



November 5, 2008

The Honorable Morris J. Chavez  
Superintendent of Insurance, State of New Mexico  
Chair, NAIC Title Insurance Issues Working Group

Dear Superintendent Chavez:

Your letter of October 14, 2008, solicited responses to the Title Insurance Working Group plan “to develop a nationwide statistical plan for capturing state-specific annual revenue and expense data from title insurance agents and underwriters for the purpose of measuring the profitability, competitiveness and reasonableness of title rates and charges.”

The American Land Title Association and its 3,000 member companies appreciate the opportunity to comment and look forward to working with the Title Insurance Working Group as you assess the feasibility and advisability of nationwide statistical plan. You will be pleased to know that we have already discussed your request with a number of relevant committees within our organization to begin to work through the issues raised by your effort.

We understand and appreciate your desire to bring more transparency and consistency to the pricing of title and settlement services. To respond to your immediate request for comment, we have contracted with Dr. Nelson R. Lipshutz, President of Regulatory Research Corporation, to discuss the challenges of implementing a nationwide statistical plan. Dr. Lipshutz is a recognized authority on title insurance statistical plans in the United States and has produced a factually-rooted, thought-provoking perspective to help inform the Title Insurance Working Group’s conversation. His report is attached to this letter.

In his comments, Dr. Lipshutz provides a cautionary note regarding the difficulty of making “apples to apples” comparisons of title and settlement services pricing information across state lines where similar terms have evolved to mean different things. Of course, even were the NAIC to develop a set of common definitions, these would have to allow enough flexibility to encompass varying real estate practices across approximately 3,300 counties that maintain real estate records. It is also important to note that regulatory requirements vary widely from state to state, affecting the availability of different title and settlement services and their pricing. Suffice it to say that there are a number of threshold issues that must be addressed prior to attempting the creation of any national statistical plan.

We look forward to continuing to work with the NAIC to ensure that current, reliable, and relevant data are available to all title insurance regulators.

Sincerely,

A handwritten signature in black ink, reading "Kurt Pfothauer". The signature is written in a cursive, flowing style with a long horizontal line extending to the right.

Kurt Pfothauer  
Chief Executive Officer

November 3, 2008

The Honorable Morris J. Chavez  
Superintendent of Insurance, State of New Mexico  
Chair, NAIC Title Insurance Issues Working Group

Dear Superintendent Chavez:

Your letter of October 14, 2008, solicited responses to the Title Insurance Working Group plan “to develop a nationwide statistical plan for capturing state-specific annual revenue and expense data from title insurance agents and underwriters for the purpose of measuring the profitability, competitiveness and reasonableness of title rates and charges.” The American Land Title Association has asked that I study this request on their behalf. Based on my experience as the author and designer of most of the title insurance statistical plans currently or previously in use for precisely these purposes in individual states (including New York, Ohio, Pennsylvania, California, Texas, Nebraska, Oregon, and Delaware, among others), I am writing to suggest some major issues that it is critical for the NAIC to address before promulgating any national statistical plan.

### **THE CLASSIFICATION OF REVENUES**

The terms “rate,” “premium,” and “title revenue” are not well-defined. This ambiguity raises the risk of inappropriate comparisons being made based on non-comparable figures.

#### *Interstate Issues*

The current Form 9, Schedule T recognizes the distinction between so-called “risk rates” and “all-inclusive rates.” This distinction does not go nearly far enough for collecting data adequate for rate and charge review, because there are material differences in what is meant by a “risk rate” or an “all-inclusive rate” in different states.

*Legal & Regulatory Economics*

24 Radcliff Road • Waban, MA 02468 • **617.964.6940** • Fax: 617.964.0426

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# REGULATORY RESEARCH CORP.

The Honorable Morris J. Chavez

Page 2 of 8

November 3, 2008

For example:

- The “risk rate” in **Florida** specifically **includes** the cost of examination.
- The “underwriting rate” (which is the equivalent of “risk rate”) in **New Jersey** explicitly **excludes** the cost of examination, for which a separate charge is made.

Similarly:

- The “all-inclusive rate” in **Texas** **includes** the cost of closing.
- The “all-inclusive rate” in **Alaska** **excludes** the cost of closing.

In both cases described above, the dollar differences in the rates are material, even though the cost to the ultimate consumer for identical services is the same.

## Intrastate Issues

The definitional problem also extends to the classification of revenues within a single state. For example, New York is divided for rating purposes into two Zones:

- In Zone 1, the “all-inclusive rate” explicitly **excludes** the cost of search of the public record.
- In Zone 2, the “all-inclusive rate” explicitly **includes** the cost of search of the public record.

Further, there are states in which major urban areas use some type of “all-inclusive rate,” while small cities and rural areas use a “risk rate” (e.g., Alabama and Tennessee).

Once again, these differences are material and raise the specter of inappropriate and misleading comparisons.

