Title Insurance Loss Reserving
Historical Results and Emerging Trends

2009 Casualty Loss Reserve Seminar

Presented by
Paul J. Struzzieri, FCAS, MAAA

September 15, 2009

Milliman

Outline of Presentation

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

1) 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?

Milliman

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

Milliman

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)

Milliman

Supplemental Reserve Needed?

a) Compare total Schedule P reserves against sum of Known Claims Reserve + SPR

b) If KCR+SPR > Schedule P, book KCR+SPR

c) If Schedule P > KCR+SPR, book KCR, SPR + Supplemental Reserve

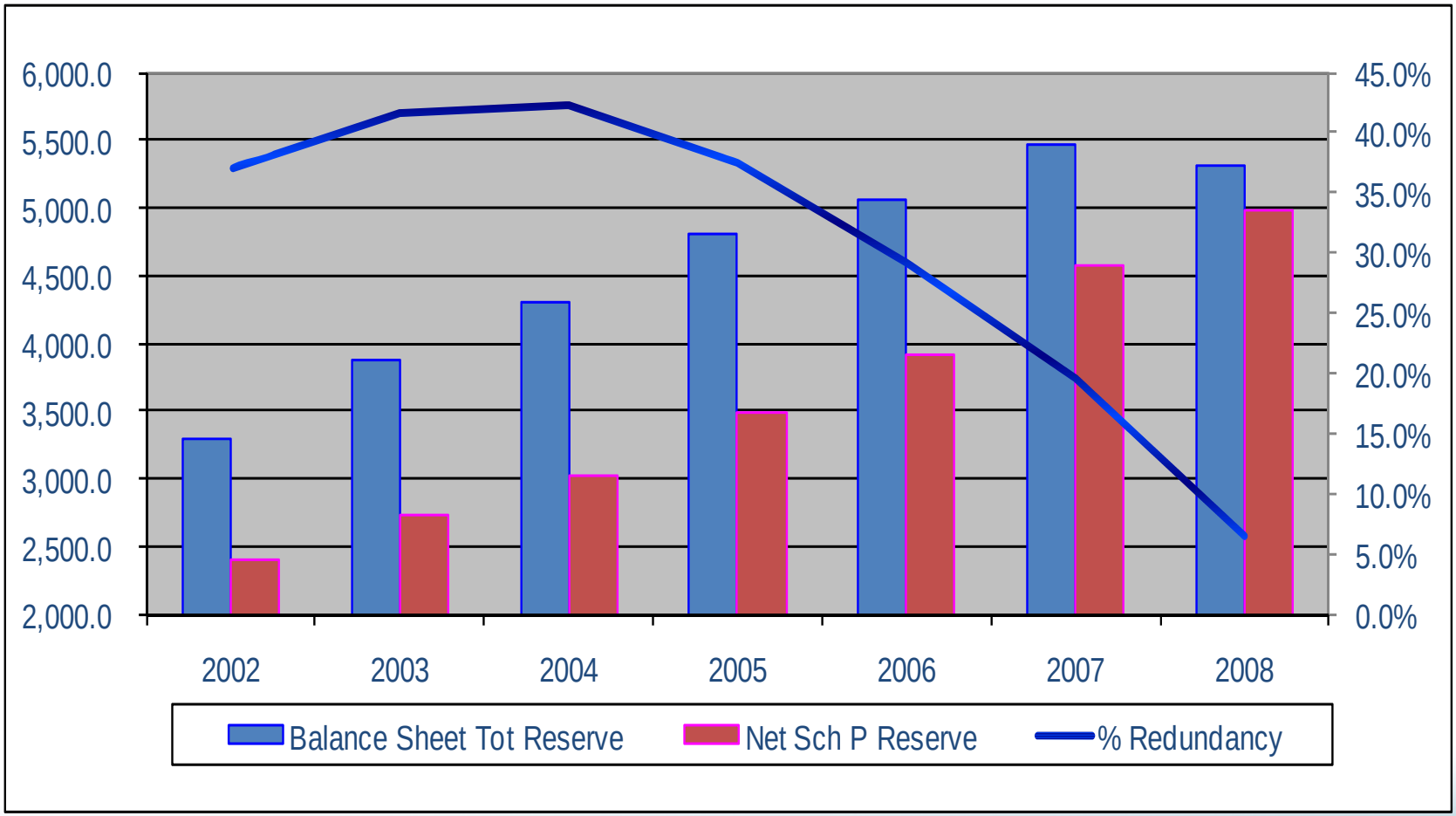
   i. Supplemental = Excess of Actuarial over Statutory reserves

   ii. Supplemental reserves are NOT tax-deductible

Milliman

Statutory Reserves – Shrinking Redundancy

Title Industry Reserve Comparison (Amounts in $Millions)



