



ALTA 21 CREDITORS' RIGHTS ENDORSEMENT MAY NOT SURVIVE THE GREAT RECESSION

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Lenders and owners of real property obtain title insurance to protect against some of the risks related to the condition of title. The risks insured by the title insurance company are set forth in the title policy, and the basic coverages provided in the policy jacket may be augmented by endorsements to the title policy. This Client Alert focuses on the current status of the ALTA 21 creditors' rights endorsement.

ALTA 2006 and ALTA 21 Background

What different times they were. Amid pressure from lenders and others concerned that they might not be receiving sufficient value for their insurance premiums, the American Land Title Association ("ALTA") agreed to provide additional affirmative coverage to parties via the ALTA 2006 title insurance policy forms. Among the most significant new coverages included in the ALTA 2006 policy forms was the creditors' rights coverage found in Covered Risk 9 (Owner's Policy) and Covered Risk 13 (Lender's Policy) (the "Covered Risks").

The Covered Risks provide coverage to the insured with respect to two creditors' rights scenarios. First, the Covered Risks insure against the avoidance of any transfer of the real property prior to the subject transaction as a fraudulent or preferential transfer under state or federal creditors' rights laws. Second, the Covered Risks protect the insured against losses resulting from the subject transaction being deemed a preferential transfer pursuant to state or federal creditors' rights statutes, based solely on the failure to record the insured instrument in a timely manner or to provide notice of the insured instrument to a "purchaser for value or to a judgment or lien creditor." Despite adding expanded creditors' rights coverage for the insureds, the ALTA 2006 policies were still a compromise between the insureds and the insurance companies. Accordingly, the expanded creditors' rights coverage remained subject to related exclusions from coverage.

In addition to exclusions related to knowledge of the insured, among others, the ALTA 2006 policy forms include two specific creditors' rights exclusions. The first exclusion from creditors' rights coverage relates to losses resulting from a finding that the subject transaction represents a fraudulent conveyance or a fraudulent transfer. The second exclusion denies coverage for claims resulting from the subject transaction being deemed a preferential transfer for any reason other than the two reasons specified in the Covered Risks. Insureds looking to bridge the gaps in creditors' rights coverage resulting from the exclusions needed to look no further than the new ALTA 21 creditors' rights endorsement. The ALTA 21 insures against "loss or damage sustained by the Insured by reason of the avoidance, in whole or in part, or a court order providing some other remedy, based on the voidability of any estate or interest shown in Schedule A or the Insured Mortgage because of the occurrence on or before Date of Policy of a fraudulent transfer or a preference under federal bankruptcy, state insolvency, or similar creditors' rights laws." Title coverage regarding creditors' rights appeared to be on solid footing.

What Is Happening Now?

Enter the Great Recession. Property values nationwide plummeted, foreclosures increased at an exponential rate and businesses large and small filed for bankruptcy. As a result of these conditions, title insurance companies have been put under significant economic strain. At the same time that fewer real estate transactions are being booked, and their premiums missing from title insurance companies' coffers, claims based on ALTA 2006 creditors' rights coverage are increasing. In direct response to the increased level of creditors' rights claims being filed, title insurance companies are searching for a way to limit their creditors' rights exposure under the ALTA 2006 policies. The current focus seems to be on limiting the availability of, or eliminating, the ALTA 21 creditors' rights endorsement.

Over the past six months, real estate practitioners have noticed changes in the process for obtaining an ALTA 21 creditors' rights endorsement. The first such change appeared to be increased information gathering from the parties to the transaction. Where title agents once completed a short form creditors' rights questionnaire to have an ALTA 21 approved, the parties themselves were now being asked to complete long form creditors' rights questionnaires—sometimes running five or six pages. Financial statements were more often being requested to evaluate creditors' rights risks. Soon after the increased due diligence, the underwriting process at title companies seemed to grind to a halt. Where once the issuance of the ALTA 21 rarely held-up a transaction, underwriting approval could now take two to three weeks. Title companies limited agents' ability to approve the ALTA 21 and centralized approval authority further up the chain of command.

