

Title Insurance Loss Reserving

Historical Results and Emerging Trends

Southwest Actuarial Forum

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November 30, 2009

Overview

1. Title Insurance Basics
2. Loss Reserving Framework
3. Current Environment
4. Adverse Loss Development

1) Title Insurance Basics

- A. The Title Insurance Process
- B. Types of Policies
- C. Issues Unique to Title Insurance
- D. Coverage Explained

The Title Insurance Process

- Real estate transaction goes to contract
- Deposit placed into escrow account
- Title search of public records
- Documents examined to understand impact on title
- Title commitment (evidence) prepared & compared
- Inspections performed; surveys examined
- Any problems are corrected
- HUD-1 form prepared
- Closing - prior liens and mortgages paid off; documents executed; title changes hands
- Documents recorded at Clerk's Office, etc.

Types of Title Insurance Policies

a) Purchase Mortgages

- i. Loan Policy – based on loan amount
- ii. Owner Policy – based on purchase amount
- iii. Simultaneous Issue Policy

b) Refinance Mortgages

- i. Lender (actually, secondary market) requires new loan policy
- ii. Original owners policy still in force

c) Other – aircraft, vessels, automobiles

Issues Unique to Title Insurance

- a) Title insurance is mono-line
- b) Goal = loss prevention
- c) Low loss ratios (< 10%)
- d) High expense ratios (90%+)
 - i. Maintain title plants
 - ii. Search and examination
 - iii. Cost to resolve problems

Unique Issues (continued)

- e) Loss is “incurred” prior to effective date
- f) No stated expiration date
 - i. Expires when home is sold or when a mortgage expires or is refinanced
 - ii. How to earn premium?
 - i. GAAP – earned immediately when written
 - ii. Statutory – pattern specified by statute
 - iii. Title insurers do not know whether policies are still in-force!
- g) Premium = one time; non-refundable
- h) Home buyer pays for both Owners and Lenders policies

Title Insurance Coverage - Covered Risks

- Mistakes in recording public documents
- Incomplete public records
- Forgery and fraud
- Errors in title search, abstract, examination or opinion
- Missed prior mortgages and liens
- Improper closing/escrow procedures
- Detailed examples on the following slides...

2) Reserving Framework - U.S. Statutory

A. Actuarial Reserves

- 1) Annual Statement Schedule P
- 2) Statement of Actuarial Opinion

B. Statutory Reserves

C. Comparison of Statutory and Actuarial Reserves

- 1) Supplemental Reserve?

Actuarial (Schedule P) Reserves

- a) Form 9 = Statutory Annual Statement
- b) Schedule P
 - i. By Policy Year (20 years)
 - ii. By Report Year
- c) Statement of Actuarial Opinion
- d) Opine on total Schedule P reserve (i.e., PY analysis)
 - i. Case + Bulk + IBNR + ULAE
 - ii. Net of reinsurance only
 - iii. RMAD with respect to Schedule P reserves