Milliman

2) Recent and Current Environment

A. Real Estate Environment

B. Impact on Claims

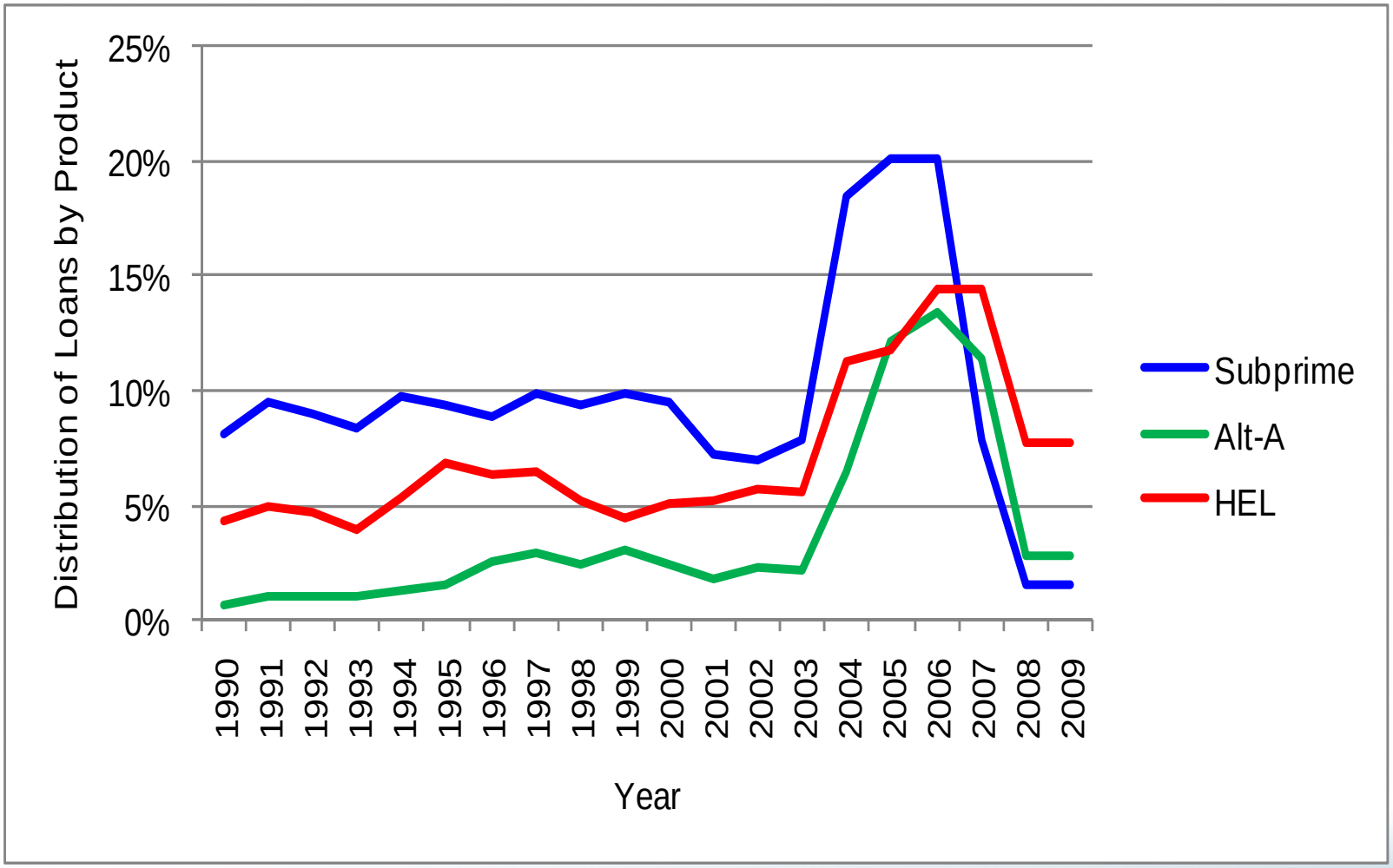
Milliman

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
- As long as home prices are rising and credit is available, people can still borrow their way out of trouble (or sell their homes)

Milliman

Distribution of Mortgage Volume by Product



Milliman

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

Milliman

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

Milliman

3) 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

Milliman

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

	Booked at		
Year	12/31/2007	12/31/2008	% Change
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%

