



October 25, 2013

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2013-290

Dear Technical Director,

The American Land Title Association (ALTA)^[1] appreciates the opportunity to comment on the Financial Accounting Standards Board's ("FASB") Exposure Draft (the "Exposure Draft") of Proposed Accounting Standards Update, *Insurance Contracts (Topic 834)* released on June 27, 2013. While ALTA commends the FASB's efforts to provide greater comparability and increase decision-useful information to the accounting for contracts that transfer significant risk between parties, we believe the Exposure Draft fails to achieve this goal as it applies to the title insurance industry and urge the FASB to maintain the current U.S. generally accepted accounting principles ("GAAP") for title insurance.

We believe current GAAP for title insurance has served its purpose well over the years and should be maintained. It provides investors, regulators and other end users with decision-useful information about financial performance and condition that is transparent, comparable and relevant. These benefits would be significantly diminished if the accounting model for title insurance were replaced with the model as proposed in the Exposure Draft.

^[1] The American Land Title Association, founded in 1907, is a national trade association and voice of the real estate settlement services, abstract and title insurance industry representing more than 4,800 member companies. 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 abstracters, title searchers and attorneys, ranging from small, one-county operations, to large national title insurers.

Adopting the Exposure Draft as proposed, would burden the title industry with unnecessarily high costs for no ascertainable benefit to end users, regulators or the industry. The sheer burden of building information systems to collect data that the industry has identified no reason to collect from a business perspective, and that from a practicality perspective is nearly impossible to collect, makes adopting this Exposure Draft a significant challenge for the industry.

In this letter, we provide the FASB with:

1. A brief overview of title insurance, including an overview of the process for producing a title insurance policy.
2. An analysis of the benefits of current GAAP as compared to the proposed guidance.
3. Discussion of the impact of the proposed guidance on end users.
4. An analysis of the cost and effort associated with implementing the Exposure Draft.
5. While we believe current GAAP to be a superior model, if the industry is required to adopt the Exposure Draft as proposed, certain observations and comments related to the Exposure Draft.

Overview of Title Insurance

Title insurance is a contract of indemnity issued to real estate owners, purchasers, and mortgage lenders to compensate them against loss or damage arising out of defects in, liens on, or challenges to their title to real estate. Coverage is provided for loss caused by past events that existed before the contract is issued, but are not discovered until after the contract begins. There are two types of title insurance policies. An owner's policy protects homeowners from prior title defects. A loan policy covers a lender's interest - often a mortgage - in a piece of real estate. The policy assures the lender of the validity, priority and enforceability of its lien. These contracts extend as long as the insured retains an interest in the property or provides warranties upon transfer. In the case of a lender's policy, the contract extends until the loan is extinguished.

Before a title policy is issued, a title insurer or its agent typically performs three functions: a title search, a title examination and curative actions. In a typical transaction, these activities will occur over a period of 45 days prior to the date of closing or settlement. While these services are performed in connection with issuing a title insurance policy, in transactions in which title insurance is not obtained (typically all-cash transactions, although frequently insurance is obtained in all-cash transactions also) these services would also be obtained.

A title search begins when a professional searches public records for matters that may cloud ownership of the property, building the chain of title or the specific rights the buyer is or is not receiving with the property. These records are used to compile a title abstract, which outlines the

history of title as it appears in the public record, but does not offer an opinion or draw any conclusion as to how the rights, or lack thereof, affect title to the land.

Once compiled the results of the search are turned over to experienced real estate and title insurance experts for examination. This examination will determine whether the seller can convey his or her title to the buyer and what liens and other issues must be resolved or cured, prior to seller conveying title. This information is reported to transaction participants and provides information that may be used by participants (prospective buyers, lenders, etc.) to make decisions regarding the transaction and disclosed exceptions that may be included in the policy.

After the title examination the title insurer or agent performs curative actions on defects that exist on the public record. Curative actions include obtaining releases or pay-offs of discovered liens such as mortgage liens, child and spousal support liens, judgment liens, tax liens, homeowner's association debts, mechanic liens as well as liens from previous owners that remain on the public record. Curative measures may also include correcting typographical recording and indexing errors, misspelled names or legal descriptions.

After all of this work is done, the title insurance company will issue a commitment to insure to the prospective policyholder setting forth the conditions that must be met in order for a title insurance policy to be issued. Once all the conditions of the commitment are met, the company issues the title insurance policy.

Benefits of Current GAAP Compared to Proposed Guidance

Title insurance is fundamentally different than most other forms of insurance, such as auto, homeowner's or life insurance. As current GAAP recognizes, these differences require the business of title insurance to be managed differently than other lines of insurance, resulting in different measures of financial performance for the industry. These differences are:

- Title insurance does not have a finite contract term. Title insurers are unable to practicably 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 at the time the policy is issued but are not discovered until after the policy is issued.
- The claim costs associated with title insurance transactions are low relative to other types of property/casualty insurance. Loss ratios typically range between 6% to 10% of premium compared with the 70-90% loss ratios typical of the property/casualty insurance industry.

