

## COVERSTORY

### National underwriters boost reserves to cover claims in '07

The major underwriters were forced to bolster their claims reserves significantly as the Big 5 combined paid about \$967 million in claims during 2007.

First American reported it added \$709.9 million to its claims reserve, while paying \$301 million in claims last year. The increase in reserves, First American said, resulted from higher-than-expected claims in policy years 2004 to 2006. There were many factors resulting in the increase in reserves, First American reported, including decreases in real estate prices during 2007, increases in defaults and foreclosures during 2007, a large single fraud loss from a closing protection letter claim involving multiple properties, higher-than-expected claims emergence for business from a large agent and higher-than-expected claims emergence from a recently acquired underwriter.

First American's provision for title insurance losses was 12.9 percent in 2007, 8 percent in 2006 and 4.9 percent in 2005.

Fidelity reported it had \$1.3 billion in title insurance reserves at the end of 2007. It paid \$335 million in claims last year, while bolstering its reserve by \$217.2 million. On policies already written, the company expects to pay \$250.2 million in 2008, \$192.5 million in 2009, \$145.0 million in 2010, \$107.3 million in 2011 and \$86.7 million in 2012. Fidelity's provision for title insurance losses was 13.2 percent last year, 7.5 percent in 2006 and 7.2 percent in 2005.

"While we believe that historical loss payments are a reasonable source of projecting future claim payments, there is significant inherent uncertainty in this payment pattern estimate," Fidelity said in a SEC filing.

Fidelity said claims could be impacted by:

- changes in future mortgage interest rates, which will affect the number of real estate and refinancing transactions and, therefore, the rate at which title insurance claims will emerge;
- the legal environment whereby court decisions and reinterpretations of title insurance policy language to broaden coverage could increase total obligations and influence claim payout patterns;
- events such as fraud, defalcation and multiple property title defects that can substantially and unexpectedly cause increases in both the amount and timing of estimated title insurance loss payments;
- loss cost trends whereby increases or decreases in inflationary factors (including the value of real estate) will influence the ultimate amount of title insurance loss payments; and
- claims staffing levels whereby claims may be settled at a different rate based on the future staffing levels of the claims department.

LandAmerica reported its claims reserve level was at \$876.5 million at the end of 2007. Its claim reserve provision ratio was 8.6 percent in 2007, compared to 6.1 percent in 2006 and 5.2 percent in 2005. The company paid \$270.5 million in claims last year. The company expects to add \$172 million to its reserve in 2008, \$141.1 million in 2009, \$111.9 million in 2010, \$84.7 million in 2011 and \$65 million in 2012.

#### Paid claims

2007: \$967 million  
 2006: \$870 million  
 2005: \$916 million  
 2004: \$700 million  
 2003: \$662 million  
 2002: \$582.7 million  
 2001: \$450 million

Source: ALTA

Stewart reported it had \$441.3 million in its title loss reserve as of the end of 2007, adding \$168.5 million to its reserve during 2007. The company paid \$117.5 million in claims last year. Stewart's provision for title losses were 8.5 percent last year, 6 percent in 2006 and 5.5 percent in 2005.

Old Republic, meanwhile, had \$273.5 million in reserve for title insurance claims at the end of 2007. The company paid \$43.3 million in claims last year. Old Republic's provision for title losses was 6.6 percent last year, 5.9 percent in 2006 and 6 percent in 2005. Overall, Old Republic Corp. built its claims reserve to \$6.2 billion in 2007, while paying out \$1.5 billion in claims. The company's title insurance segment accounts for roughly 21 percent of its revenue.

"When housing hits the skids there tends to be more claims," said Old Republic chairman and CEO **Al Zucaro**. "Another thing that happened is when we went through a period of high refinance activity, problems with titles got buried by continued refi production. When the music stops, people have to own up to some of the problems that may be genetically imbedded in these loans."

According to **Gerry Glombicki**, an analyst with Fitch Ratings, accelerated claims is a good thing for title insurance companies — "assuming they did some underwriting work and really researched the claims."

Glombicki said typical claims are made within five years of issuing the policy and underwriters have to hold the liability on the books for a certain amount of years — some states require underwriters to hold it for 20, some require 30 years. As an example, Glombicki said, if an underwriter reserves \$10 and gets a \$2 claim, they get to bring \$8 back as capital. However, if a company didn't properly do its underwriting work and the \$10 reserve turns into a \$20 claim, an underwriter must dip into earnings.

Glombicki said predicting reserve balance is not an exact science, however. "It should never be 0, that's a red flag," he said. "As credit analysts, we prefer to see the minus side, meaning that you overstated the reserve balance and equity was understated. But we won't beat a company up for being over 5 percent. If you go beyond that, a company will have some ratings ramifications."