Statutory (Balance Sheet) Reserves

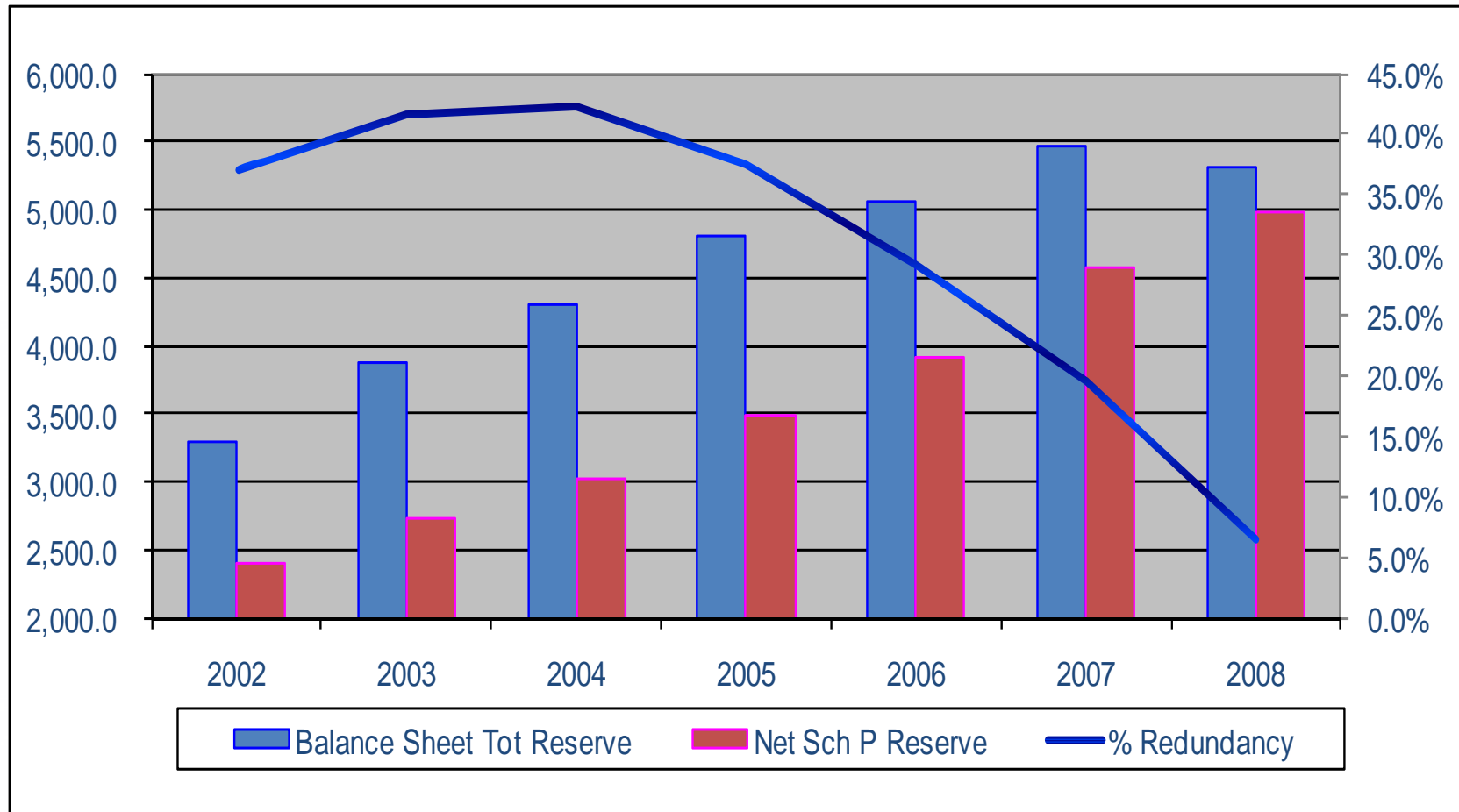
- a) Known Claims Reserve =
 - i. Case reserves
 - ii. Bulk reserves (if any)
- b) Statutory Premium Reserve (SPR) = “Unknown” Claims
 - i. SPR = Unearned Premium Reserve
 - ii. Formula = Amount & Take-down Pattern
 - iii. Example:
 - i. Add - \$0.15 per \$1,000 of Insured Liability
 - ii. Take-down – 5% per year for 20 years
- c) Supplemental Reserve (if any)

Supplemental Reserve Needed?

- a) Compare total Schedule P reserves against sum of Known Claims Reserve + SPR
- b) If $KCR+SPR > \text{Schedule P}$, book $KCR+SPR$
- c) If $\text{Schedule P} > KCR+SPR$, book $KCR, SPR + \text{Supplemental Reserve}$
 - i. Supplemental = Excess of Actuarial over Statutory reserves
 - ii. Supplemental reserves are NOT tax-deductible

Statutory Reserves – Shrinking Redundancy

Title Industry Reserve Comparison (Amounts in \$Millions)