## **STATE-SPECIFIC EXPENSE DATA - UNDERWRITERS**

A mechanism already exists for developing state-specific expense data for underwriters. In the mid-1970’s, I designed the Uniform Financial Reporting Plan (UFRP) which was adopted by the American Land Title Association and subsequently incorporated in many state-mandated title insurance statistical reports (including, for

# REGULATORY RESEARCH CORP.

The Honorable Morris J. Chavez

Page 3 of 8

November 3, 2008

example, Delaware, New Jersey, New York, Pennsylvania, and Texas). The UFRP provides a well-tested framework for state-level expense collection.

Several states have augmented the UFRP by adding schedules which break down state level expenses into several functional categories. For example:

- The New York statistical plan uses the functional categories of Underwriting and Claims, Title Order Processing, Agency Administration, and General Administration.
- The Pennsylvania statistical plan uses the same functional categories with the addition of a category for “Settlements.”

One of the primary reasons for the success of the UFRP for over three decades has been the fact that it specifies a practical level of data aggregation. Sporadic attempts to develop highly specific costs to justify individual rates (say, the cost and profitability of marketing, producing and servicing a \$150,000 owner’s policy) have invariably foundered on the twin rocks of:

- Joint costs (such as title plant maintenance) which apply to all policies.
- A cross-subsidy of small consumers by large consumers built into the title insurance rate structure (often explicitly encouraged by statute as in, e.g., Montana and Pennsylvania).

## **STATE-SPECIFIC EXPENSE DATA – AGENTS**

The problem of avoiding misleading comparisons reappears in collecting data on agent costs, because agents perform materially different activities in different jurisdictions.

For example, one of the most important and most cost generating title production activities is title examination:

- In most states, agents **perform** this function.
- In North Carolina, agents are specifically **forbidden to perform** this function.
- The costs incurred by independent non-agent attorneys in conducting examinations never appear on the books of agents or underwriters in any state.

# REGULATORY RESEARCH CORP.

The Honorable Morris J. Chavez

Page 4 of 8

November 3, 2008

Agent compliance with a data call can also be problematic. While many states license title insurance agents, this is not universally true. For example:

- Title insurance agents are not licensed in New York.
- Even if agents are licensed, state statutes may not authorize an insurance regulator to collect agent data.

For attorney-agents, the issue of attorney-client privilege may cloud the data disclosure issue, and the prevalence of attorney-agents varies substantially among states. For example:

- In many states, agents are **may or may not** be attorneys.
- In Connecticut, agents **must** be attorneys.

There is also an enormous difference in the scale of the effort required to collect agent data in different states. In the states that currently collect agent data, the number of agents is relatively low. For example:

- California has only about 100 agents (known as “underwritten title companies”).
- Texas has only about 500 agents.

In contrast, Eastern states have very large numbers of agents, often in the thousands. In aggregate, there are perhaps 20,000 active title insurance agents in the country.

There is also a very broad spectrum of title agent sizes:

- Several agents write annual business volumes in excess of \$100 million, have over 1,000 employees, and maintain their records using large, customizable accounting systems.
- In contrast, many title agents write annual business volumes of only a few thousand dollars, have only one or two employees, and maintain their accounts on a rudimentary accounting system such as Quicken.

The data compilation capabilities of these two types of agents are very different. Further, because many attorney-agents conduct their title businesses in conjunction with a

# REGULATORY RESEARCH CORP.

The Honorable Morris J. Chavez

Page 5 of 8

November 3, 2008

law practice using common employees and facilities, allocation of costs to title operations for these attorney agents is difficult.

## STATISTICAL PLAN STRUCTURE

At the threshold, the NAIC needs to determine which of two general types the plan should be:

- A **unit statistical plan** - a plan which collects a data record for each individual policy, or
- An **aggregated statistical plan** - a plan which collects summarized data for groups of policies.

The cost implications of implementing these two types of plans are very different:

- Operating a unit statistical plan is extremely expensive. The entity collecting data must maintain dedicated large capacity computer equipment, staff the facility, and develop extensive state-specific computer programs to check the validity of each individual record and to produce the reports required. The scale of the costs that are incurred can be gauged by noting that ISO, which carries out similar activities for many P&C lines, has some 2,600 employees and an annual budget of around \$500 million. NCCI, which carries out similar work for the single line of worker's compensation, has some 1,200 employees. The initial cost for even an existing statistical agent to take on a title insurance unit statistical plan would be in the millions of dollars, and ongoing costs would also be in the millions of dollars per year. These large costs would ultimately be borne by title insurance consumers.
- Operating an aggregate statistical plan requires much more modest expenditures. For example, employing a staff of only two, my firm collects statistical plan data from title underwriters on an aggregated basis for the 4th and 6th largest title insurance volume states in the U.S.