Milliman

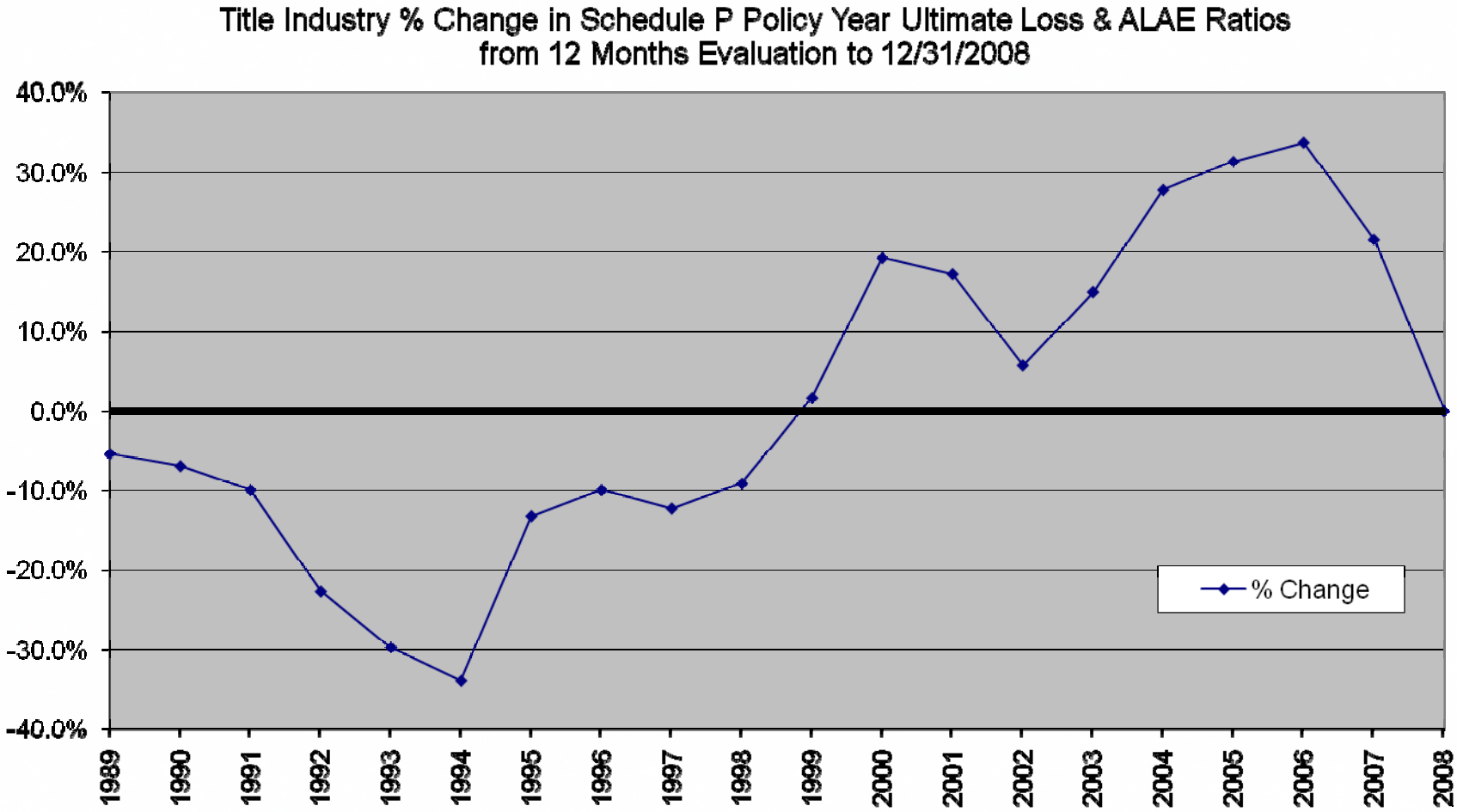
Runoff of Schedule P Policy Year Ultimate Loss & ALAE Ratios From Year of First Report to 12/31/2008

