

The Creditor's Rights Endorsement: What Its Extinction Means for Owners and Lenders

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[Joanne M. Schreiner](#), [Julie A. Schoepf](#), [April L. Butler](#)

Lenders and property owners relying on the creditor's rights endorsement to their policy of title insurance will quickly learn, if they have not already, that this endorsement has become widely *unavailable*. Effective March 8, 2010, the American Land Title Association ("ALTA") withdrew the ALTA Form 21-06 Creditor's Rights Endorsement as an ALTA form. The California Land Title Association ("CLTA") also voted to decertify its counterpart to the ALTA Form 21-06 in February. Title companies, including First American Title Insurance Company and members of the Fidelity National Title Group (which include Chicago Title, Commonwealth Land Title and Lawyer's Title, to name a few), have followed suit, announcing that they will no longer provide this coverage. State Departments of Insurance in Pennsylvania, Delaware, Oregon and New Jersey, are also rejecting any policy form affording creditor's rights coverage. Further, Freddie Mac and Fannie Mae have temporarily suspended the requirement that they receive this coverage as part of their loan process. This not only means that the ALTA Form 21-06 is unavailable, but also that title insurance companies will not delete the creditor's rights exclusion, issue similar endorsements, or in any way modify the basic form of policy to provide affirmative coverage for creditor's rights issues. Even those underwriters that are still offering a creditor's rights endorsement are doing so under heavy underwriting standards and at a steep premium.

Creditor's rights coverage insured property owners and their lenders, against loss due to the occurrence, on or before the date of the policy, of a fraudulent transfer or voidable preference under federal bankruptcy, state insolvency or similar creditor's rights laws. The title insurance company would defend the insured against the claim of a creditor in bankruptcy that the transfer should be set aside because:

1. it was made with the actual intent to hinder, defraud or delay its creditors; or
2. the debtor received less than reasonably equivalent value in the transfer and was, or became insolvent as a result of the transfer.

The coverage also included attorneys' fees and costs of defense, which could be substantial compared with other types of title defenses due to the fact that the end result could be a total loss of title.

What does this mean for future insureds?

For lenders, this coverage insured that a mortgage could not be invalidated at the request of creditors of the property owner on the basis that the property owner did not receive adequate consideration to support the mortgage. In general, loss of this coverage shifts the risk from the title insurers to the insureds. Lenders will need to conduct a greater level of due diligence of the borrower, its organizational structure, its assets and creditors, and the transaction itself to evaluate the risk. Arguably, Lenders are in a better position than title insurers to evaluate this risk anyway. In order to issue the creditor's rights coverage, title insurers must analyze the nature of the transaction, the business being conducted at the property, and the financial position of the borrower and its parent companies. This analysis is akin to credit underwriting, a process

already undertaken by the lender. Likewise, purchasers of property will need to take a closer look at the financial stability of their sellers and be cautious when purchasing property for less than fair market value, which is particularly difficult to ascertain in the current economic environment.