either an update of a vintage survey or, if no survey exists, a brand new survey. This is a long lead time item, so an early decision could be critical.

3. Negotiating a Title Report

Terminology. The following definitions will assist in understanding the title insurance process:

Omit: the referenced Schedule B item will be deleted from the final title policy.
Except: the Schedule B item will be an exception in the final title policy.
Affirmative Insurance: the Schedule B item will be excepted from coverage on the final title policy, however some insurance over an aspect of the exception will be provided. This sometimes takes the place of an endorsement, where no endorsement is available.
For Information Only: the referenced item is not an exception to title. The title insurance company is merely advising the insured of the item's existence.

Format. The standard 2006 form title insurance policy is issued by the American Land Title Association ("ALTA"). Although the Covered Risks, Exclusions from Coverage and Conditions set forth in each jurisdiction's (and in each title insurer's) policy jacket are identical, the other informational formats will vary slightly from jurisdiction to jurisdiction. These variations are not substantive. Covered Risks, Exclusions from Coverage and Conditions are all set forth in the jacket boilerplate and may be reviewed in the sample policy attached as Exhibit __. The Conditions are the rules of the road: how to file a claim, how damages will be calculated, notice addresses and so forth.

An ALTA policy provides four basic coverages:

(i) that the estate referenced in Schedule A is owned by the party referenced in Schedule A;
(ii) that the only encumbrances, liens or defects affecting the title are those listed in Schedule B-2, and that otherwise the title is good.
(iii) that the property has access to a public way; and
(iv) that the title is marketable, e.g. there is nothing ambiguous or questionable about the title that would allow a buyer or a lender to refuse to enter into an agreement to buy or lend.

Upon receipt of the title report, counsel for the proposed insured should first turn to Schedule A (See Exhibit _). Schedule A will set forth the following information which should be reviewed carefully:

A) Name of party in whom title to the estate proposed to be insured is presently vested. In the case of a purchase transaction, this should be the seller. In the case of a mortgage transaction, this should be the mortgagor.

B) Estate vested: fee, leasehold, fee mortgagee or leasehold mortgagee.

C) Date of Title Report. This will be the date up to which the title plant is current. Instruments submitted for recordation after that date will not appear. At closing, the date will be "brought down" (a new search will be performed) and the policy will be dated the date of closing. Upon delivery of the vesting documents to be recorded, receipt of consideration and payment of all premium and any other charges, a title insurance policy will be issued, effective on that date (or, if specified, the later date of recordation of the instrument being recorded).

D) Description of Property to be insured. This will either be a brief Block and Lot description or a reference to an Exhibit containing a metes and bounds description. In either case, it should be compared to the legal description in the survey and any discrepancies should be reported to the title insurance company and the surveyor.

E) Name of Insured. This is often left blank or "TBD" until the acquiring/borrowing entity is formed.

F) Amount of insurance. In the case of an acquisition, this will usually be the purchase price. In the case of a mortgage, this will usually be the mortgage amount.

Schedule B-1 sets forth the title insurance company's requirements to insure. Since the policy will insure that the transaction has been duly authorized, at a minimum, the requirements will consist of applicable entity formation and authority documents: proof of formation; good standing certificate(s); articles of incorporation (or formation); shareholder or member consents and so forth. Where there is a particular issue that the title insurer needs to become comfortable with, such requirement may also appear here in Schedule B-1.

Schedule B-2 sets forth the real property taxes as well as exceptions to title reported by the examiner. In many jurisdictions, the first five are called the "standard" exceptions, and can usually be negotiated away, as will be discussed later. The remaining numbered exceptions reference instruments recorded against the subject property: judgments; liens; covenants; restrictions and any other documents granting rights in the property to third parties.

As part of her diligence efforts, insured's counsel should carefully review these instruments to confirm applicability and to determine whether any provisions might negatively impact her client's intended use or enjoyment of the property. If an instrument does not (or no longer) affect the property, counsel should request that the title company underwriter omit it from Schedule B-2. Random examples of this might be a prior mortgage that can be proven to have been satisfied; a memorandum of lease where the lease can be proven to have been terminated; or a restriction affecting only a parcel that has since been conveyed out. Provisions of recorded documents that: provide for the property to revert to a prior owner upon the occurrence of certain events; require the property owner to pay money; or which affect or restrict the use of the property should be promptly discussed with the client. For example, where the client intends to use the premises as a restaurant, a prior deed restriction prohibiting the sale of alcohol at the property might be a deal killer. Counsel should also be alert for setbacks, height restrictions, mechanics liens and any other ownership issues (such as breaks in the chain of title). This process should be conducted as an ongoing conversation (by phone or by email) with the title company underwriter.