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

Milliman

Runoff of Schedule P Policy Year Ultimate Loss & ALAE Ratios



Milliman

Calendar Year Results

Components of Calendar Year Incurred Losses =

Current Policy Year (PY) Ultimate Losses

+

Change in Ultimate Loss

Estimates for Prior PY's

Milliman

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%

Milliman

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

4) Trends

a) Claim Frequency

b) Claim Severity

c) Loss Cost

d) Loss Ratio

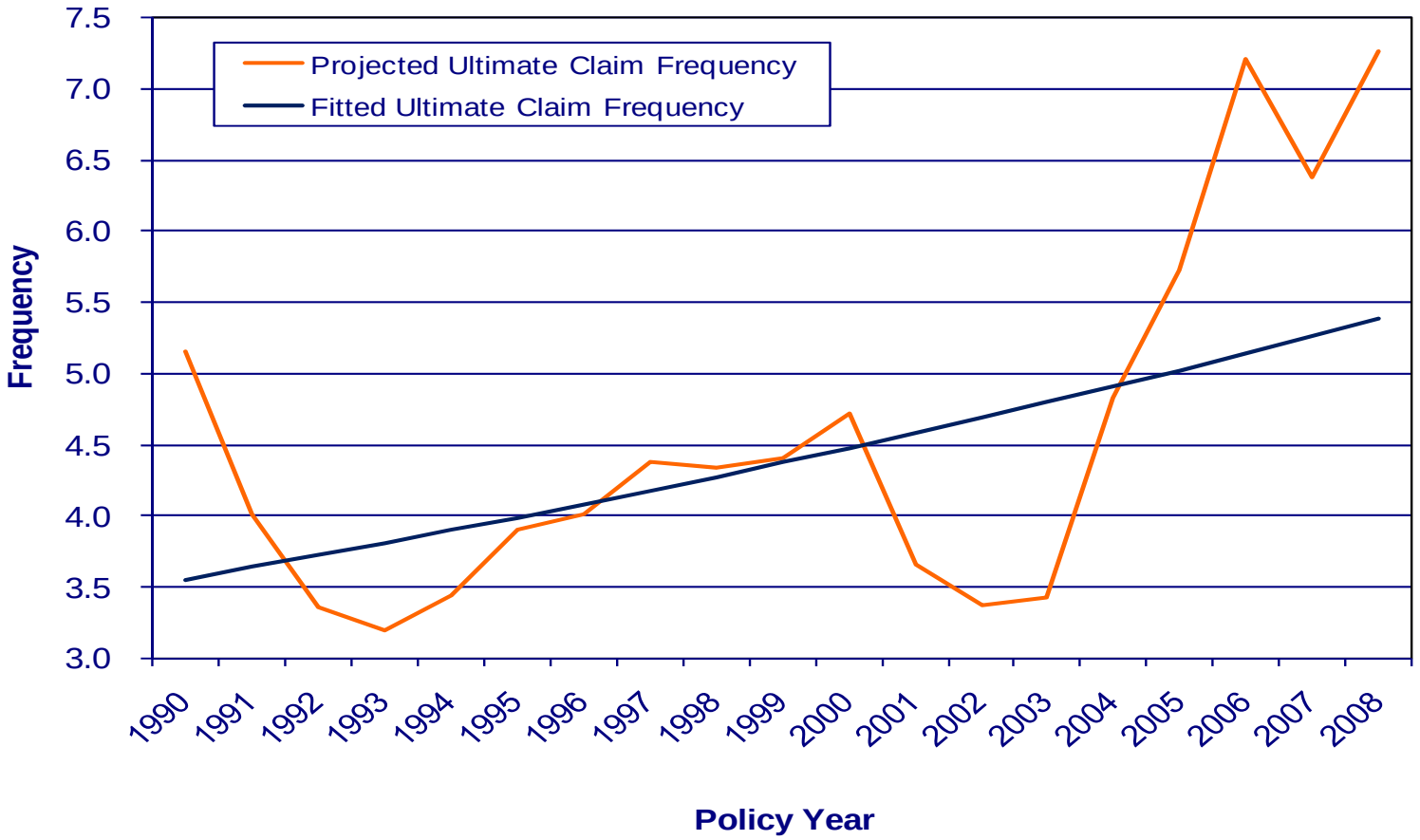
Claim Frequency Trends

- Claim Frequency defined here as:
  - (Projected Ult. # of Claims) / (Adjusted Title Revenue in $000s)
  - Adjusted Title Revenue is a proxy for number of policies
- Generally cyclical trend; varies with real estate cycle
- Spike in recent years due to real estate market collapse
- Possible long-term upward trend due to broadening coverage, court decisions, underwriters relationship with its customers

