

**Fidelity National Financial, UCC Risk  
Management Program**

***Stimulating Bank Lending and  
Small Business Growth***

**UCC Insurance for Secured Lenders**



**Prepared for Financial Institutions, Corporate  
Borrowers, Commercial Finance Lawyers, Investors,  
Industry Analyst, Regulators, Bank Examiners and  
Public Policy Makers**

## **Fidelity National Financial** **Stimulating Bank Lending and Small Business Growth**

The Financial Services Industry has developed and refined a program to protect bank credit quality and improve small business borrower loan applications. By protecting the collateral of secured lenders and the government as a direct lender or guarantor, and improving the small business loan application, the program enhances bank lending, and the hiring related to small business growth. Suggested legislative language is set forth below.

Based upon FDIC data:

- Commercial and industrial loan delinquency and charge-offs grew from 2006 to 2009 from \$10.9 billion to \$69.1 billion, representing an increase of 531%. These loans, charged-off loans, loans in which banks recorded a loss and charged the loss against statutory capital, grew from \$2.3 billion to \$23.6 billion, an increase of 946%.
- Non-accrual loans, loans in which the bank discontinues charging interest, and loans delinquent more than 90 days grew during the same period at a similarly astounding rate of 487% and 168% respectively.
- Loans defaulted and charged-off in the next three year time frame are generally anticipated to increase by 50% over current year figures, to a staggering \$103.7 billion.

Industry experts have determined that of the loans defaulting, commercial lenders face documentation errors and defects in 30% of the loans, which result in the secured lender's loss of lien priority, and subsequently reliance collateral. In 80% of these transactions, the bank fails to generate any substantial recovery from their defaulted loans, in that their lien perfection and priority in the loan collateral is "set aside" over competing priorities and third party challenges due to the documentation errors and defects.

Utilizing projected loan figures, it is anticipated that 30% of defaulted loans over the next three years represents \$31.11 billion in loan amounts. Because 80% of these improperly perfected loans do not yield any substantial recovery of collateral, \$24.88 billion in losses and direct hits to bank capital could be avoided with UCC insurance, assuming the original loans were adequately collateralized.

The rigor and discipline provided by UCC insurance policies would support the secured commercial banking industry, and government agencies (to the extent they are a direct lender or guarantor) avoid the losses and capital reductions as noted above. UCC insurance improves the quality of the Borrower's loan package, providing for increased and safer lending.

Industry experts are anticipating that the corporate lending segment is the next most-likely loan segment to suffer increased losses. Corporate bankruptcy filings are up an astounding 276% from 2007 levels. Many of the loans anticipated to

default and incur a loss to the bank are in the Small Business loan segment, which is under significant focus as both the engine of the nation's economic recovery and the sector in which job creation is most likely to occur. Increased focus on the integrity of the documentation and reliance collateral supporting small business loans will help reduce these losses.

### **Suggested Legislative Language**

*Secured lending should require banks to receive independent, third party verification of the lender's proper perfection and first priority security interest in commercial loans secured by non-real estate collateral exceeding \$2 million. The third party must be separate from lender's counsel and ensure lender's rights to collateral assets over the life of the loan. Bankers and the government as lender or guarantor are to take advantage of available resources to insure attachment, perfection and priority of their security interests in non-real estate assets collateralizing commercial loans.*

### **Summation**

The next economic bubble facing the nation's fragile economy is anticipated by many to be the commercial loan market, evidenced by significant increases in delinquencies, defaults, charge-offs and losses which serve to deplete bank capital. This depletion of bank capital may expose lenders, investors, shareholders, bondholders, government lending functions, government guarantors, government insurance agencies and taxpayers to significant liability. Simply put, UCC insurance can mitigate much of the pressure on lending institutions by protecting lien perfection and priority on reliance collateral, with the goal to maximize recoveries in the event of a third party challenge, foreclosure or liquidation. UCC insurance should be considered as an important "best practices" risk management tool for commercial loans. This is an effective and low-cost tool that should be utilized to identify measure and manage commercial loan related risk. Bank examiners should be familiar with this private-sector program, and should evaluate the benefits for adoption by all banks, including in particular those banks that are the beneficiary of direct government lending, government guarantees and taxpayer subsidy.

