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## Limits on Creditors Rights Title Insurance Coverage

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**All major title insurance companies have recently communicated to their customers that they will no longer provide "creditor's rights" title insurance coverage in lender's or owner's policies of title insurance through the American Land Title Association's (the "ALTA's") Form 21 Endorsement.**

Form 21 provides coverage if an insured mortgage is voidable because of a "fraudulent transfer or preference" under federal bankruptcy, state insolvency or "similar creditors' rights laws." Under the Bankruptcy Code and similar state laws, a transfer may be voided if the debtor incurred the obligation or made the transfer with the actual intent to hinder, delay, or defraud its creditors, or received less than a reasonably equivalent value in exchange for the transfer or obligation and was, or became, insolvent as a result of the transfer. The Bankruptcy Code also provides that under certain circumstances, the trustee in bankruptcy may avoid some transfers made before bankruptcy on account of an existing obligation if the relevant transfer allows the creditor to improve its position relative to other creditors and the debtor received insufficient or no new value for the transfer. The determination of whether a fraudulent or preferential transfer occurred is a fact-specific inquiry.

The 1970 ALTA Policy forms did not contain an exclusion for creditors' rights. The ALTA added exclusions for these matters to the 1992 ALTA Policy forms. For that reason, many insureds who desired ALTA coverage for creditors' rights required issuance of coverage on the 1970 ALTA Policy form until as late as 2006. In 2006 the title industry responded to the concerns of the insured community by including a new "Covered Risk" in Section 9(b) of the owner's Policy and in Section 13(b) of the Lender's Policy, which provides coverage for the voidability of any transfers made prior to the insured transfer or mortgage based on creditors' rights concerns. The 2006 form of policy still excludes the present transfer or mortgage from coverage under the "Exclusions from Coverage" (Section 4(b) of the Owner's Policy Form and Section 6(b) of the Lender's Policy form), but the industry

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began offering the ALTA Form 21 Endorsement to provide coverage to the Owner's Policy form and Lender's Policy form as a way of insuring the gap in coverage created by the Exclusions from Coverage.

Beginning in 2009, it became much more difficult to obtain the ALTA Form 21 Endorsement for creditors' rights coverage, without a rigorous approval process being undertaken at the title companies. For example, title companies would often require an applicant for a policy of title insurance to obtain an MAI Appraisal as a condition to issuing the creditors' rights coverage. On February 3, 2010, the ALTA decided to "decertify" the ALTA Form 21 Endorsement. Effective March 8, 2010, the ALTA Form 21 will no longer be offered as part of the package of standard endorsements available for purchase from any major title company. Most major title companies have already begun to notify their customers of this decision. Furthermore, First American Title Insurance Company and the Fidelity National Title Group (which includes Chicago Title Insurance Company, Fidelity National Title, Ticor Title, Lawyers Title, Commonwealth Land Title, Security Union Title and Alamo Title) have also given notice to their customers that they will no longer agree to issue the ALTA 1970 Form of Loan Policy, as they did before the introduction of the 2006 Policy and the ALTA Form 21 Endorsement.

As a result of this recent change, lenders and purchasers are now faced with the risk that there will be no affirmative coverage for creditors' rights risk. Lenders or owners who are concerned about this risk may be forced to take additional measures to maximize any arguments they may have that the relevant transaction does not raise creditors' rights issues. For example, a third-party appraisal performed in accordance with accepted appraisal standards may provide evidence, in a deed in lieu of foreclosure transaction, that the debtor received "reasonably equivalent value" for the transfer of the property, if the amount of the loan forgiven exceeds the value of the property. Additional information, such as debtor financial statements and lien searches, could help prove that the debtor was not insolvent, or was rendered insolvent by a transfer.

Some significant lenders have already begun to change their title insurance requirements based on this new development. For example, Fannie Mae and Freddie Mac have suspended the requirement that any loan they enter into include title insurance that includes protection against creditors' rights claims.

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