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AS OF MARCH 8, 2010, MAJOR TITLE INSURERS WILL NO LONGER UNDERWRITE POLICIES TO PROTECT CREDITORS' RIGHTS

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On February 3, 2010, the American Land Title Association ("ALTA") Board of Governors unanimously voted to withdraw and decertify its Form 21-06 Creditors' Rights Endorsement ("Endorsement"). The California Land Title Association ("CLTA") Board of Governors quickly followed suit, withdrawing its own Endorsement (Forms 131 and 131-6) on February 16, 2010. While the ALTA Board made clear that its action had no effect on an individual title insurers' ability to provide protection to owners and/or lenders with respect to creditors rights, many of the major industry leaders—for example First American Title and Fidelity National Title (including related companies such as Chicago Title)—promptly announced they would no longer be providing insureds with coverage for creditors' rights.

Accordingly, as of March 8, 2010, when the ALTA and CLTA actions become final, owners and lenders will effectively be unable to obtain title insurance policies that provide protection against risks associated with a seller or borrower insolvency or subsequent bankruptcy, most notably fraudulent transfer or preference claims which could void the insured transfer or mortgage. Because owners and lenders will not be able to look to title insurers to protect against these risks, they should be much more cautious and thorough in performing due diligence on the parties with which they transact. Specifically, owners and lenders should make efforts to determine the true financial condition of the seller or borrower, and should consider requiring representations and warranties regarding the financial condition that party along with covenants addressing the potential unwinding of any transaction deemed to be fraudulent or otherwise voided by bankruptcy law.

For industry insiders, these announcements come as no surprise. While some believe that the lack of consistency as to creditors' rights coverage throughout the nation was a major force behind these decisions, the reality is that the current recession has put the economy in a tailspin and insurers are paying out huge dollar amounts for creditors' rights claims—mostly involving borrower bankruptcy. This raises the question: is ALTA trying to send a message to insurance regulators to help lessen risks to title companies? The answer to this question may become more clear in the coming months.

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