As described above, title insurance is a unique insurance product with substantially different risk mitigation and risk transfer characteristics as compared to other insurance products historically considered long-duration contracts under GAAP. This uniqueness was the impetus for accounting guidance written into Statement of Financial Accounting Standards No. 60, *Accounting and Reporting by Insurance Enterprises* (now Topic 944) specific to the title insurance industry.

Under current GAAP, premiums for title insurance contracts are recognized as revenue on the effective date of the insurance contract and a liability for estimated claim costs relating to the title insurance contract, including estimates of costs relating to incurred-but-not-reported claims, is accrued when title insurance premiums are recognized as revenue. Liability recognition and measurement is consistent with a best-estimate liability under the property/casualty model in current GAAP.

The current accounting model has been in place for many years and is well understood by the end users of our financial statements: investors, analysts and regulators. Due to the minimal amount of management judgment required under the current model, financial results among the title insurance industry can be easily compared and analyzed helping investors, analysts and other end users make timely informed decisions. Under the current accounting model, management judgment is primarily limited to the determination of the liability for estimated claim costs. While there is variability in the cash outflows associated with claim costs, this variability is mitigated by the fact that overall claim costs are a small portion of the overall premium revenue, typically 6 to 10 percent. As a result, changes in these estimates are typically not significant in relation to the overall financial results. Further, under the current model, end users can easily identify the impact of and adjust, if needed, for differences to the liability for estimated claim costs between competitors, since this liability is a separate line item on the face of the financial statements.

The proposed guidance will introduce a significant amount of management judgment related to the preparation of financial statements, which will result in financial results that cannot be easily compared among the title insurance industry. The primary judgments that will impact comparability include, among others, approaches to unbundling cash flows among service and insurance components, portfolio determinations, estimation of release of risk period, and selection of discount rates. The degree of complexity and subjectivity associated with certain of these judgments could easily result in significant differences among financial results in the title industry. Certain of these judgments are discussed in more detail in the “Certain Observations and Comments Related to the Exposure Draft” section.

Additionally, the title industry believes that decision useful information should not reside solely in the disclosures, but should also be reflected on the face of the financial statements. However, that will not be the case under the proposed guidance, as the face of the financial statements will not include certain information key to end users, such as premium revenue and liability for estimated claims costs, while the disclosures will be voluminous so that end users will

be able to glean sufficient relevant information for decision making. We believe this dynamic will result in the increased reliance by end users on non-GAAP disclosures.

The proposed accounting model under the Exposure Draft will result in less transparent, less comparable, less reliable and more complex financial statements than current GAAP. This added subjectivity in financial results will likely lead to confusion and lack of confidence among end users. Lastly, the current accounting model better aligns with the economics of the title insurance business. **For these reasons, we strongly believe that the current accounting model for title insurance transactions should be maintained.**

Impact of the Proposed Guidance on End Users

Analysts that closely follow this segment of the industry have expressed concerns that the Exposure Draft will move the accounting for title insurance away from the economics of the business, and they have indicated that the lack of transparency in financial reporting may decrease investor interest in the title insurance industry and could increase the cost of capital. As one industry analyst suggested, to effectively compare two title insurers, an analyst would need to dissect the disclosures in an attempt to reverse engineer the high level of management judgment which would be included under the proposed standard. Essentially, they would convert the financial statements back into one based on current GAAP which they find more useful. Further, the title industry and the analyst community following the title insurers are concerned that the Exposure Draft introduces complexity, potential volatility, and significant and permanent additional costs that are considered unnecessary and harmful to the transparency that exists today in the financial reporting for title insurance.

Cost of Compliance and Time to Implement

ALTA believes that the costs to comply with the Exposure Draft will be significant. Furthermore, given the volume of new processes and systems that would be needed, the time necessary to implement will be lengthy.

Title insurers will need to hire staff and design, build and test systems, processes and controls to capture data in order to determine the release of risk period, build portfolios, track acquisition cost information including successful efforts analysis, allocate cash flows among the service and insurance performance obligations, accumulate disclosure information, etc. Most of this will require title insurers to collect data that is not currently collected or, in many cases, is not readily available. This will require companies to build these systems from scratch and have them in place long enough to collect sufficient data to make informed decisions.

This data collection is made more complicated because title insurers issue a significant portion of their title insurance policies through agents. The typical agent is a small operation with less than \$500,000 in revenue, with limited staff and systems. Therefore, title insurers would be

required to work with thousands of agents to collect data that is not otherwise needed for business purposes.

Another costly aspect of this proposed Exposure Draft is its incongruence with statutory accounting principles promulgated by our state-based insurance regulators. If the Exposure Draft were finalized and implemented, title insurance companies would have to build and maintain complex accounting systems to be able to produce the types of data and financial statements necessary to meet both GAAP and statutory requirements. We suggest that the FASB work with the National Association of Insurance Commissioners, as well as international regulators, to try to unify accounting standards to reduce complexity and cost.