Milliman

Claim Frequency

Industry projected ultimate reported claim counts per $1M of adjusted premium



Milliman

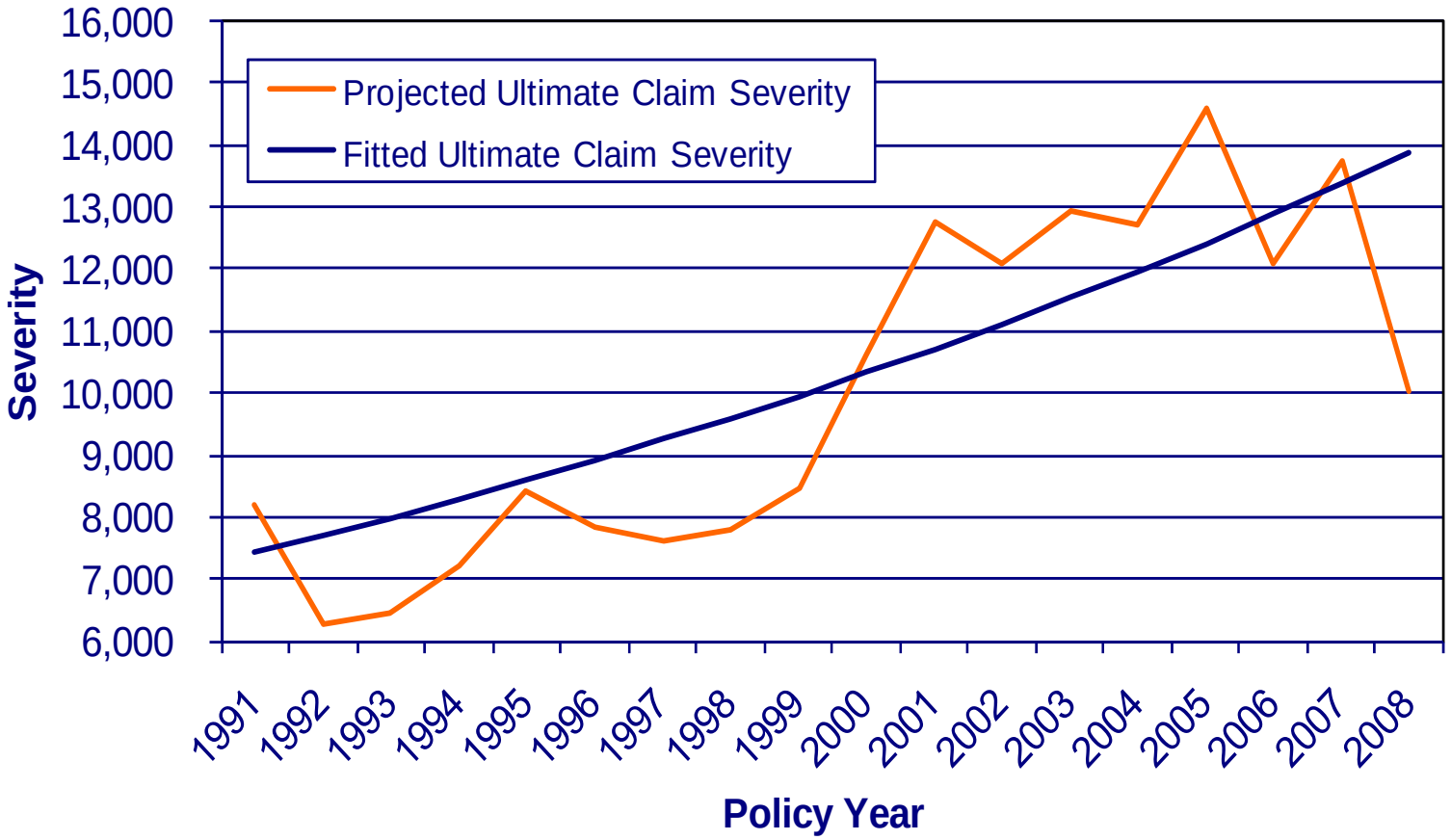
Claim Severity Trends

- Claim Severity defined here as:
  - (Ultimate Loss + ALAE) /(Projected Ultimate # of Reported Claims)
- Claim severity tends to vary directly with, real estate prices, defense costs, inflation, etc.
- Will claim severity decrease for policy year 2008/2009?
- Large defalcations may disguise severity trends

