

Title Management Today

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From The Editor's Desk

I am pleased to introduce Demotech to our readership. In 2003 Demotech purchased the CDS Performance of Title Insurance Companies from our good friend Larry Kirwin of Corporate Development Services, Inc. In keeping with that tradition it recently announced the release and availability of the 2005 Edition of Demotech Performance of Title Insurance Companies. This publication includes a review of 88 title underwriters representing more than 99% of the industry's premium activity. With the release of the new edition, Demotech has become the definitive resource for title insurance underwriter information and analysis within the title industry. This year marks the 20th Anniversary of Demotech. Demotech, Inc. is an independent financial analysis and actuarial services firm serving the insurance industry and title insurance industry providing, inter alia, a wide range of consulting services and independent opinions of the financial stability of Property and Casualty insurers and Title Insurance underwriters. For a copy of its most recent newsletter, entitled The Demotech Difference, please click [here](#) or go to the Demotech Link on our home page.

Below is an article recently prepared by the President of Demotech that I suggest you append to the 2005 Edition of Demotech Performance of Title Insurance Companies. The article discusses the impact of captive reinsurance transactions upon the various title insurance companies Financial Stability Ratings® (FSRs).

Affiliated Business Arrangements, Captive Reinsurance Not Problematic to Financial Stability

Regulatory Reform Should Include Prior Approval of Title Insurance Rates

By Joseph L. Petrelli, President, Demotech, Inc.

Recently, prominent Title underwriters have settled investigations related to alleged kickbacks through captive reinsurance arrangements. Demotech, Inc., the first company to review and rate the financial stability of Title underwriters, will not revise any Financial Stability Ratings® (FSRs) based upon affiliated business arrangements or captive reinsurance arrangements.

Our rationale is straightforward. In calendar year 2004, all reinsurance cessions – premium paid for reinsurance – totaled approximately \$70 million. Given that the aggregate calendar year 2004 premium for the Title industry was approximately \$16 billion, all reinsurance cessions accounted for less than one-half of one percent of premium. Accordingly, affiliated business arrangements and captive reinsurance arrangements were a small portion of less than one-half of one percent of premium.

From an economic perspective, the financial impact of the arrangements is the proverbial tempest in a teapot. However, in the long-term, Demotech is hopeful that the departments of insurance will focus on the unique regulatory constraints of Title underwriters. Specifically, Demotech believes that prior approval of Title insurance rates is consistent with the needs of consumers as well as the needs of Title underwriters. We hope the recent activity will re-focus attention on the need for prior approval of Title insurance rates.

In *Federal Trade Commission v. Tigor Title Insurance Company, et. al.*, initiated in 1985 and decided by the United States Supreme Court in 1992, the Supreme Court established a two-pronged test for establishing the antitrust immunity of collective title insurance activities.

The Court concluded that the insurance industry's antitrust exemption under the McCarran-Ferguson Act required active state regulation. Active state regulation was necessary "to determine whether the State has exercised sufficient independent judgment and control so that the details of the rates or prices have been established as a product of deliberate state intervention, not simply by agreement among private parties." In addition, the Court concluded that for antitrust immunity to be available to Title insurance rates, the State's position must be "clearly articulated and affirmatively expressed as state policy." In sum, the two-pronged test required active supervision and clear and affirmative articulation of policy.

Given this Supreme Court decision, it is somewhat ironic that since 1985 the regulatory approach of most departments of insurance has been toward the deregulation of rates. Although the movement toward file and use or use and file regulatory systems was applicable to a Property and Casualty insurance industry converting from rate filings to loss cost filings, these same regulatory changes placed the Title insurance industry in the cross-hairs of antitrust liability. With the Title insurance industry needing clear articulation and active supervision to form a rating bureau and present proposed rates for the review and consideration of a department of insurance, anything less than prior approval became problematic. Some departments of insurance, Virginia and Indiana for example, have statutory prohibitions against the regulation of Title insurance rates.

Compounding the Title insurance industry's dilemma, some Property and Casualty insurance companies introduced Title insurance products purporting to be casualty insurance. As Title insurance is a monoline product, these Property and Casualty insurers disguised rate, rule and form filings so state insurance departments were unable to isolate that the products were Title insurance or otherwise included Title insurance. Based upon anecdotal evidence, we believe that once the departments of insurance were alerted to the issue, most withdrew approval of the disguised products.

We observed that the investigations of the Title insurance industry's captive reinsurance arrangements and the Property and Casualty industry's unauthorized expansion into monoline Title insurance demonstrate the need for the departments of insurance to re-focus their regulatory effort on clear articulation of policy and active supervision of title insurance rates. Since *FTC v. Tigor* (1985), the Title insurance industry has been attempting to comply with the standards promulgated by the United States Supreme Court. Regrettably, few outside the Title insurance industry were familiar with the revised rules of engagement.

Demotech views the current situation as an opportunity for regulatory reform. Title underwriters deserve and desire a regulatory environment that stresses a clear and affirmative articulation of policy. Consumers expect Title insurance rates to be actively supervised. The immaterial, albeit embarrassing, bumps in the road were, in part, the result of the change in the regulatory paradigm created by the *FTC v. Tigor* decision, and the concurrent transition from prior approval of rates to statutory provisions that anticipated Property and Casualty loss costs, but not necessarily Title insurance rates.

In summary, Demotech, Inc. has concluded that the existence of captive reinsurance arrangements and affiliated business arrangements is immaterial with respect to the financial stability of the specific Title underwriters involved. However, we view prior approval of Title insurance rates, consistent with the *FTC v.*

Ticor decision, as part of the longer-term solution. Recognizing that Title insurance is not the same as Property and Casualty insurance is the other part of the solution.

Joseph L. Petrelli is the founder and President of Demotech, Inc. Founded in 1985, Demotech, Inc. has been reviewing the financial stability of Title underwriters since 1992. They have reviewed and rated more Title underwriters than any other company. Additional information can be found at www.demotech.com.

Ed. Note: There have recently been a number of news media articles relating to “captive reinsurance transactions” with lender-affiliated subsidiary reinsurers designed for the sole purpose returning illegal rebates or kickbacks to lenders, builders and realtors. For an additional discussion of these allegations our readers are referred to the Inman News release of Monday, August 1, 2005