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### New Risks: Credit of Title Insurers; Safety of Escrow Accounts

#### A new concern – the health of the title insurers

Unfortunately, as the storm battering the financial markets continues, another risk has surfaced; namely, the risk that the title insurance companies that have insured (or are about to insure) the various real estate transactions are (or will be) solvent in the event a claim is made.

We are informed that all of the major title insurance companies have recently had their credit ratings downgraded by the major rating agencies and the outlook of these companies remains negative as market conditions continue to deteriorate.

As virtually all U.S. real property has a title insurance policy standing behind it, the question becomes how a property owner can best protect against the risk of a default of a title company under both existing policies and policies that will be issued in the future. We suggest you consider the following:

First, you might want to review your existing portfolio to determine the amount of title insurance on each of its assets and which title insurance companies are providing the insurance under such policies.

Second, identify transactions which either (i) are insured by weakly rated title insurance companies or (ii) have special title issues that cause particular concern (and maybe you negotiated heavily and significantly relied on the title company in order to close – you will probably remember these pretty easily as they often tend to stick out in one's memory).

#### Funds in Escrow Accounts Are Not Necessarily Safe

When was the last time you made a deposit under a contract or placed your closing funds in an escrow account for a day or two before the closing? Until recently, chances are that you did not dwell much upon where such funds were held once they were sent to the escrow agent. Unfortunately, the string of recent bank failures highlights the risks associated with the handling of these deposits.

What happens to escrowed funds if the depository bank fails? Given the size of most commercial transactions, the amount of most deposits and certainly all closing funds will exceed FDIC insurance limits and, accordingly, one must look at the contract documents for guidance. However, often your average purchase and sale agreement does not address the issue of who should bear the risk of loss should the depository institution of the escrow agent fail. In addition, most escrow agreements provide that the escrow agent is not liable for the loss of monies deposited with a failed bank. So – to be blunt about it – your escrow agent could be placing a very large sum of your money in a bank that fails and you could be stuck with potentially disastrous consequences.

In light of the above, it would be prudent for you to establish some careful procedures to ensure that you (or your CFO or similar person) has a chance to approve the actual banks holding funds. Before money goes out, you should consider the following:

1. Determine a designated person(s) at your organization who is authorized to approve banks holding funds.

Third, make a decision whether it is worthwhile curing the problem.

Fourth, for new transactions, consider making it part of your procedures to (i) investigate and confirm the credit rating of the title insurance company being used as insurer and (ii) require that the title insurance company issuing a policy on a given transaction spread that risk through co-insurance and/or reinsurance measures.

In terms of curing the problem for existing policies, our inquiries have revealed that this is likely an issue of first impression with the title companies and, accordingly, there is no accepted or usual manner in which title companies have of curing these types of problems for existing policies. However, we have been informed that it will likely be possible to obtain reinsurance on existing title policies to provide added protection against a default by the title insurer thereunder. The availability and price of such reinsurance would have to be verified by the title insurance company holding the policy.

2. Advise your deal people and all of your outside counsel that no monies are to be wired out into an escrow (or other arrangement where the funds still belong to you) unless and until the designated person approves where the escrow agent will place the funds.

3. Advise your deal people and outside counsel to review the boilerplate in escrow agreements and purchase agreements to confirm that you will have control over where monies are invested, at least for as long as you are the one responsible for the loss.

4. In some transactions, it may be appropriate to negotiate who – buyer or seller –should bear the risk of a failed depository institution causing a loss of the “deposit” under a purchase agreement. Given the novelty of this issue, it is too early to say what will emerge as “market” in these circumstances, so this is just something to think about and negotiate if you feel appropriate.

### **Distressed Real Estate Practice Group**

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If you would like additional information regarding the substance of this Plain & Simple newsletter, please contact one of Duval & Stachenfeld LLP's [Distressed Real Estate Practice Group](#) chairs.

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