



December 15, 2010

Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
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Norwalk, CT 06856-5116  
*Sent via e-mail to: [director@fasb.org](mailto:director@fasb.org)*

*Re: File Reference No. 1870-100 – Preliminary Views on Insurance Contracts*

Dear Technical Director:

The American Land Title Association (“ALTA”) appreciates the opportunity to comment on the Financial Accounting Standards Board’s (“FASB”) Discussion Paper (“Discussion Paper”), *Preliminary Views on Insurance Contracts*. While ALTA supports the FASB’s and the International Accounting Standards Board’s objective of developing common requirements for the accounting of similar insurance contract risks, it is important that the FASB fully consider the differences between title insurance contracts and other types of insurance contracts, since we believe these differences present a challenge to adopting the proposed accounting model set forth in the Discussion Paper. Our comments will focus on the differences that exist between title insurance contracts and other types of insurance contracts. Title insurance is almost exclusively an American line of insurance and is vastly different in concept and application than other lines of insurance. It has thusly been accorded unique accounting treatment under generally accepted accounting principles in the United States (“GAAP”) and should continue to receive that same treatment under any revisions to GAAP or any international accounting standard.

ALTA, founded in 1907, is the national trade association and voice of the real estate settlement services, abstract and title insurance industry. With more than 8,000 offices throughout the country, ALTA members operate in every county in the United States to search, review and insure land titles to protect home buyers and mortgage lenders who invest in real estate. ALTA members include title insurance companies, title agents, independent abstractors, title searchers and attorneys, ranging from small, one-county operations, to large national title insurers.

## **What is Title Insurance?**

Title insurance plays a fundamental role in facilitating ownership and investment in real estate in the United States. At its core, title insurance is essentially different from other lines of insurance. Title insurance seeks to prevent risks by insuring against events that have already occurred with an open-ended policy term while other lines of insurance seek to assume risk by insuring against future events with a closed policy term.

In general, the industry offers two types of title insurance policies, both of which are typically issued after the closing of a real estate or mortgage financing transaction: an owner's policy and a loan policy. An owner's policy insures the purchaser of real estate against financial loss or damage that may arise from defects in the title as insured, including the assertion of liens and claims against the property that are not otherwise excepted from policy coverage. The owner's policy includes protection against both public record defects that were not discovered during a search of those records or their significance was not appreciated, and against certain non-record defects that even the most comprehensive search of public records would not reveal.

A loan policy insures the lender that as of the date of policy, it has a valid, enforceable lien on the property in accordance with the mortgage rights created by the loan, that the person to whom the lender is making the mortgage loan has title to the property being mortgaged; and that no other claimant, other than those specifically noted in the policy; has a prior, superior claim. Under both policies, the title insurer is obligated to pay for the costs of defending the title as insured against any covered claim. In virtually all areas of the country, if an owner's policy is issued in the transaction, the cost of a loan policy that is "simultaneously issued" with the owner's policy involves a relatively small additional charge to the cost of the owner's policy because much of the work needed to underwrite the policy has already been done.

Because the history and current status of each parcel of property is unique, title insurance policies cannot be issued on a "casualty" basis – i.e., by assuming that, statistically, a certain number of properties are going to have certain kinds of claims against them. Rather, title insurance policies can only be issued on the basis of a thorough search and examination of the relevant public records pertaining to the particular property to be insured. This is the only way to determine whether the seller, in fact, owns the fee simple title rights he or she has contracted to convey to the buyer, and what liens or encumbrances exist that would limit the use or value of the property when acquired by the buyer. This title search and examination (discussed further below) is critical not just from the insurer's standpoint in underwriting the issuance of the policy but also from the buyer's standpoint of having confidence in the transaction.

## **Title Insurance Differs from Other Lines of Insurance**

Title insurance differs in fundamental ways from most other lines of insurance, such as auto, homeowner's or life insurance. Understanding these differences is important for avoiding misconceptions that may result from erroneous comparisons with those other lines. Differences between title insurance and other lines of insurance in the policy terms, premium remittance requirements, and underwriting make it challenging to create a uniform accounting standard for all lines of insurance.