The Five Standard Exceptions. A title insurance company can only insure over that which it has knowledge of; e.g. documents and information of record. Each of the five standard exceptions pertains to facts or circumstances which the title insurer has no way of ascertaining: tenancies; off record matters; physical aspects of the property and work performed at the property that might generate mechanics' liens. To omit these exceptions, title insurers require representations from a party with knowledge to be set forth in an Owner's Affidavit (see Exhibit _). Below is a list of each of the five standard exceptions followed by the pertinent owner's affidavit representation required to omit that exception from Schedule B-2.

1. Any facts, rights, interests, or claims which are not shown by the public records but which could be ascertained by an inspection of said land or by making inquiry of persons is possession thereof.

   To omit, the affidavit should state:

   "That Owner is in sole possession of the Property, and that no other party has possession, or has a right of possession under any tenancy, lease or other agreement, written or oral, other than the tenants listed on EXHIBIT A attached hereto. Further, unless noted on EXHIBIT A, no tenant has any rights to the Property other than as tenants, nor any option or rights of first refusal to purchase the Property."

2. Discrepancies, conflicts in boundary lines, shortage in area, encroachments, or any other facts which a correct survey would disclose, and which are not shown by public records.

   This exception can be omitted by providing a recent survey, certified to the title company.

3. Any lien, or right to a lien, for services, labor or material theretofore or hereafter furnished, imposed by law and not shown by the public records.

   To omit, the affidavit should state:

   "That Owner has not contracted for, received any notice regarding, and does not know of any improvement, alteration or change to be made in or about the Property other than as set forth on EXHIBIT B, and there has not been any new construction or major repair work performed on the Property for at least ___________________ days for which the Owner has contracted or been a party thereto. That the Owner has not contracted for, or been a party thereto, any labor to be supplied to the Property, or for any materials to be delivered thereto, that might become the subject of a lien upon the Property and that has not been paid for.

That other than as set forth on EXHIBIT B, there has not been any new construction or major repair work performed on the Property for at least __________________ days for which a tenant has contracted. That no tenant has contracted for, or been a party thereto, any labor to be supplied to the Property, or for any materials to be delivered thereto, that might become the subject of a lien upon the Property and that has not been paid for.

That other than those items shown on EXHIBIT B, there is routine maintenance being conducted on the Property in an amount not exceeding $______________, which will be paid in the ordinary course of business.

That there are not any unpaid bills or claims for labor, services, or materials, nor any recorded or unrecorded mortgages, home improvement loans, chattel mortgages, conditional bills of sale, retention of title agreements, security agreements, agreements not to sell or encumber, financing statements, or personal property leases, which affect the Property or which affect any fixtures, appliances, or equipment now installed in or on the Property."

4. Easements, liens or encumbrances or claims thereof, which are not shown by the public records.

   This exception can be omitted by providing a recent survey, certified to the title company.

5. Defects, liens, encumbrances, adverse claims or other matters, if any, created, first appearing in the public records or attaching subsequent to the effective date hereof but prior to the date the proposed insured acquires of record for value the estate or interest or mortgage thereon covered by this commitment.

   To omit, the indemnity in the affidavit should state:

   "NOW THEREFORE it is agreed that in consideration of the Company issuing its policy or policies without making exception therein of matters which may arise between the most recent effective date of the title commitment (the last date upon which the search of title is effective) and the date the documents creating the interest being insured have been filed for record and which matters may constitute an encumbrance on or affect said title, the undersigned agrees to promptly defend, remove, bond or otherwise dispose of any encumbrance, lien or objectionable matter to title (collectively, "objection(s) to title") which may arise or be filed, as the case may be, against the captioned Property during the period of time between the most recent effective date of Title Commitment and date of recording of all closing instruments, and to hold harmless and indemnify the Company against all expenses, costs and reasonable attorneys fees which may arise out of its failure to so remove, bond or otherwise dispose of any said objection(s) to title."

When negotiating the balance of the representations contained in the owner's affidavit, where the title insurance company is capable of ascertaining the requested information by other means, the affiant should decline to make the requested representation. For example, the affiant need not represent that it owns fee simple title to the property. The title company can determine that by its search of the deed chain.

4. Survey Review.

Where a new or updated survey is required, a proposed survey certification (often generated by the lender) should be furnished to the surveyor as early as possible in the transaction. A survey certification will indicate the level of detail (and expense) required. A survey can be a long lead time item, capable of delaying closing. The final certification signed by the surveyor with a raised seal should run to the insured, the insured's lender and the insured's title insurance company.

