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Title Insurance Loss Reserving

Historical Results and Emerging Trends

2010 Casualty Loss Reserve Seminar

Presented by
Joel A. Vaag, FCAS, MAAA

September 20, 2010

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Outline of Presentation

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

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1) Reserving Framework - U.S. Statutory

A. Actuarial Reserves
   1) Annual Statement Schedule P
   2) Statement of Actuarial Opinion
   3) No AOS Required

B. Statutory Reserves

C. Comparison of Statutory and Actuarial Reserves
   1) Statutory Reserves cannot be less than the Actuarial Reserves

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 <u>total</u> Schedule P reserve (i.e., PY analysis)
   i. Case + Bulk + IBNR + ULAE
   ii. Net of reinsurance only (this will likely be changing in 2011)
   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 > Schedule P, book KCR+SPR

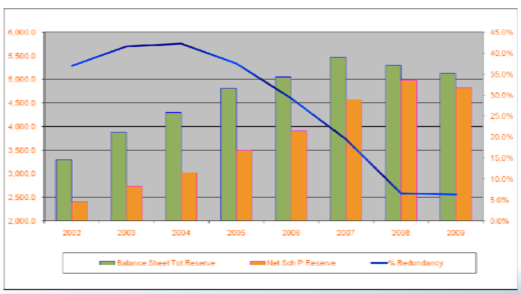
c) If Schedule P > KCR+SPR, book KCR, SPR + Supplemental Reserve

i. Supplemental = Excess of Actuarial over Statutory reserves

ii. Supplemental reserves are NOT tax-deductible

Statutory Reserves – Shrinking Redundancy

Title Industry Reserve Comparison (Amounts in $Millions)



2) Recent and Current Environment

A. Real Estate Environment / Credit Market

B. Impact on Claims

Real Estate Environment / Credit Market

- 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)

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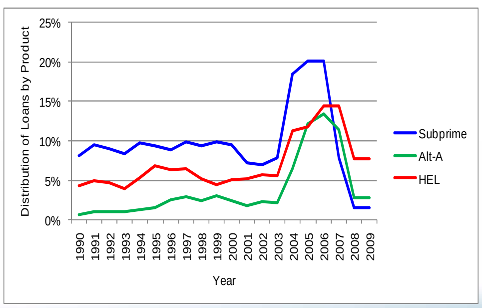
Distribution of Mortgage Volume by Product



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Real Estate Environment / Credit Market (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

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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
- Much Higher frequency
  - Policy Years 2005 – 2007 in particular

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3) Adverse Loss Development

a) Statutory Reserves – shrinking redundancy!

a) Changes in prior policy year ultimate loss estimates
   - Change from 12/08 to 12/09
   - Change from 1st report to 12/09

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

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Runoff of Schedule P Policy Year Ultimate Loss & ALAE Ratios
From 12/31/2008 to 12/31/2009

	Booked at		
Year	12/31/2008	12/31/2009	% Change
1990	9.6%	9.6%	0.3%
1991	6.2%	6.2%	0.1%
1992	3.9%	4.0%	0.8%
1993	3.7%	3.8%	1.0%
1994	4.4%	4.4%	0.3%
1995	5.7%	5.6%	-0.9%
1996	5.2%	5.3%	0.4%
1997	5.4%	5.4%	1.0%
1998	5.2%	5.3%	1.8%
1999	5.6%	5.6%	0.2%
2000	7.3%	7.3%	-0.1%
2001	6.3%	6.4%	1.6%
2002	5.2%	5.2%	0.1%
2003	5.2%	5.2%	0.2%
2004	6.4%	6.3%	-2.2%
2005	7.7%	7.7%	-1.0%
2006	7.6%	7.9%	3.4%
2007	7.9%	8.1%	2.5%
2008	7.3%	7.4%	1.5%
2009		6.4%	
Total			0.7%
'05-'08			1.6%

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Runoff of Schedule P Policy Year Ultimate Loss & ALAE Ratios From Year of First Report to 12/31/2009