### **Addendum**

Exposure to lenders and outside counsel is often revealed in matters involving 1. Failure to file/continue the financing statement, 2. Incorrect/ambiguous financing statement, 3. Defective description of collateral, 4. Incorrect filing jurisdiction. Cases generally fitting into these categories include:

1. **Receivables Purchasing Company** Cite: Georgia Court of Appeals-October 2003

**Issue:** Debtor's correct name was Network Solutions, Inc. The financing statement was filed against Net Work Solutions, Inc. A UCC search on the correct debtor name did not uncover the filing. The court commented that a party filing a financing statement now acts at its peril if it files a financing statement under the wrong name.

**Conclusion:** The secured party did not perfect properly despite only adding a space in the debtor's name.

**2. Pankratz Implement Company** Cite: Kansas Superior Court-March 2006

**Issue:** Debtor's Correct Name was Rodger House. The financing statement was filed against Roger House. A UCC Search on the correct debtor name did not uncover the filing. The court commented that article 9 had the effect of shifting responsibility of getting the name right on the financing statement to the filing party.

**Conclusion:** The secured party did not perfect properly despite missing only one letter in the debtor's name.

**3. In Re Tyringham Holdings, Inc.** Cite: United States Bankruptcy Court Virginia- December 2006

**Issue:** Debtor's correct name was Tyringham Holdings, Inc. The financing statement was filed against Tyringham Holdings. A UCC Search on the correct debtor name did not uncover the filing. The Secured Party argued that a private search service using a different search logic would have found the filing. The court ruled that the Virginia search logic did not find the filing and the filing was therefore seriously misleading.

**Conclusion:** The secured party did not perfect properly despite only missing the Inc. in the debtor's name.

**4. Host America Corporation v Coastline Financial, Inc.** Cite: United States District Court- Central District of Utah-May 2006

**Issue:** Debtor's correct name was K. W. M. Electronics Corporation. The financing statement was filed against KWM Electronics Corporation. A UCC Search on the correct debtor name did not uncover the filing. The court ruled that "given the importance of the debtor's name, it should come as no surprise that a failure to adequately provide the name will render a financing statement, "seriously misleading".

**Conclusion:** The secured party did not perfect properly despite missing 3 periods and spaces in the Debtor's name.

**5. Fuell v MNTC** Cite: United States Bankruptcy Court Idaho-December 2007

**Issue:** Debtor's correct name was Andrew Fuell. The financing statement was filed against Andrew Fuel. The court held that the financing statement was ineffective and that the Debtor's name on the financing statement was seriously misleading.

**Conclusion:** The secured party did not perfect properly despite missing only one letter in the debtor's name.

***Additional Footnotes:***

Publicly adjudicated cases illustrate exposure to lender's relying on search vendors and/or outside counsel to assure proper attachment, perfection and priority of its security interest in personal property:

The "Failure to File" a UCC-1 Financing statement by outside counsel led to a legal

malpractice judgment against a law firm in an action brought by the client, in *Kory vs Parsoff*, 745 NY S. 2d 218 (2002).

An “Incorrect/Ambiguous Financing Statement” limited collateral subject to a bank’s filing in *Shelby County State Bank vs. Van Diest Supply* 303 F. 3d 7<sup>th</sup> Cir (2002).

A “UCC Search Vendor’s Liability for Damages” was limited to \$25 for the failure/inaccuracy of the vendor’s search in identifying prior liens in *Puget Sound Financial, LLC vs. Unisearch, Inc.* 146 Wn. 2d 428 (2002).

A “Defective Description in Collateral” and “Incorrect Filing Jurisdiction” led to a lender failing to properly perfect its security interest in *Fleet National Bank vs. Whippany Venture I* 370 B.R. 762 (d. Del 2004).