



March 8, 2012

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

Ms. Weiner:

Thank you for participating in a conference call between American Land Title Association<sup>1</sup> (“ALTA”) members and Financial Accounting Standards Board (“FASB”) staff on January 12, 2011, to discuss challenges to scoping title insurance into the Discussion Paper, *Preliminary Views on Insurance Contracts* (“the Discussion Paper”). On the call you listened to ALTA members’ concerns and asked us to identify alternative solutions that allow for improved accounting treatment of title insurance transactions. ALTA members, through our Accounting Committee, have studied potential solutions and we thank you, in advance, for considering our suggestions.

*Preliminary Views on Insurance Contracts*

The Discussion Paper presents significant challenges to the title insurance industry. On December 15, 2010, ALTA, Fidelity National Financial, Inc. and Stewart Information Services Corporation, each submitted comment letters regarding the Discussion Paper which identified the significant differences between title insurance contracts and other types of insurance contracts. 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.

<sup>1</sup> Founded in 1907, ALTA is the national trade association and voice of the real estate settlement services, abstract and title insurance industry. With more than 8,000 office locations throughout the country, ALTA members operate in every county in the United States to search, review and insure land titles and conduct closings to protect the rights of home buyers and mortgage lenders who invest in real estate. ALTA members include title insurance companies, title agents, independent abstracters, title searchers and attorneys, ranging from small, one-county operations, to large national title insurers.

- Title insurance is issued for a one-time premium, and there are no renewals.
- Title insurance provides coverage to compensate for past events that existed 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.

According to the Discussion Paper, all insurance contracts would be accounted for under the proposed model, unless expressly excluded. The *Definition and Scope* section of the Discussion Paper indicates, “regardless of the type of entity issuing the contract,” an insurance contract is a “contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.”

A title insurance contract is a contract under which one party (the title insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if an unidentified past event (the insured event) adversely affects the policyholder’s interest in real property. Title insurance indemnifies the policyholder for costs to defend against defects in title that were not discovered prior to the issuance of the title insurance policy and any loss in value to the insured’s interest as a result of such defect.

In order to issue a title insurance policy, a title insurer or agent performs research on the particular parcel of real estate to be insured, called a title search. They then examine the evidence identified by the title search. The issuance of a commitment for a title insurance policy is predicated on the results of the search and examination. The commitment outlines the status of the title to the parcel, exceptions to coverage that will be included in the policy and any requirements to be completed before a title policy can be issued by the insurer or agent of the insurer to the policyholder.

Once issued, the title policy obligates a title insurer to indemnify and defend against covered risks. The title insurer’s indemnity and defense obligation generally relates only to risks to the title that existed before the date that the policy was issued. The title insurer’s obligation under the policy generally provides for compensation to the policyholder for a past defect in title that was not identified during the title search and examination but is discovered at some future date subsequent to policy issuance.

Under current accounting guidance, premiums for 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 this time. A liability for estimated claims costs is also recognized at this time.

### Alternative Accounting Treatment for Title Insurance

Based on the above explanation of the nature of the title "insurance" transaction, ALTA believes title insurance policies would more appropriately follow the proposed revenue recognition guidance set forth in the FASB Exposure Draft, *Revenue from Contracts with Customers* ("the Exposure Draft"). As such, ALTA has been exploring with members of the FASB staff the possibility of granting title insurance an exclusion from the proposed guidance as presented in the Discussion Paper. That is, the bulk of the title insurer's activities and costs are centered on the insurer or designated agent's performance of research (the title search) and subsequent examination and analysis of evidence identified by the title search and less so on the indemnification provisions. This is more akin to the performance of a service rather than the "indemnification for loss" concept exemplified in a typical insurance contract. The component of the title insurance premium that provides for the insurer's indemnification and defense relating to defects in the title is typically of much smaller significance when compared to the cost of the title search and examination, and the indemnification provisions contained in the title insurance contract are akin to representation and warranty provisions in a service contract.

Given that the current definition of an insurance contract in the proposed standard is rather broad, and as acknowledged by constituents, if read literally, could cover many types of service contracts (including title insurance), and given past practice of considering title insurance as "insurance" we believe the board should grant an explicit exception for title insurance from the proposed standard. If such exclusion were granted, title insurance would fall within the proposed revenue recognition guidance set forth in the Exposure Draft from which title insurance contracts were previously exempted.

As discussed below, the proposed guidance in the Exposure Draft would serve as a more appropriate model for title insurance given the substance and economics of title insurance arrangements.

### Interpretation of Revenue Recognition Guidance

The Exposure Draft requires entities to recognize revenue upon the transfer of goods or services to customers, and to do so in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying this principle, the Exposure Draft focuses on performance obligations within a contract. An entity would need to identify separate performance obligations within the contract, determine the transaction price,

allocate the transaction price to the separate performance obligations and then recognize revenue when the entity satisfies each performance obligation by transferring the promised good or service to the customer.

### Application of Revenue Recognition Guidance for Title Insurance

Determining the transaction price is generally straightforward for title insurance policies, as insurers and agents receive fixed, one-time payments. The short timeframe between the collection of funds and the effective dates of policies makes present value calculations unnecessary. Collectability would still require analysis but would not differ from the bad debt allowance processes currently utilized.

For title insurance policies, the sole performance obligation is the declaration of the state of title as presented in the policy, which is the culmination of the title search and examination process. The performance obligation is satisfied upon transfer of title as evidenced through the issuance of the title policy; therefore, revenue would be recognized on the effective date of the title policy.

In defining a performance obligation, the proposed guidance considers product warranties and product liabilities. Product warranties, which the customer has the option to purchase separately, result in a performance obligation as do those that are not sold separately but provide a service as part of the warranty. A warranty that is not sold separately and provides assurance that the product sold complies with agreed upon specifications is accounted for under existing guidance on product warranties in ASC 460-10. The indemnification provision in a title insurance policy would not be considered a performance obligation under the Exposure Draft because it is consistent with this latter type of product warranty, as the indemnification component is not sold separately from the title search and examination component, nor is it providing a separate service.

In the case of a title insurance policy, the product is the declaration of the state of title as presented in the policy, which is the culmination of the title search and examination process. The state of title is accompanied by a warranty which is the indemnification provisions. The policy warrants against title being vested other than as stated in the policy and against existing defects, liens, or other matters that affect title to the parcel other than those listed in the policy. Generally, if the insurer had perfect information about each title it examined, there would never be a liability.

### Claims Liabilities

Under current accounting guidance, a liability for estimated claims costs relating to title insurance contracts is accrued when title insurance premiums are recognized as revenue. If we view the obligation to indemnify and defend against title defects as being similar conceptually to a product warranty under the Exposure Draft, the accounting guidance would follow that for product warranties in ASC 460-10-25-6, which references ASC 450-20-25-2. This guidance states that “An estimated loss from a loss contingency shall be accrued by a charge to income if both of the following conditions are met:” (1) It is probable that a liability has been incurred, and (2) The loss can be reasonably estimated. Following this guidance, title insurers would continue to record an accrual for expected claims losses at the time a policy is issued.

Conclusion

ALTA appreciates this opportunity to comment on the Discussion Paper. Title insurance policies should be excluded from the proposed guidance as outlined in the Discussion Paper. Rather, we believe that title insurance should be scoped into the revenue recognition guidance under the proposed Exposure Draft. We thank you for considering these suggestions, and we look forward to continuing to work with you to update the current accounting model for title insurers. If you have any questions please contact Justin Ailes at 202-261-2937 or [justin@alta.org](mailto:justin@alta.org).

Sincerely,



Michelle L. Korsmo  
Chief Executive Officer