First, most other forms of insurance provide protection for a limited period of time and, hence the policy must be periodically renewed. Failure to continually pay the premiums results in the policy lapsing. Title insurance is issued for a one-time premium. There are no renewals. The owner's policy protection extends for as long as the owner owns the property or has liability in connection with the property. The insured lender's protection extends as long as there is a balance due on the loan secured by the mortgage.

Unlike other lines of insurance products, title insurance does not have a finite contract term. The lack of a set termination date for the policy prevents title insurers from determining how long they will be exposed to potential liability under a policy. Claims can be presented under the policy as long as the insured owner maintains an interest in the property (no matter whether they own the property for 5 years or 30 years or if the property stays in the family for 100 years) or the insured lender's mortgage is outstanding. Title insurers are not typically informed when the owner divests all of their interest in the property or the lender's mortgage is satisfied unless that insurer is fortunate enough to have written both the new and the old coverage. Thus title insurers face the situation where they are unable to determine which and how many of its policies are still in force at any time.

Second, other forms of insurance provide coverage to compensate for future events after the policy has been issued – such as a fire, an accident or, in the case of life insurance, death. Title insurance provides coverage to compensate for past events that exist before the policy is issued but not discovered until after the policy is issued. While the claim is not asserted until after the policy is issued, it generally must be based on matters that existed prior to the date the policy was issued.

Third, because title insurance usually involves the acceptance of prior transaction-related risk rather than future risk, the underwriting process differs markedly from most other insurance products. Property and casualty or life insurance companies try to minimize claims and losses by taking steps to inspect and assess the risks they are being asked to insure before they issue a

policy. However, there is only so much information that these insurers can obtain and assess before the policy is issued that will predict the likelihood of a future claim. Rather, they rely primarily on an actuarial prediction of various kinds of claims and losses that might occur in the future and then determine the appropriate rate necessary to generate adequate revenue to pay the level of claims that they predict are statistically likely to occur thought the policy term.

Since title insurance insures matters that exist at the time the policy is issued, the underwriting of title insurance operates almost entirely on the basis of identifying, evaluating, and correcting covered matters before the policy is issued. Therefore it is theoretically possible, through a thorough search and examination of the title, to identify all the covered matters that would cause a claim (but, of course, not the non-record covered matters) and then to resolve them and either eliminate them, insure over them, or exclude them from coverage. This process frequently results in title companies taking curative actions to remove invalid or previously paid liens or claims from the public records, or otherwise repair errors in the public records. While claims and losses are inevitably bound to occur, title insurers have a greater ability to minimize the possibility of future claims than other lines of insurance.

### **Title Insurance Underwriting**

As stated above, title insurance is underwritten primarily on a loss mitigation basis instead of the actuarial basis used by other lines of insurance. Thus the first step after an order is received is to collect the relevant records and information pertaining to the property to be insured, and information regarding possible claims against the seller (or owner in a refinance transaction) that could affect the title to the insured property. This is referred to as the “title search” and the information collected is the “title evidence.”

Having collected the title evidence, professionals experienced in real estate law and title insurance examine the title evidence to determine: (i) whether the seller has, and can convey, fee simple title to the buyer; (ii) what other liens or other objections must be resolved or corrected; and (iii) what title defect exceptions may have to be included in the policy. It is at this “title examination” stage that the title agent performs one of the most valuable services, which is an inherent part of the title insurance underwriting function: curing defects and problems that may exist in the title records. This curative action includes obtaining releases or pay-offs for discovered liens (e.g., prior mortgage liens, child and spousal support liens, judgment liens, tax liens, homeowner’s association debts, mechanic liens); obtaining releases for deeds and mortgages; and correcting typographical recording and indexing errors that could create problems (e.g. misspelled names, incorrect legal descriptions).

On the basis of the title examination, a commitment to insure is then provided to the prospective policyholder. The commitment sets forth the conditions that must be met for a title insurance policy to be issued such as: (i) documents to be produced (e.g., the execution of a deed, the execution of a new mortgage in favor of the buyer's lender); (ii) items to be removed (payoff of mortgages, judgments, liens, taxes, municipal bills); (iii) exceptions to be taken from policy coverage found during the title search and examination process. All of this information is discovered in the public record not by simply finding a document but through reading and reviewing each page of every of the hundreds or sometimes thousands of documents found. If exceptions pose problems for the prospective policyholder, an attempt may be taken by the parties with the assistance of the title agent to eliminate those exceptions.