When the survey is available, insured's counsel promptly should compare the title commitment legal description to that on the survey. They should match exactly. Any discrepancy should be reported to the title company and to the surveyor for clarification. Counsel should also confirm that the property has access to a public road or highway (even via access easement) and locate the physical path on the survey (usually indicated by broken lines) for each easement referenced in the title commitment. Having read each easement document, counsel should understand the purpose and application of each depicted easement. Any easement shown on the survey map as running beneath an improvement should be scrutinized carefully. All title exceptions capable of being shown on a survey map should be similarly plotted. Any encroachments onto the subject property by a neighboring property (or by the subject property onto a neighboring property) should be evaluated.

5. Endorsements.

A title insurance policy, absent endorsements, is like an off-the-rack suit. Just like a suit might need to be taken in (or let out), trousers cuffed or buttons moved, so a title insurance policy may need tailoring to fit the specific transaction or property being insured. Endorsements to a title insurance policy are designed to add to the coverage contained within the four corners of the pre-printed policy and, in some instances, to even override express policy provisions limiting coverage. Endorsements are narrowly drafted supplements that are made a part of the policy and provide specified affirmative insurance.

A few examples: a Land Same as Survey endorsement (available only where a recent survey certified to the title insurer has been issued) insures that the property depicted in the survey is the same as the property described in the title insurance policy. This endorsement creates privity among the insured, the title insurer and the surveyor. Thus, if a survey claim arises, the deep-pocketed title insurer may be held liable. A Non-Imputation Endorsement (available only with a selling party affidavit) insures that, where the insured purchases some or all of the membership interests in an LLC that owns the subject real property, prior acts of the seller out of which a claim might arise will not be attributed to the insured purchaser. This negates any defense by the title insurer that the claim arose out of the acts of the insured and is therefore excluded from coverage. A Tie-In Endorsement (for multi-site transactions) insures that the aggregate liability amount of all the insured properties' policies will be available to pay a claim against any one property.

Although endorsements address a wide range of concerns, not all endorsements are available in every jurisdiction. Endorsement availability is a patchwork quilt across the United States. Attached as Exhibit __ are various forms of ALTA endorsements addressing a host of issues. Before finalizing a title insurance policy, discuss with your title company representative whether any endorsements are available to address any particular concerns about the subject transaction.

6. The Pro Forma Policy

The internet and the speed of computing have made producing and revising a title policy fast and seamless. As a result, a hybrid product (more than a commitment, but less than a policy) has become widely used. A Pro Forma Policy is a title commitment that has been revised to omit all Schedule B exceptions which are anticipated to be omitted in accordance with ongoing title company/insured negotiations and subject to the delivery of required proofs (mortgage satisfactions; lien waivers; documents to be insured etc.). It is what the final policy will be once the words "Pro Forma" are deleted from the jacket. The parties like pro forma policies because, in theory, they shorten the review process which streamlines the path to closing. For the title company, it is a matter of keeping straight what has (or has not) been finalized (despite the clean pro forma).

7. The Closing

There are two kinds of closings: a "New York style" sit-down closing and a "mail" or escrow closing. In a sit-down closing, the title insurer, the parties and their counsel convene in a conference room and documents are exchanged for money and the issuance of one or more title polices. This process can be costly and time consuming. Today, escrow closings (which originated on the West coast and have spread East) are the preferred closing method. In an escrow closing, executed documents in recordable form are delivered in escrow to the title company together with a direction letter setting forth the required conditions for their release. Similarly, funds are wired to the title company by the lender and/or purchaser also accompanied by a direction letter. Once the title company has received all necessary funds and documents (and sometimes has even recorded them) and is otherwise prepared to insure, escrow is broken and the closing is deemed to have occurred.

8. The Gap

Where a closing occurs in the morning, what is to prevent a seller or borrower from selling or mortgaging the property again a few hours later with a different title company before the first title company has had time to record the deed or mortgage it was given that morning? This period of time, between delivery and recording, is known as the "Gap" and one other benefit of title insurance is that it insures over the Gap. In some jurisdictions, the title company treats this as the assumption of a market-place risk, in other jurisdictions, the title it requires an indemnity from the seller/borrower against Gap risk. It is a custom-driven phenomena that facilitates closings everywhere.

9. Reinsurance and Coinsurance

Title insurance companies are subject to financial limits: statutory; self-imposed or customer imposed. Based on the size of the assumed risk, the company may need to "lay off" a portion of the risk on another insurer. There are two ways to accomplish this.