Milliman

Claim Severity

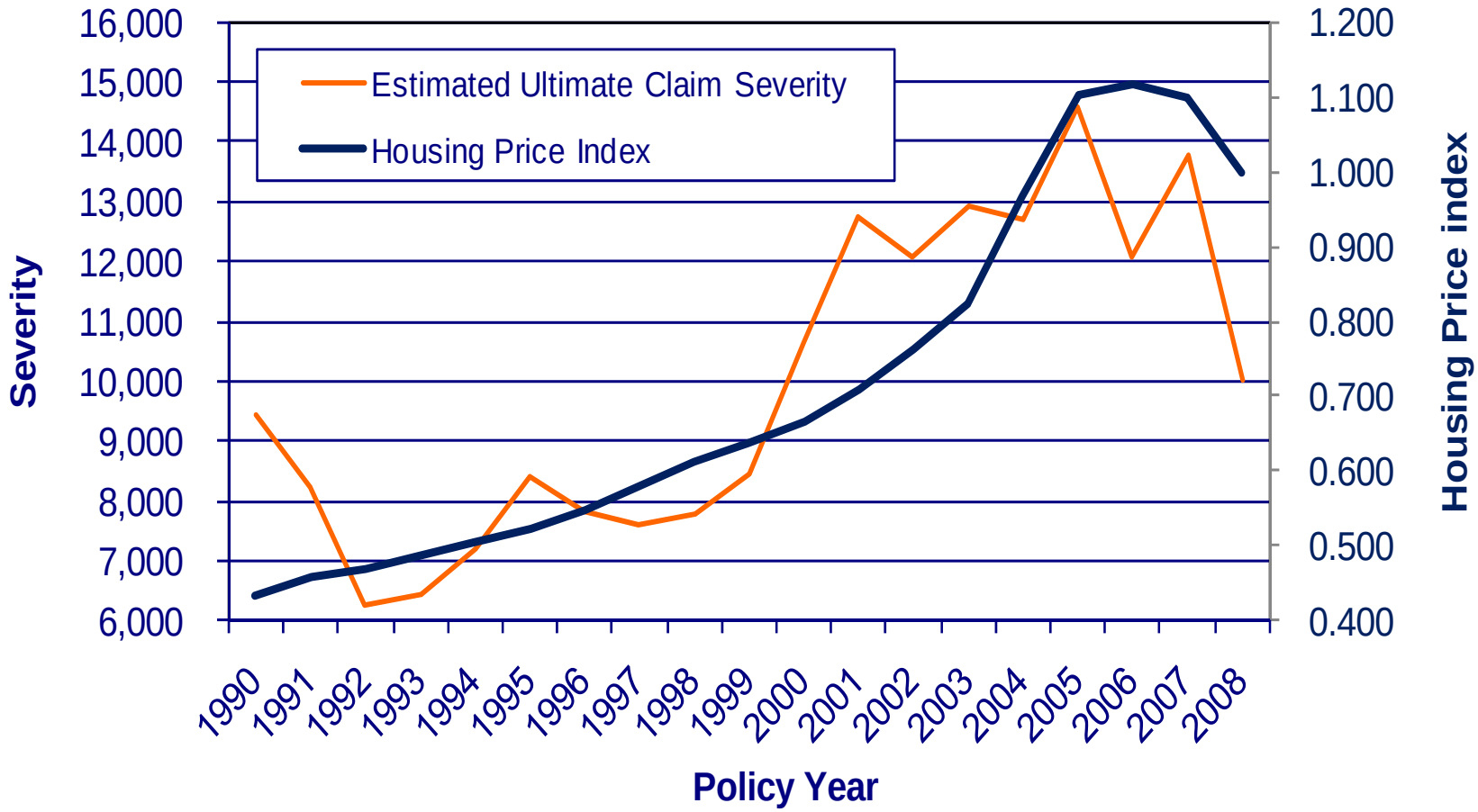
Schedule P ultimate loss & ALAE per projected ultimate reported claim counts