3) Recent and Current Environment

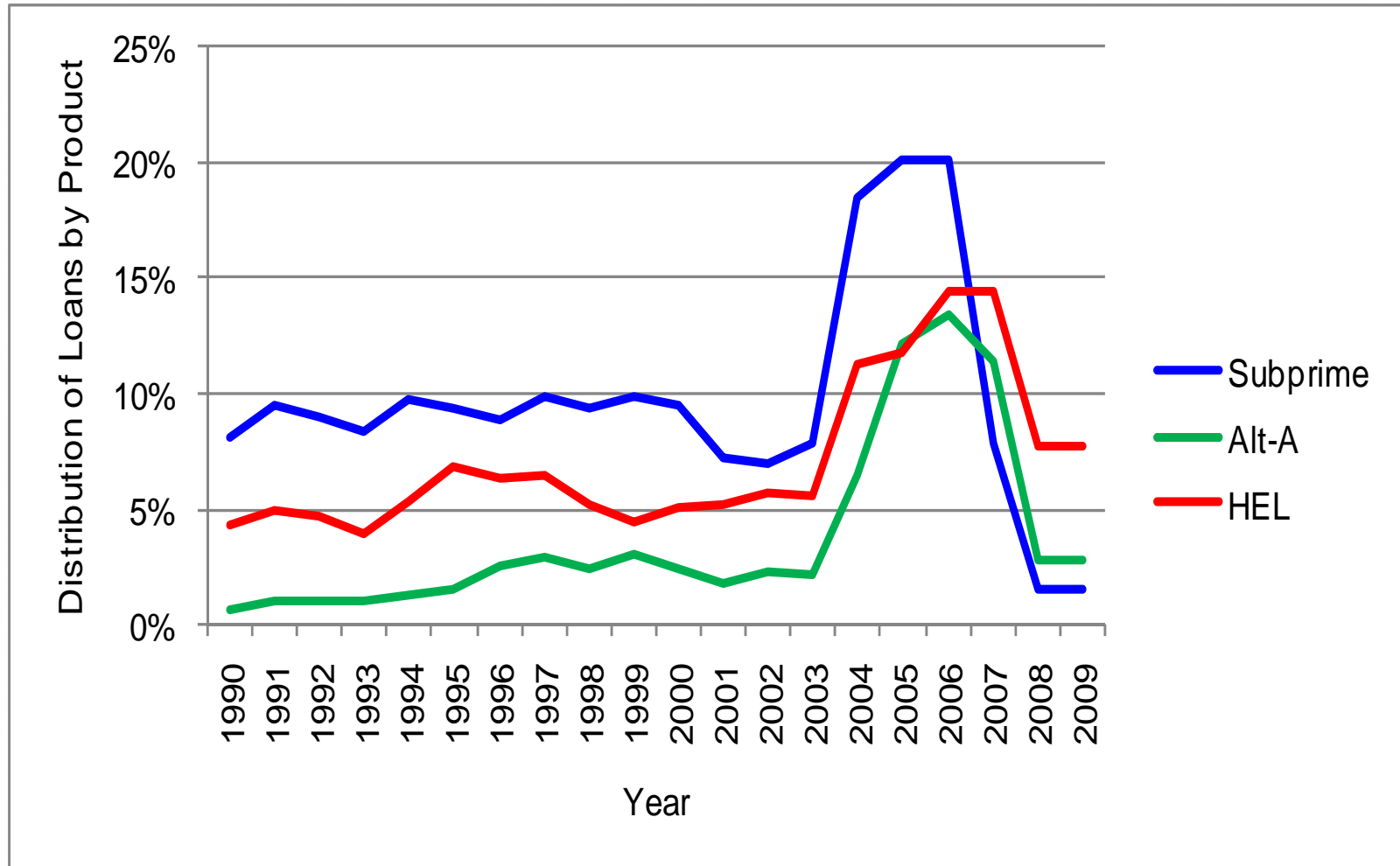
A. Real Estate Environment

B. Impact on Claims

Real Estate Environment

- 2001-03:
 - Low, low mortgage rates
 - Record homes sales & refinance activity
 - Annual, double-digit increases in property values
 - Huge growth in title insurance premium volume; few losses
- 2004-2007:
 - Credit markets loosening – more sub-prime, alt-A loans
 - Adjustable mortgages with low initial rates, resets
 - No income, job verification
 - Loans in excess of property value
- In this environment, people can still borrow their way out of trouble (or sell their homes)

Distribution of Mortgage Volume by Product



Real Estate Environment (continued)

- 2007 – credit markets tighten
- 2008 – credit markets freeze
 - Plummeting real estate sales
 - Declining home prices
 - Owners unable to borrow (or sell) their way out of trouble
 - Increasing delinquencies, defaults
 - Spike in foreclosures
 - More lenders find themselves with financial losses
- Title insurance claims come out of the woodwork

Impact on Claims

- Foreclosure searches trigger wave of reported claims
 - Surge in reported claim frequency
 - Possibly higher % close no pay
- Mortgage fraud on the rise
 - What is the title agents role/responsibility?
- Large defalcations
 - Emerge as business volumes drop off
- Claims not brought in a rising housing market, but are an issue in a declining one
- Higher frequency and severity
 - Policy Years 2005 – 2007 in particular

4) Adverse Loss Development

- a) Statutory Reserves – shrinking redundancy!