Reinsurance, distributes the liability risk of a large title insurance policy among several companies. The issuing company is paid the full premium for its policy in the amount of 100% of the liability. In turn, it buys insurance from others in the same industry. The "ceder" is the company issuing the policy that will be reinsured by a reinsurer, a company that agrees to sell insurance to a ceder and thereby assumes a portion of the ceder's liability in the event of a loss. In most states an insured is issued one policy. The ceding title insurer is fully liable to the insured but is entitled to reimbursement from all reinsurers for specified portions or shares of the loss. If a reinsurer is unable to pay its specified portion of a loss, the ceding company is fully liable to the insured. "Primary retention" (or "primary liability") is a level of reinsurance liability. It is the amount of liability retained by the ceding company. When reinsurance is obtained by a ceding company, the reinsurer's liability is secondary to the primary liability of the ceding company. Tertiary retention only applies if primary and secondary retentions are exceeded.

Coinsurance, differs from reinsurance. Coinsurance is a risk-spreading procedure by which the insured risk is distributed among two or more title insurance companies. Each bears a portion of the risk and obligates itself *directly* to the common insured. Each coinsurer accepts a stated fraction of the risk (equal or proportionate) and is paid its proportionate premium. The sum of all coinsurance policies equals the total coverage for the transaction.

There is a "coinsurance clause" in each company's policy (or a separate endorsement attached to each policy) that lists each of the coinsurers, states the amount of coverage provided by each of the companies and defines their share of liability in the event of loss. Unlike reinsurance, if a coinsurer becomes insolvent, the insured has no recourse to any other co-insuring company for the insolvent company's proportion or share of any loss.

"Joint and Several Coinsurance" is available for an additional fee. With this clause, in the event of a minor loss, an insured avoids dealing with different co-insurers. An insured can make a claim against any of the co-insuring companies, with no **[?]** right of contribution from any other coinsuring company up to a specified dollar limit.

Reinsurance can also be used by co-insurers if the co-insured amount is in excess of the normal retention of the co-insuring company. Co-insurance does not require the issuance of a written agreement.

The ALTA Facultative Reinsurance Agreement current standard form was adopted June 17, 2006. It is a contract for indemnity for the risk already assumed by the ceding insurer. It allows direct access by the insured for claims under the policy against the reinsurer(s). The Agreement together with its attached schedules constitutes an "offer" to reinsure.

A Reinsurance Treaty is sometimes used. It enables the ceding company to reinsure a portion or all of its risk with a specified reinsurer. The treaty provides for automatic reinsurance of every transaction insured by the ceding company.

Reinsurance is much more complicated than it was in the past. Risks to be reinsured must be submitted prior to their acceptance to the proposed reinsuring company. Today, a reinsuring company re-underwrites the transaction from its own standpoint. If a reinsuring company is not satisfied with the risk, then it will refuse to accept the reinsurance.

10. State by State Premium and Endorsement Regimes

Title insurance premium rates and the availability of policy endorsements vary from state to state, but generally fall into the following categories:

In "filed rate" states, premiums are set by each state's department of insurance. Premium pricing is not negotiable and is uniform for each underwriter. Similarly, only certain endorsements are allowed to be issued. Note that, in New York, which is considered to be a filed rate state, premiums are set by the Title Insurance Rate Service Association, Inc. ("TIRSA"), a trade association sponsored and controlled by the various title insurance underwriters.

In "non-filed rate" states, premiums are negotiable and set by the marketplace. A title insurance underwriter may issue any endorsement it deems suitable.

In "promulgated rate" states, each underwriter sets its own rates and available endorsements.

In "partially filed rate" states, the state's insurance department regulates rates up to a certain liability threshold above which, rates are negotiable.

The cost of title insurance varies greatly across the United States. When structuring a transaction, counsel should determine from her title company representative the rate and endorsement regime(s) of the affected states.

11. Conclusion

Without title insurance, buyers of real property and lenders whose loans are secured by real property could not have absolute assurance as to the status of judgments, liens and other matters affecting title to that real property. Title insurance is a strict liability contract backed by millions (or billions) of dollars in reserves. Additionally, the title insurance process from commitment to policy provides a lit pathway to closing: real property due diligence; local financial stakeholder services and a deep knowledge of local marketplace practices and customs.

- -Promulgated, filed and negotiated rates
- -Promulgated, filed and negotiated forms
- -Partially filed
- -Filed rates: NY, NJ, PA
- -Promulgated: TX
- -Non-filed: MA and IL
- -Partially filed: CA

-ordering a title report

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- -Transaction information
- -Cost and timing
- -What to do when you receive title report
- -Schedule A
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-5 Standard Exceptions and their interplay with the Owner's Affidavit
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