Secured finance practitioners are scrambling to educate themselves about the benefits of UCC insurance and, in many instances, requiring such lien perfection and priority insurance in connection with their Uniform Commercial Code filings.<sup>1</sup> They are doing so either as part of their prudent underwriting practices or in response to the uncertainty that has been created by the revision to Article 9 to the Uniform Commercial Code.<sup>2</sup> This article will summarize various protections offered by UCC insurance and identify the kinds of transactions where UCC insurance is becoming commonly used.

1. What is UCC Insurance?

UCC insurance provides a lender coverage insuring that its security interest is validly created and is enforceable, and that its lien has been properly perfected and has priority as insured, subject to the policy exclusions and exceptions to the coverage. Generally, UCC insurance indemnifies a named insured, and its successors and assigns, against loss it incurs if a perfected security interest in scheduled collateral fails as a result of any of the following insured risks:

(a) failure of the security interest to attach to or be created as to the collateral;

(b) failure of the security interest to be perfected;

(c) failure of the security interest to have priority against

   (i) other security interests in the same collateral;

   (ii) the lien of a lien creditor<sup>3</sup>; or

   (iii) a party acquiring an interest in the collateral after the date of the policy;

(d) failure of the security interest to be valid and enforceable due to fraud, forgery, undue influence, duress, incapacity, incompetency or impersonation;

(e) failure of an assignment of the security interest by its holder; and

(f) a claim in an adversary proceeding under the Bankruptcy Code asserting that the security interest is not valid or does not have the priority insured.
Similar to a real estate title insurance policy, the UCC insurance policy provides for defense of an insured against a risk protected against by the policy at the expense of the insurer. If that defense is ultimately not successful, the insurer pays for the covered loss.

UCC insurance coverage is based upon the same due diligence which should be conducted to issue a legal opinion, but without the exceptions, qualifications and assumptions which so diminish the assurances offered in such opinions. Under a UCC insurance policy, the insurer is an indemnitor of the accuracy of the underlying due diligence, whereas a legal opinion assumes and relies on such accuracy. This important distinction can be compared to the difference between strict liability and ordinary liability. The scope of protection under a UCC insurance policy far exceeds that afforded under any customary legal opinion.

Except in connection with certain mezzanine finance transactions, UCC insurance does not provide coverage against the debtor's failure to have title to the collateral which is subject to the lien insured under the UCC insurance policy. It is important to note, however, that a legal opinion would not give assurances regarding title to the collateral under any circumstances. An endorsement to the UCC insurance policy deleting the exclusion regarding title to the collateral where the collateral is certificated securities pursuant to Article 8 of the UCC may be available for a mezzanine finance transaction subject to the satisfaction of certain underwriting requirements.

In addition, at the lender's request, and for no additional charge, the insurance company issuing the UCC policy will prepare all of the insured UCC-1 financing statements.

2. Recent Revision to Article 9 of the Uniform Commercial Code

As most secured finance practitioners know, by July 1, 2001, most states will have enacted legislation repealing the current Article 9 to each state's Uniform Commercial Code and adding a new Article 9, based on a revision of Article 9 prepared under the sponsorship of the American Law Institute and the National Conference of Commissioners on Uniform State Laws. The revision, which is intended to simplify and standardize rules for the creation, perfection, priority and enforcement of security interests and to promote electronic commerce, affects, among other things, changes to the way collateral is described, changes to the way security interests are perfected, and changes in the locations in which filings of financing statements are to be made. Revised Article 9 provides for a five-year transition period with complex transition rules. For lenders concerned by the potential for erroneous filings due to confusion during this transition period, the transition rules endorsement to a UCC insurance policy provides coverage against the failure to comply with the transition rules.

3. What Kinds of Transactions Are Most Suited for UCC Insurance?
As a general proposition, any lender which is secured by a material amount of tangible or intangible personal property (e.g. a loan to a hotel operator who pledges its interests in fixtures, fittings and equipment; a project finance loan where equipment or machinery are a major portion of the collateral; or a loan against inventory) should consider the protections offered by UCC insurance. Most lenders will therefore benefit from UCC insurance, unless (as in the case of a loan secured only by a mortgage on raw land) the lender is not secured by any personal property of value.

The lender of a mezzanine loan - a loan secured by pledges of individuals' equity interests in the entity which is the mortgagor under an existing mortgage loan secured by the mortgagor's interest in real property - can, in particular, realize substantial protection by insuring the attachment, perfection and priority of its security interest in the pledged equity interests. Like a mortgage loan lender, the validity and priority of whose lien against real property is typically insured under a mortgagee title insurance policy, the mezzanine lender can now obtain coverage against the failure of its UCC filings to attach, be perfected or have the priority insured under the UCC insurance policy.

Today, many lenders are requiring lien perfection and priority insurance in connection with their Uniform Commercial Code filings, either as a part of prudent underwriting practice or in response to the uncertainty created by the revised Article 9 to the Uniform Commercial Code. Secured finance practitioners can alleviate their lender clients' concerns by considering the protections offered by UCC insurance.

1 As of April 2001, UCC insurance substantially in excess of $1,000,000,000.00 has been ordered.

2 As of the date of this article, the First American Title Insurance Company and its family of companies, including the First American Title Insurance Company of New York, is the only company offering UCC insurance.

3 Coverage as to tax liens is by endorsement after additional searches are conducted.