Policy Year	Ultimate Loss & ALAE Ratio at First Report		Current Ultimate Loss & ALAE Ratio	Percentage Change
1990	10.3%	*	9.6%	-6.6%
1991	6.9%	*	6.2%	-9.9%
1992	5.1%	*	4.0%	-22.0%
1993	5.3%		3.8%	-29.0%
1994	6.6%		4.4%	-33.6%
1995	6.5%		5.6%	-14.0%
1996	5.8%		5.3%	-9.6%
1997	6.1%		5.4%	-11.3%
1998	5.8%		5.3%	-7.4%
1999	5.5%		5.6%	1.9%
2000	6.1%		7.3%	19.5%
2001	5.4%		6.4%	19.6%
2002	4.9%		5.2%	6.2%
2003	4.5%		5.2%	14.9%
2004	5.0%		6.3%	24.7%
2005	5.9%		7.7%	29.2%
2006	5.8%		7.9%	37.2%
2007	6.6%		8.1%	23.5%
2008	7.3%		7.4%	0.5%
2009	6.4%		6.4%	0.0%

*Loss ratios are as of 12/31/1993

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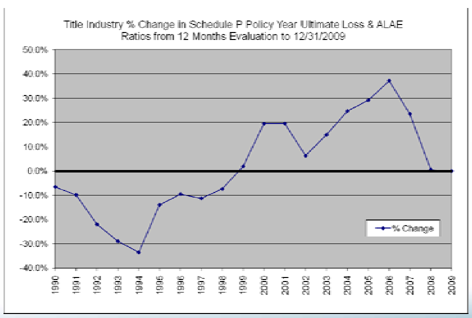
Runoff of Schedule P Policy Year Ultimate Loss & ALAE Ratios



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Calendar Year Results

Components of Calendar Year Incurred Losses =

Current Policy Year (PY) Ultimate Losses
+
Change in Ultimate Loss
Estimates for Prior PY's

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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	Policy Year Ultimate Loss & ALAE Ratio	Adverse Development Contribution to CY Loss Ratio	Calendar Year Ultimate Loss & ALAE Ratio
2000	7,809	477	(59)	6.1%	-0.5%	5.6%
2001	9,837	530	(39)	5.4%	-0.4%	5.0%
2002	12,985	632	7	4.9%	0.1%	4.9%
2003	17,024	769	67	4.5%	0.4%	4.9%
2004	16,736	840	(2)	5.0%	0.0%	5.0%
2005	18,253	1,082	338	5.9%	1.9%	7.8%
2006	17,953	1,033	110	5.8%	0.6%	6.4%
2007	15,719	1,031	547	6.6%	3.5%	10.0%
2008	11,231	822	621	7.3%	5.5%	12.8%
2009	10,723	682	82	6.4%	0.8%	7.1%
'00-'04	64,392	3,249	(25)	5.0%	0.0%	5.0%
'05-'08	63,156	3,968	1,616	6.3%	2.6%	8.8%
'09	10,723	682	82	6.4%	0.8%	7.1%

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Calendar Year Results

- Slightly favorable development (i.e., decreases) in prior policy year ultimate loss & ALAE in calendar years 2000 through 2004
- $1.6 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
- Calendar year 2009 (and after) returning to more “normal” levels

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4) Trends

a) Claim Frequency

b) Claim Severity

c) Loss Cost

d) Loss Ratio

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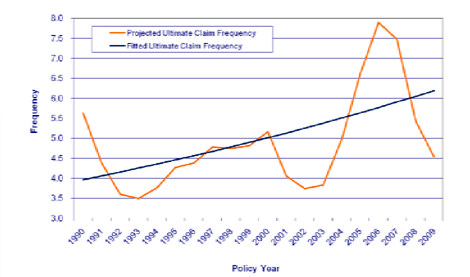
Claim Frequency Trends

