LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
TUESDAY, MAY 22, 2018

Specific-risk title insurance: Something new under the sun?

By Robert C. Barnes

Great amounts of ink have been used over the years in examining the ways in which policies of title insurance differ from more traditional forms of insurance. But a new approach to underwriting title risks by reinsurers may lead to fewer dissimilarities and at the same time more flexibility and choices for insureds.

Anyone who has purchased or financed a house or commercial property has some passing familiarity with title insurance. Title insurance allows a buyer or lender to be assured that as of the date of closing, the state of title to the property being purchased (or loaned against) is as described in the policy — and if a claim arises after closing based on a pre-closing defect in title (such as an easement that wasn't described in the policy, or a claim that the property is actually owned by another third party), then the insured owner or lender can look to the title company to defend title in any resulting litigation, and if necessary to reimburse the insured for their monetary loss (up to the amount of the policy).

The differences between title insurance and typical indemnity insurance (whether for life, property damage, liability or otherwise) are striking: To begin with, title insurance covers claims for past events (that is, title matters that occurred before the policy was issued), not future casualties or accidents. Unlike traditional insurance, title insurance requires only a one-time premium payment, and the policy provides coverage for as long as the insured owns the property or mortgage — theoretically forever.

The risks that are not insured under traditional insurance policies are typically spelled out in the insurance policy itself and are not usually specified for particular assets or persons. That's not the case in title insurance, where the state of title to real property is examined by specialists and many of the matters affecting title as of the issuance of the policy — such as easements, CC&Rs and the like — are shown as specific exceptions to coverage in addition to the blanket exceptions that are basically the same for all policies issued in a particular state. That means that if a post-closing claim arises out of an excepted matter — in other words, a specific risk — there will be no coverage for the owner or lender's possible loss.

Endorsements exist that, depending on the issue and the level of perceived risk, can be issued in conjunction with the underlying title policy and can reduce or eliminate specific risks, such as a possible lack of access to a site. Generally speaking, though, the risk of loss presented by specific risks isn't covered by normal title insurance policies.

A handful of European reinsurance companies, such as Dual Asset Underwriting in London, have been offering to title insurers, and some title insurers in turn have been offering to their insureds, the ability to underwrite specific risks in ways that are reminiscent of traditional non-title insurance policies.

That may be about to change somewhat. A handful of European reinsurance companies, such as Dual Asset Underwriting in London, have been offering to title insurers, and some title insurers in turn have been offering to their insureds, the ability to underwrite specific risks in ways that are reminiscent of traditional non-title insurance policies. (Full disclosure: the author's firm represents Dual Asset Underwriting, among other reinsurers.)

Specific-risk insurance for real estate has been around in England in one form or another since the 1960s, and it became widespread in the 1990s as a way to facilitate difficult real estate transactions. It arose as a result of England's land registration system (as opposed to the more common recording system used in the U.S.), which can make resolving potential claims based on title defects expensive and time-consuming.

Specific-risk coverage is offered in a number of ways, all of which are familiar in the world of traditional insurance underwriting. Thus, a particular specific risk (say, an easement affecting title that hasn't been used in some time but that, if actually used, could drastically interfere with the property owner's use of the site — for example, think of the effect on a regional shopping mall) would be analyzed according to underwriting standards that would attempt to quantify the risk and the possible loss from a claim: how long has the easement been unused? What are the likely damages if the easement were to be used now — reconstruction costs, breach of leases, etc.?

From there, various possibilities might exist: the premium for the policy could be increased to address the issue, meaning a bigger initial payment but ultimately peace of mind for the new owner (and its lender). Alternatively, claims arising out of the easement alone could be subject to a deductible or stop-loss, a concept that currently is foreign to title insurance, with the title insurer liable only for losses after the insured has paid a certain amount. Another approach would be to cap the insurer's exposure by limiting losses only up to a certain amount, but less than the policy's total coverage amount.

This approach highlights another difference between traditional insurance and title insurance: While traditional insurance premiums are most often calculated using actuarial science, title insurance premiums usually aren't. Rather than calculating premiums according to the probability of losses for a particular event and the associated projected costs, title insurance very often depends on either eliminating the possible loss, if not the risk (for example, by requiring a third-party indemnity for losses arising out of an old lien that for whatever reason can't be released). Showing a title defect as an exception to coverage eliminates the risk and potential loss entirely from the title insurer's perspective and shifts the risk of loss to the insured, something that specific-risk coverage tries to address.

Specific-risk title insurance coverage seeks to bring a more flexible underwriting analysis to particular title defects, with a goal of providing coverage — albeit possibly at an increased cost, with capped coverage, or with greater monetary contribution from the insured. The result can be greater certainty for the insured, both as to cost and possible outcomes. For a seller, it can increase the marketability of an asset and provide a clean exit, with no post-closing indemnities or contingent liabilities. And for a buyer and its lender, it can ultimately enable financing and serve to reduce funding costs.

Currently the kinds of specific risks that are being covered in Europe range from violations of use restrictions to challenges to building permits to historic ownership challenges. Unsurprisingly, there are often conditions to coverage, depending on the nature of the risk; for example, an owner wouldn't be able to apply to the local governmental authority for retrospective consent where a building permit is missing without obtaining the insurer's consent beforehand.

Like all insurance products, title insurance is highly regulated on a state-by-state basis, so it's unclear when, or even if, specific-risk title insurance might be available in California or the United States. But some reinsurers are already offering this coverage abroad, and at least some are betting that U.S. title insurance companies, and their insureds, will find this more flexible approach worth exploring here.

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