Certain Observations and Comments Related to the Exposure Draft

While ALTA strongly believes that the current accounting model for title insurance transactions should not be changed, we would like to outline the following observations and comments related to the Exposure Draft, in the event that title insurers are required to adopt the proposed accounting model.

The title insurance industry supports the unbundling concept, for the reasons described in the Exposure Draft at 834-10-25-5 and provided in the example on page 95.

ALTA agrees with the FASB's example on page 95 that the revenue and cash flows related to the title search should be considered a separate service component and accounted for under the revenue recognition standard. However, ALTA also believes that the examination and curative process, as described in further detail in the "Overview of Title Insurance" section, should also be considered a separate service component based on the Exposure Draft's definition of a distinct service and accounted for under the revenue recognition standard. ALTA believes this was the intent of the example, as the same facts and circumstances apply to the examination and curative process as to the title search. Unbundling of the industry's insurance revenue and noninsurance revenue in this manner will allow the title insurance industry to present financial results that more closely align with the economics of the business. This will result in more useful financial statements for end users and the industry.

Acquisition costs should be allocated to the insurance component.

Since revenue will be bifurcated between the service and insurance components, related costs (including expenses and acquisition costs) will also need to be attributed to the appropriate component. In the FASB's July 25, 2012 meeting minutes we noted the simplified illustration of the proposed model seemed to suggest that acquisition costs should be allocated entirely to the service component. The industry disagrees with this approach and believes that some acquisition costs should be allocated to the insurance component since this revenue stream could not be generated

without related acquisition costs. We believe such costs can be allocated on a rational and consistent basis as prescribed in the Exposure Draft. We recommend that the FASB clarify this in its discussion of the application of the Exposure Draft to title insurance.

Also, since, under current GAAP, title insurers recognize all revenue as earned at the policy effective date, they historically have not deferred any acquisition costs and, hence, they have not needed to apply the ASU 2010-26 guidance, including the guidance on successful versus unsuccessful efforts. Title insurers will now be required to collect, analyze and report such costs for the first time, which will be an additional cost of the new standard. This should also be considered in assessing time to implement. We support convergence with the International Accounting Standards Board with respect to inclusion of both successful and unsuccessful efforts in acquisition costs. This approach will reduce implementation costs, and is also more reflective of the cost of acquiring the revenue stream.

ALTA believes the FASB should provide more practical guidance on recognition of the margin over the settlement period specific to the title insurance industry.

Title insurers do not keep track of the number of policies in force. Tracking this information would be extremely costly and impractical due to the fact that title insurance policies do not have finite periods over which claims can be presented.

As discussed above, the policy remains in force for claims incurred prior to the issuance date until the owner or his/her heirs dispose of the property in a manner that terminates coverage (owner's policy) or the mortgage loan is repaid in full or extinguished (lender's policy). The only effective way to track this data would be to effectively perform title searches and examinations on each insured property at each balance sheet date to determine if the owner still possesses the property (or made a warranty when selling the property) and the lender's mortgage is still outstanding. Given the substantial costs associated with performing each title search and examination, it is obviously cost-prohibitive for an insurer to track its in force business.

Our members have evaluated whether more limited studies could be conducted to develop reliable estimates of release of risk periods. Given that this metric can change frequently due to external economic factors – often in ways that are not predictable beforehand- and can vary widely from policy to policy, by geographic location, etc., we anticipate that using this information as a basis for reporting financial results would be inappropriate and could result in significant variability among reporting entities and volatility in reported results.

ALTA urges the FASB to clarify its guidance on “Portfolio of Contracts”

The Exposure Draft requires a reporting entity to group its insurance contracts into portfolios of contracts subject to similar risks, expected durations, cash flows and pricing. 834-10-55-48 lists a number of factors for building these portfolios including:

- Type of coverage (comparable risks);
- Product line (comparable products);
- Type of policy holder; and
- Geographical location.

Depending on how these requirements are interpreted, this could lead to a substantially larger number of portfolios than we believe the FASB intended. Furthermore, the title industry does not currently track complete cash flow information related to title insurance policies at a portfolio level and has never identified a compelling business reason to incur such an expense given the limited historical claim costs. Unlike property and casualty insurance, there is little variability in coverages among policyholders and the product is fairly uniform across the country. Any need to track and evaluate complete cash flow information at a portfolio level will be entirely new to the title insurance industry and require a significant level of effort and system modification to achieve.

Conclusion

ALTA appreciates this opportunity to comment on FASB's Exposure Draft. We believe that the current accounting model for title insurance is time tested and well understood by end users and closely aligns the accounting for title insurance with the economics of the business. ALTA supports targeted changes to current guidance where there are clear opportunities to enhance decision useful information for end users. Before the FASB makes any changes to this model we suggest they reach out to industry analysts, investors and other users of title insurance financial data to solicit their feedback. We look forward to continuing to work with the FASB to help address the issues we have identified. Should you have any questions, please do not hesitate to contact Steven Gottheim, Legislative and Regulatory Counsel, at 202.261.2943.

Sincerely,



Michelle L. Korsmo
Chief Executive Officer