The next indication that the status of the ALTA 21 creditors' rights endorsement was in flux was pricing. Where the ALTA 21 endorsement was often of little cost (or even free in some cases), a number of title companies have begun increasing the premiums for the ALTA 21. Several title companies simply mandated a higher minimum charge per \$1000 of the amount being insured. Others dictated that the ALTA 21 be removed from any "bundled" pricing discount being offered. The title companies that did not take one or both of the foregoing steps alerted their customers that pricing for creditors' rights endorsements was unsettled and likely to increase. Practitioners began to wonder how much longer the ALTA 21 creditors' rights endorsement was going to be a viable option for their clients.

Finally, word spread that ALTA was considering decertifying the ALTA 21 endorsement nationally, removing it from the standard set of available ALTA endorsements. Over the last week or so, state title insurance bodies have taken the lead in attempting to decertify the ALTA 21, or equivalent state creditors' rights endorsement, on a state-by-state basis. For example, on all closings taking place after February 1, 2010, the Title Insurance Rating Bureau of Pennsylvania has withdrawn the PA 1300 and the PA 1301—Pennsylvania's creditors' rights endorsements. Similar actions are pending before the Delaware Department of Insurance and the New Jersey Department of Banking and Insurance. It seems likely that Delaware and New Jersey will decertify the ALTA 21 by early March. There is no doubt that other states have been receiving submissions seeking to decertify the ALTA 21 or state equivalent creditors' rights endorsements and are watching these proceedings carefully.

What Does This All Mean?

The ability to obtain an ALTA 21 creditors' rights endorsement, or state equivalent, is increasingly in doubt. As a result, now is the time for lenders and others to determine how they will proceed when they receive the news that a creditors' rights endorsement is not available on a particular transaction. One possibility is to revert to the cobbled-together creditors' rights coverage relied upon prior to adoption of the ALTA 2006 policies. That is, if there are states that have not decertified use of the ALTA 1992 policy, or even the 1970 policy, parties may consider requesting older policy jackets in order to proceed in a pre-ALTA 2006 manner. There are several significant downsides to this approach. First, the ALTA 2006 policies provide many non-creditors' rights benefits to the insured that make them superior to the older policies. These pro-insured provisions would be lost by requesting an earlier policy form. In addition, the old approach of obtaining creditors' rights coverage under an ALTA 1992 policy by requesting a deletion of the creditors' rights exclusion may not be effective. In any event, neither the 1970 policy (by its silence regarding creditors' rights issues) nor the ALTA 1992 policy (with the creditors' rights exclusion deleted), provides the affirmative creditors' rights protection afforded by the ALTA 2006 policies in conjunction with the ALTA 21 creditors' rights endorsement.

The second possibility is that individual title insurance companies may decide to craft their own creditors' rights endorsements. The decertification of the ALTA 21 does not mean that title companies cannot continue to offer creditors' rights coverage. Even if title insurance companies decide to go this route, the resulting coverage will likely be more expensive and less expansive than the ALTA 21. For instance, several title companies are considering offering a creditors' rights endorsement that does not cover the cost of defense. It remains to be seen whether title insurance companies will offer a viable, cost-effective alternative to the ALTA 21.

In the meantime, the most likely scenario is that lenders and others will eventually need to proceed without the creditors' rights coverage provided by the ALTA 21. This may mean that parties need to undertake additional due

diligence in the area of creditors' rights. As just one example, a lender financing an acquisition may want to evaluate how well it understands the financial strength of the seller. In addition, the unavailability of the ALTA 21 reallocates risk. Previously the risk was placed on the title insurance company and the borrower paid for that risk through the title insurance premium. Lenders should be aware that their risks may have increased and they should price the transaction accordingly. The exact impact of the potential demise of the ALTA 21 can only be determined by analyzing the structure of a specific transaction. Nonetheless, it is safe to say that the Great Recession forced title insurance companies to concentrate on creditors' rights issues in title insurance. The increasing unavailability of the ALTA 21, and state equivalents, should focus lenders and others on the same issues.

For more information about this topic or assistance with financing issues, please contact one of the authors or any member of the Ober|Kaler [Finance Group](#).

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