The closing package is then prepared and a "bring-down" search is conducted to ensure that no right has been asserted or filed in the public records since the date of the original search. The last step in the process involves the closing of the transaction. The relevant deeds, mortgage instruments, and other documents are executed and funds are exchanged. The new deed and mortgage lien are recorded and title insurance policies are issued to the lender and the new owner.

It is important to note that because of the historical differences in laws, customs, and practices in various parts of the country – and even within different areas of a single state – the title insurance issuance process described above is subject to numerous variations throughout every state in the United States.

### **Title Insurance Regulation**

A more extensive regulatory framework applies to title insurance than is generally applied to other lines of insurance due to the important role title insurance plays in homeownership, the major driver of our economy, and the unique and long-tailed nature of the policy coverages and how those affect reserving. While the specifics of such regulation vary from state-to-state, certain core elements of regulation remain consistent across all states.

Before discussing state regulation of the title industry, it is important to note that title insurers in the United States are subject to federal consumer protection requirements under the Real Estate Settlement Procedures Act ("RESPA"). One of the purposes of RESPA is to help consumers shop for real estate settlement services and to eliminate kickbacks and referral fees that unnecessarily increase the costs of settlement services.

As an insurance product, title insurance is primarily regulated by states. As part of this regulatory regime, title insurance is one of the few lines of insurance that is required to be mono-line. A licensed title insurer is not permitted to offer any other line of insurance. Similarly, an insurer licensed to engage in another line of insurance cannot provide title insurance coverage. This restriction is expressly set forth by statute in a majority of states and imposed generally through licensing statutes in most of the remaining states. These states have recognized that because of the vast differences between insurance products, it is not prudent to mix title insurance risks with other kinds of insurance risks.

Additional regulatory requirements are imposed to ensure the safety and solvency of title companies. From the financial perspective, states generally require increased capitalization and reserve requirements in comparison to other lines of insurance, recognizing the longer loss tail for title insurance policies and the fact that there is no revenue collected from the renewal of policies. Title insurers are also subject to restrictive limitations on dividend distributions and to specialized statutory financial reporting requirements.

Furthermore, many states have codified minimum search requirements to ensure that a search is always performed and that title insurance is not issued on a “casualty” basis. These requirements are intended to preserve the solvency and integrity of the title industry by minimizing claims.

### **Title Insurance Statutory Reserving**

The unique characteristics of title insurance such as the one-time premium, claims mitigation underwriting method and long loss tail require stronger statutory reserving to ensure the insurer’s ability to pay future claims. State law requires title insurers to maintain two reserve accounts: known claims and statutory premium.

An insurer’s known claims reserve represents the estimated cost of paying all claims presented to the insurer by the end of each reporting period. This differs from the incurred-but-not-reported (“IBNR”) reserves used with other lines of insurance for statutory purposes. Known claims represent the expected payout for presented claims, while IBNR reflects the expected payout for estimated future claims not yet presented.

Statutory premium reserves (“SPR”) are state-mandated reserves set aside to pay claims in the event the title insurer ceases operations. State-mandated formulas govern the size of this liquidation reserve. Depending on the rules of the state where the insurer is domiciled, the SPR is reduced over time (typically 20 years) with a corresponding increase in income.

While similar to IBNR reserves seen with other insurance lines SPR differs from IBNR because its formula are statutorily mandated, while IBNR reserves are determined actuarially. State regulators require title insurers to maintain and segregate the SPR as investment-grade assets, a feature unique to title insurers. These assets cannot be used to pay current claims, operating expense, or dividends, but rather only future claims in the event of insolvency. Finally, the annual additions to title insurer's SPR are recognized by the IRS as a tax deduction while provisions to a title insurer's IBNR are not. This differs from other lines of insurance who receive a tax deduction for additions to their IBNR.