- 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

Claim Frequency

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

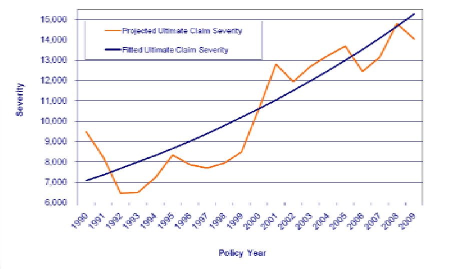


Claim Severity Trends

- 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.
- Large defalcations may disguise severity trends

Claim Severity

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



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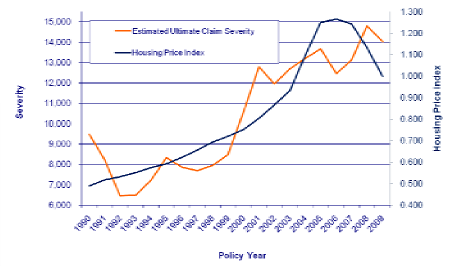
Claim Severity

Correlation Between Claim Severity and Home Prices



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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

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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	378,739	1,190,798	0.318
1991	240,385	1,163,263	0.207
1992	200,856	1,537,321	0.131
1993	228,482	1,835,885	0.124
1994	256,510	1,769,333	0.145
1995	267,266	1,439,596	0.186
1996	291,102	1,675,175	0.174
1997	322,935	1,805,598	0.179
1998	437,364	2,481,426	0.176
1999	489,964	2,687,868	0.182
2000	570,404	2,315,270	0.246
2001	633,759	2,932,901	0.216
2002	671,821	3,934,566	0.171
2003	883,445	5,218,630	0.169
2004	1,047,122	5,058,892	0.207
2005	1,397,361	5,727,726	0.244
2006	1,417,368	5,598,522	0.253
2007	1,273,443	5,203,928	0.245
2008	826,471	3,648,644	0.227
2009	682,451	3,393,164	0.201
Total	12,517,248	60,618,506	0.206

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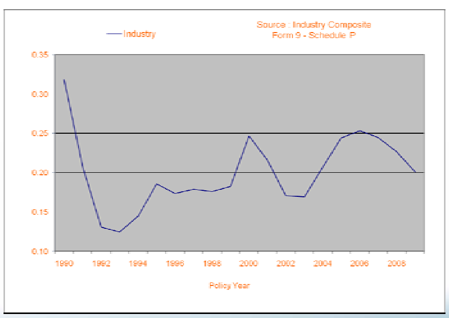
Industry Loss Cost per $1,000 of Insured Liability



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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

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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
2000	7,809	2,315,270	$3.37
2001	9,837	2,932,901	$3.35
2002	12,985	3,934,566	$3.30
2003	17,024	5,218,630	$3.26
2004	16,736	5,058,892	$3.31
2005	18,253	5,727,726	$3.19
2006	17,953	5,598,522	$3.21
2007	15,719	5,203,928	$3.02
2008	11,231	3,648,644	$3.08
2009	10,723	3,393,164	$3.16
Total	138,271	43,032,243	$3.21

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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)

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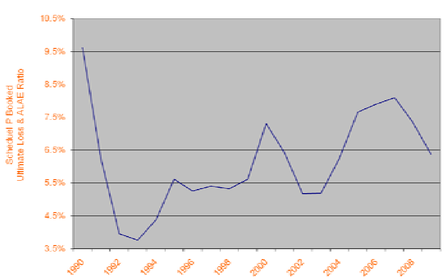
Title Industry Ultimate Loss & ALAE Ratios @ 12/31/2009



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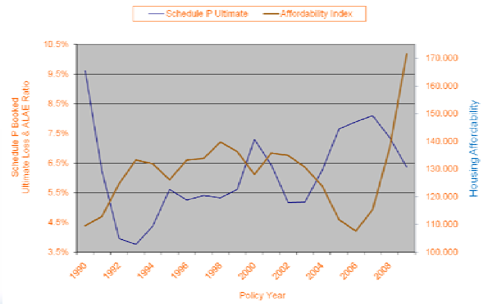
Title Industry Ultimate Loss & ALAE Ratios @ 12/31/2009

Inverse Correlation Between Loss & ALAE Ratios and Housing Affordability



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