Collection on an aggregated basis does not preclude quantitative checks on data integrity. For example:

- The New York statistical plan builds checks of average categorical data against filed rates into the data call instruments in order to reduce or eliminate errors prior to data submission.

- The Pennsylvania statistical plan checks the consistency of reported liabilities.

## **DATA ELEMENTS TO BE COLLECTED**

Aggregate revenue and expense data do not directly address the issue of prevailing rates and charges. These issues can only be addressed if data on the *numbers* of policies issued and charges made are collected as well.

However, a single figure for the aggregate number of policies is virtually meaningless for title insurance because of the material differences among the rates for different policies (even if the policy form is the same).

### *Rates for Different Coverages and Conditions*

The distinction between owner's policies and loan policies is well known, and has a clear meaning in all jurisdictions. However, there are a variety of different rates that may apply to the issuance of the same policy form under different conditions. For example:

- Different rates may be applied to a loan policy depending on whether it is for a loan to finance a property sale or a loan to refinance a prior loan. The conditions under which a refinance rate applies differ from jurisdiction to jurisdiction, and from underwriter to underwriter.
- Another important consideration is the existence of "simultaneous issue" rates. When two policies are issued simultaneously in a single transaction (e.g., an owner's policy and a loan policy in a residential property sale; a leasehold policy and a loan policy in a business transaction), one of the policies is generally issued at a much reduced rate. If two jurisdictions differ in the frequency with which simultaneous issue transactions occur, the average revenue reported per policy will differ markedly, even if the rate schedules are identical.
- A similar phenomenon occurs when jurisdictions have very different property value distributions, since the charge for title insurance invariably depends on the amount of liability insured.

The approach taken to address these issues in existing title insurance statistical plans in individual states is to collect data from underwriters using categories that recognize differences in rate schedules and in liability amounts. Applying this methodology on a national basis, however, would require the development of universal and comprehensive rate category definitions. This is a formidable task.

# REGULATORY RESEARCH CORP.

The Honorable Morris J. Chavez

Page 7 of 8

November 3, 2008

To illustrate the scale of this task, note that:

- The New York statistical report utilizes 79 policy rating categories, 7 special charges categories, and 47 endorsement categories.
- The Pennsylvania statistical report utilizes 33 policy rating categories, 12 special charges categories, and 50 endorsement categories.
- The Texas statistical report utilizes 53 policy rating categories, 11 special charges categories, and 49 endorsement categories.

The overlap between these sets of categories is limited.

## Initial Experience Period

The title insurance industry is highly cyclical, so that any valid analysis needs to examine performance over the entire real estate cycle. However, it is infeasible to collect many elements of statistical data retrospectively, because such data are not maintained routinely by agents or underwriters in many jurisdictions. To balance these two opposing considerations, the initial data call for any national statistical plan needs to establish different levels of detail for the collection of prospective and retrospective data.

## **DATA COMPILATION AND ANALYSIS - PROFITABILITY**

No single method of data compilation and analysis can address the needs of all states, because the rate-making and rate review profit analysis methodologies used in different states differ substantially. For example:

- Pennsylvania and New York use a specific profit margin on premium as the rate standard.
- Texas derives a profit allowance periodically based on return on investment criteria.

The scope of regulation can also be very different, For example:

- Pennsylvania regulates closing charges by underwriters and agents.
- Virginia does not regulate closing charges.
- Oklahoma reviews abstract rates but not premium rates.

# REGULATORY RESEARCH CORP.

The Honorable Morris J. Chavez

Page 8 of 8

November 3, 2008

## **DATA COMPILATION AND ANALYSIS - COMPETITIVENESS**

The level of competition in title insurance cannot be assessed at the national level, but must be analyzed at the individual geographic market level, because competition occurs primarily within local real estate markets. Since real estate records are maintained at the county level, the relevant title insurance markets are counties or contiguous groups of counties in a metropolitan area. There are approximately 3,300 counties in the U.S.

## **DATA COMPILATION AND ANALYSIS - REASONABLENESS**

Existing state-level title insurance statistical collection systems generally rely on underwriters for detailed data on policies and charges, and collect only aggregate revenue and expense data from agents. However, this approach would not work well if applied on a national level. In those jurisdictions which have both regulated (or at least filed) charges and non-regulated charges, local agents generally establish the level of the unregulated (or non-filed) charges independently. Analysis of the reasonableness of total customer charges would require the collection of these agent-specific charges as well, which implies the need for a very large and cumbersome database if it is to cover the entire country.

## **SUMMARY**

The technical issues I have described above demonstrate that a national title insurance statistical plan will produce misleading results unless these issues are addressed and resolved before a plan is promulgated. I stand ready to assist the NAIC and the American Land Title Association in this process in any way that I can.

Very truly yours,



Nelson R. Lipshutz

NRL/sh

CC: Mr. Kurt Pfothauer  
Chief Executive Officer  
American Land Title Association