- a) Changes in prior policy year ultimate loss estimates
 - Change from 12/07 to 12/08
 - Change from 1st report to 12/08

- b) Impact of changes in prior policy year ultimate loss estimates on calendar year losses

Runoff of Schedule P Policy Year Ultimate Loss & ALAE Ratios From 12/31/2007 to 12/31/2008

Year	Booked at		% Change
	12/31/2007	12/31/2008	
1989	11.9%	12.0%	0.3%
1990	12.0%	12.1%	0.3%
1991	6.3%	6.2%	-0.2%
1992	3.9%	3.9%	0.6%
1993	3.7%	3.7%	0.1%
1994	4.4%	4.4%	0.0%
1995	5.7%	5.7%	0.0%
1996	5.2%	5.2%	0.4%
1997	5.3%	5.4%	0.8%
1998	5.3%	5.2%	-0.3%
1999	5.6%	5.6%	0.1%
2000	7.3%	7.3%	-0.3%
2001	6.2%	6.3%	1.5%
2002	5.2%	5.2%	0.0%
2003	5.1%	5.2%	1.0%
2004	6.2%	6.4%	3.1%
2005	7.1%	7.7%	8.8%
2006	6.5%	7.6%	17.5%
2007	6.5%	7.9%	21.7%
2008		7.3%	
Total			4.4%
'05-'07			15.5%

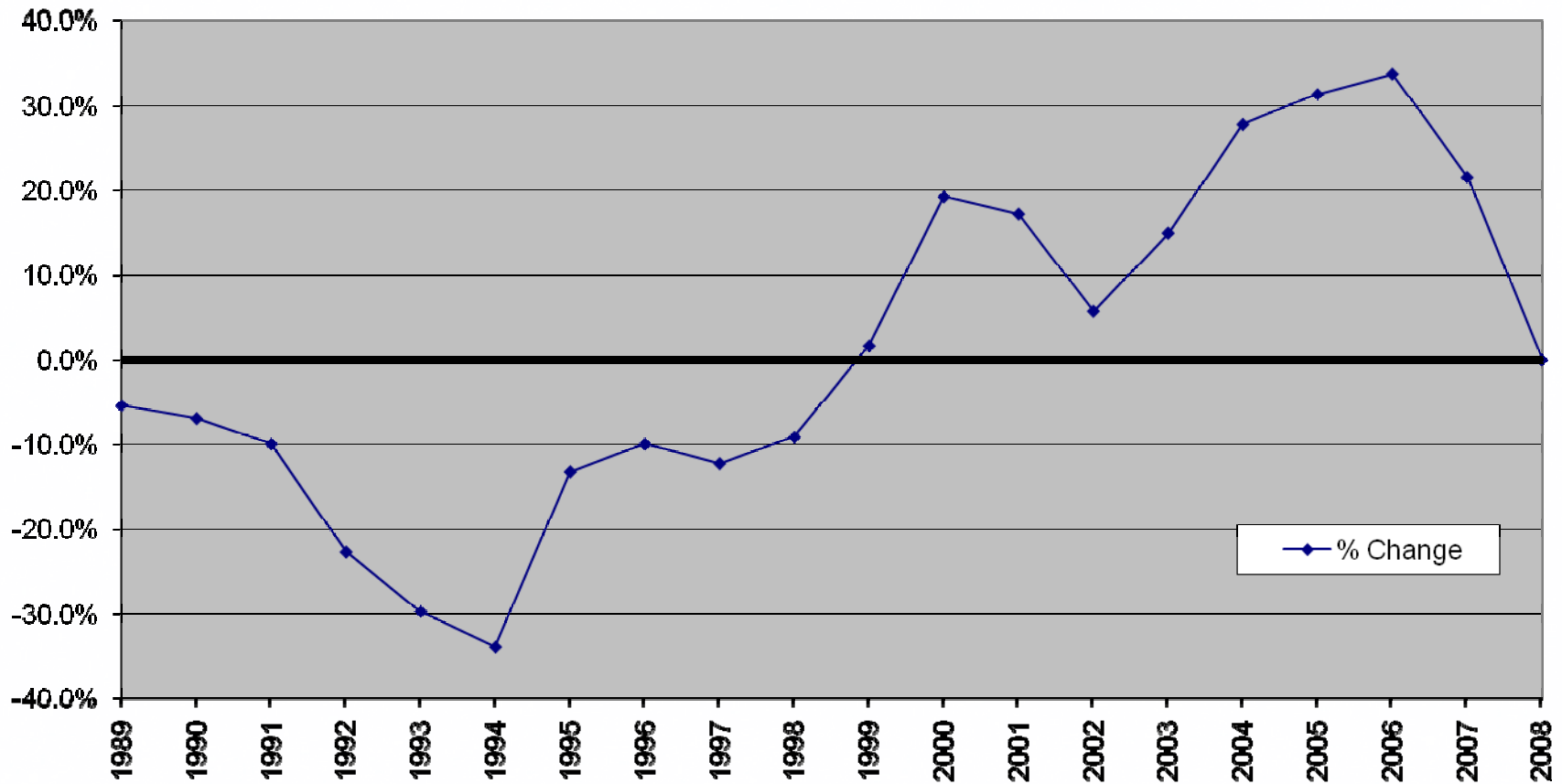
Runoff of Schedule P Policy Year Ultimate Loss & ALAE Ratios From Year of First Report to 12/31/2008