Milliman

Claim Severity

Correlation Between Claim Severity and Home Prices



Milliman

Loss Cost Trends

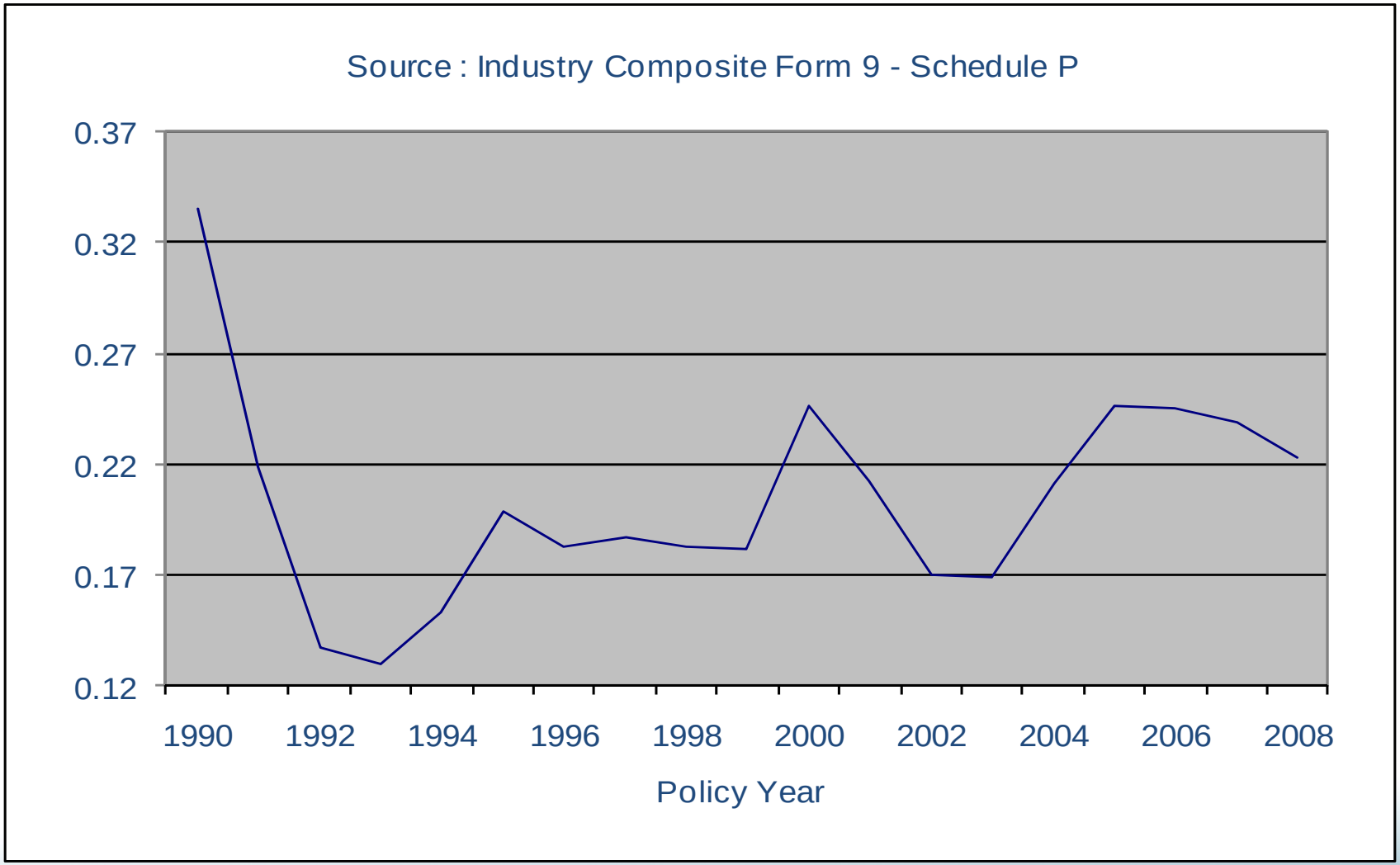
- Loss Cost defined here as:
  - (Ultimate Loss + ALAE) /(Amount of Insured Liability in $000s)
- Loss Cost trends are a combination of both:
  - Claim Frequency trends
  - Claim Severity trends

Industry Loss Cost per $1,000 of Insured Liability

Policy Year	Schedule P Ultimate Loss & ALAE ($000s)	Amount of Insurance ($Millions)	1,000 x Loss & ALAE/ Amt of Ins
1990	377,437	1,125,197	0.335
1991	240,169	1,099,179	0.218
1992	199,255	1,452,630	0.137
1993	226,300	1,734,746	0.130
1994	255,657	1,671,860	0.153
1995	269,789	1,360,288	0.198
1996	289,891	1,582,889	0.183
1997	319,711	1,706,128	0.187
1998	429,489	2,344,724	0.183
1999	489,113	2,687,868	0.182
2000	571,145	2,317,071	0.246
2001	623,490	2,934,618	0.212
2002	671,142	3,936,093	0.171
2003	881,501	5,220,114	0.169
2004	1,070,505	5,058,239	0.212
2005	1,411,277	5,726,812	0.246
2006	1,370,718	5,597,780	0.245
2007	1,241,964	5,204,058	0.239
2008	814,485	3,647,909	0.223
Total	11,375,601	55,283,006	0.206

Milliman

Industry Loss Cost per $1,000 of Insured Liability



Milliman

Trends in Average Rates

- Average rate defined here as:
  - [Premium per $1,000 of Insured Liability]

- Average rate is a function of several things:
  - Mix by State
  - Mix by Product
  - Property Values / Mortgage Amounts
  - Changes in Rate Levels

Industry Average Rate
[Premium per $1,000 of Insured Liability]

Policy Year	Written Premium + Other Income ($Millions)	Amount of Insurance ($Millions)	Average Rate x 1,000
1999	8,725	2,687,868	$3.25
2000	7,816	2,317,071	$3.37
2001	9,849	2,934,618	$3.36
2002	12,997	3,936,093	$3.30
2003	17,042	5,220,114	$3.26
2004	16,768	5,058,239	$3.31
2005	18,252	5,726,812	$3.19
2006	17,952	5,597,780	$3.21
2007	15,717	5,204,058	$3.02
2008	11,196	3,647,909	$3.07
Total	136,314	42,330,562	$3.22