### **Current GAAP Accounting Model for Title Insurance**

Under current GAAP, insurance contracts are classified as short-duration or long-duration contracts. Title insurance contracts classified as long-duration contracts because they "are expected to remain in force for an extended period." The authoritative accounting guidance for title insurance is FASB Statement 60, *Accounting and Reporting by Insurance Enterprises* and FASB Statement 61, *Accounting for Title Plant*, which were codified into FASB Accounting Standard Codification ("ASC") 944, *Financial Services – Insurance*. The current GAAP requirements acknowledge the significant differences between title insurance and other types of insurance contracts. The accounting model for title insurance contracts is described below, including excerpts from ASC 944 addressing the rationale.

Premiums from title insurance contracts are generally recognized as revenue on the effective date of the insurance contract because "most of the services associated with the contract have been rendered at that time." A liability for estimated claim costs relating to title insurance contracts, including estimates of costs relating to IBNR claims, are accrued when title insurance premiums are recognized as revenue. Estimated claims costs are recognized when premium revenue is recognized because "the insurance provides protection against claims caused by problems with title to real estate arising out of ascertainable insured events that generally exist at that time."

Lastly, state law requires title insurers file their annual National Association of Insurance Commissioners Form 9 with their regulators using statutory accounting principles. These statutory accounting principles differ from GAAP. Statutory accounting principles value liabilities on a liquidation basis instead of the GAAP going-concern basis. Under statutory accounting principles, all assets that consist of cash or can be easily converted into cash are considered admitted assets on the financial statements. Meanwhile all assets that are uncertain in nature, including assets whose collectability is questionable are non-admitted and receive no value. Further, under GAAP standards, SPR does not appear on a company's balance sheet

because it is viewed as restricted equity and not a reserve for losses. However, this is offset by the GAAP requirement for title insurers to carry an IBNR reserve.

## **Conclusion**

As discussed above, there are several significant differences between title insurance contracts and other types of insurance contracts. These differences are contemplated in the current GAAP accounting model for title insurance, and we believe these differences should continue to be contemplated by the FASB in any proposed changes to the accounting for insurance contracts. Further, we believe these differences present a challenge to adopting the proposed accounting model set forth in the Discussion Paper. In summary, the key differences are:

- Title insurance does not have a finite contract term, which can lead to the situation where the title insurer is unable to determine which and how many of its policies are still in force.
- Title insurance is issued for a one-time premium, and there are no renewals.
- Title insurance provides coverage to compensate for past events that exist before the policy is issued, but are not discovered until after the policy is issued.
- Title insurance underwriting operates almost entirely on the basis of identifying, evaluating and correcting covered matters before the policy is issued. Therefore title insurers incur significant cost related to underwriting prior to issuance of the policy.

These key differences make the current GAAP standards codified as ASC 944 more appropriate for title insurance than the proposed accounting model set forth in the Discussion Paper. The current GAAP requirements discussed above allow title insurers to recognize a profit at the policy's inception, which is appropriate, because the largest component of the title insurers' costs (the agent's retention for searching the public records, identifying and evaluating the interests found and underwriting the policy) are incurred before the policy is issued. At issuance, the IBNR is relatively small and has a minimal impact on whether a particular policy (or policy year) is profitable or unprofitable.

As the FASB considers changes to the current GAAP standards for insurance contracts it should consider the consequences these changes would have on investors, regulators, ratings agencies and other users of industry financial data. ALTA believes the current GAAP recognition of the differences between title insurance and other lines of insurance best serves the interests of these stakeholders by ensuring that financial statements accurately reflect the

business models of these vastly different insurance lines. Further, changes could make historical comparisons with past financial statements difficult or impossible, preventing stakeholders from appropriately assessing the financial health of title and other insurers.

ALTA appreciates this opportunity to comment on the Discussion Paper. As the FASB attempts to unify the accounting for all insurance contracts, the FASB should ensure that any changes improve upon the current accounting model for title insurers and do not create any unintended consequences that may adversely impact those who utilize financial statements. If you have any questions please contact Justin Ailes at 202-261-2937 or [justin@alta.org](mailto:justin@alta.org).

Sincerely,

A handwritten signature in black ink that reads "Kurt Pfothauer" followed by a horizontal line.

Kurt Pfothauer  
Chief Executive Officer