Policy Year	Ultimate Loss & ALAE Ratio at First Report	Current Ultimate Loss & ALAE Ratio	Percentage Change
1989	12.6% *	12.0%	-5.3%
1990	12.9% *	12.1%	-6.9%
1991	6.9% *	6.2%	-9.9%
1992	5.1% *	3.9%	-22.7%
1993	5.3% *	3.7%	-29.7%
1994	6.6%	4.4%	-33.8%
1995	6.5%	5.7%	-13.2%
1996	5.8%	5.2%	-9.9%
1997	6.1%	5.4%	-12.2%
1998	5.8%	5.2%	-9.1%
1999	5.5%	5.6%	1.7%
2000	6.1%	7.3%	19.2%
2001	5.4%	6.3%	17.2%
2002	4.9%	5.2%	5.8%
2003	4.5%	5.2%	15.0%
2004	5.0%	6.4%	27.8%
2005	5.9%	7.7%	31.4%
2006	5.7%	7.6%	33.8%
2007	6.5%	7.9%	21.7%
2008	7.3%	7.3%	0.0%

*Loss ratios are as of 12/31/1993

Runoff of Schedule P Policy Year Ultimate Loss & ALAE Ratios

Title Industry % Change in Schedule P Policy Year Ultimate Loss & ALAE Ratios
from 12 Months Evaluation to 12/31/2008



Calendar Year Results

Components of Calendar Year Incurred Losses =

Current Policy Year (PY) Ultimate Losses

+

Change in Ultimate Loss
Estimates for Prior PY's

Title Industry Calendar Year Loss Ratios (Amounts in \$Millions)

Calendar Year	Written Premium	Initial PY Schedule P Ultimate Loss & ALAE	Prior PY (Favorable)/ Adverse Development	Initial PY Sched. P Ult. Loss & ALAE Ratio	Adverse Development Contribution to CY Loss Ratio	Calendar Year Ultimate Loss & ALAE Ratio
2000	7,816	479	(35)	6.1%	-0.5%	5.7%
2001	9,849	532	(39)	5.4%	-0.4%	5.0%
2002	12,997	635	4	4.9%	0.0%	4.9%
2003	17,042	766	58	4.5%	0.3%	4.8%
2004	16,768	838	(1)	5.0%	0.0%	5.0%
2005	18,252	1,074	173	5.9%	0.9%	6.8%
2006	17,952	1,024	112	5.7%	0.6%	6.3%
2007	15,717	1,021	548	6.5%	3.5%	10.0%
2008	11,196	814	614	7.3%	5.5%	12.8%
'00-'04	64,473	3,249	(14)	5.0%	0.0%	5.0%
'05-'08	63,116	3,933	1,446	6.2%	2.3%	8.5%

Calendar Year Results

- Slightly favorable development (i.e., decreases) in prior policy year ultimate loss & ALAE in calendar years 2000 through 2004
- \$1.4 billion of unfavorable development of prior policy year ultimate loss & ALAE in calendar years 2005 through 2008
 - \$1.2B in calendar years 2007 and 2008 alone!!!
 - Double digit loss ratios in calendar years 2007 and 2008