Milliman

Loss Ratio Trends

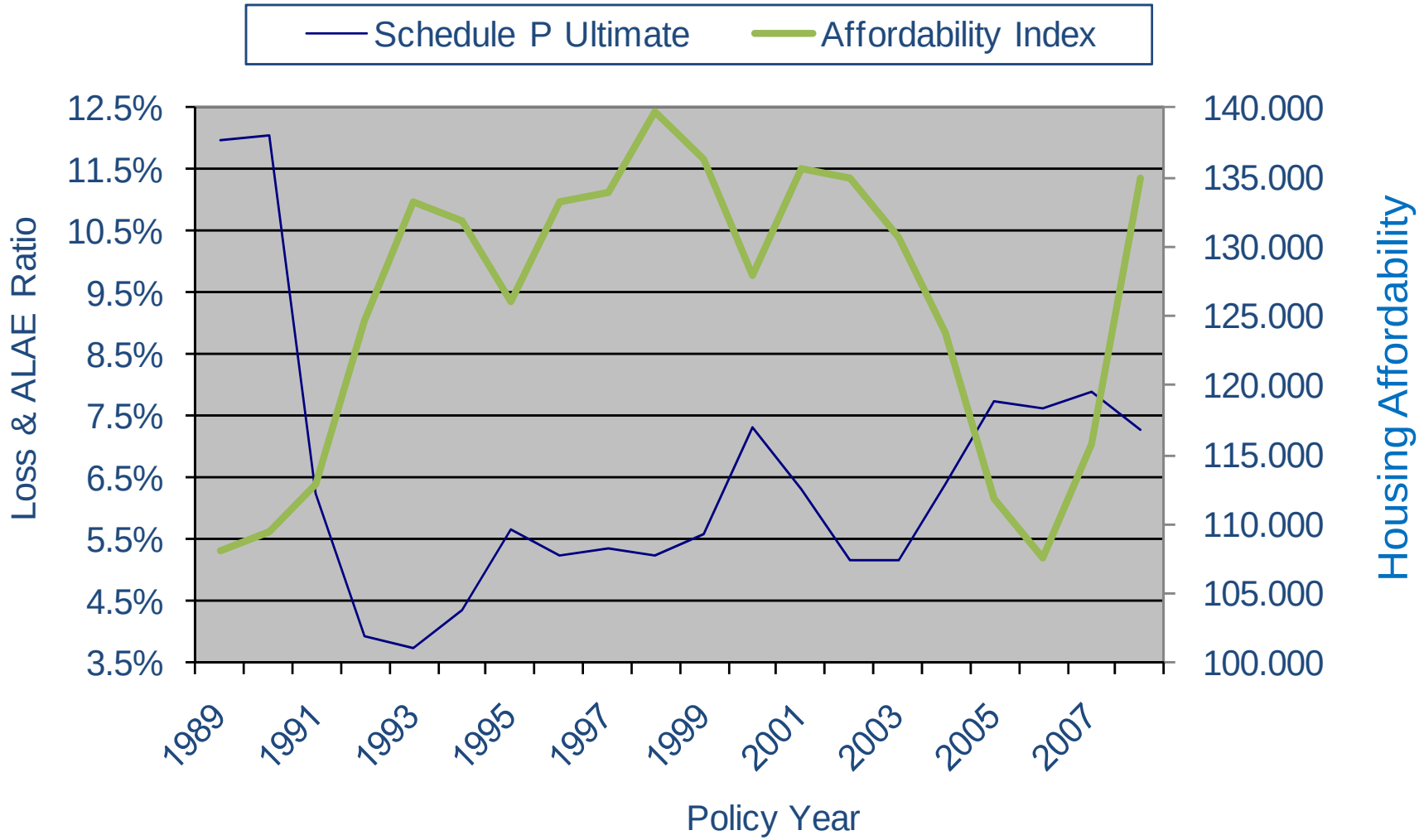
- Loss Ratio defined here as:
  - (Ultimate Loss + ALAE) /(Premium + Other Income)

- Loss Ratio trends are a combination of:
  - Claim Frequency trends
  - Claim Severity trends
  - Premium trends (difficult to measure)
  - Rate changes (impossible to measure)

- Therefore, try to measure Loss Ratio trends directly by looking at external measures (e.g., affordability index)

Title Industry Ultimate Loss & ALAE Ratios @ 12/31/2008

Inverse Correlation Between Loss & ALAE Ratios and Housing Affordability



Milliman