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A QUANTITATIVE ANALYSIS OF TITLE INSURANCE LOSSES AFTER THE MORTGAGE MELTDOWN

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INTRODUCTION

The current difficulties in the mortgage credit markets are common knowledge. Foreclosure rates unseen since the Great Depression of the 1930's, skyrocketing bankruptcies and plummeting home prices are all trumpeted forth as harbingers of impending economic doom. This may or may not be the case. But even if it is so, what has the effect of the meltdown been on title insurance losses? This article examines that question.

There is only limited industry-wide data available on title insurance loss experience. This paper analyzes the available data on the recent behavior of reported title insurance losses based on data from the Annual Statements (Form 9) filed by all insurers with their domiciliary insurance departments.[1] The Annual Statements present policy year data for the U.S. as a whole, but only calendar year revenue and loss experience by state.[2]

The distinction between calendar year and policy year loss data is an important one. Calendar year data report all losses occurring during a given year, irrespective of the year in which the policy was written. Policy year data, in contrast, report data by the year in which the policy was written. This means that the trend in calendar year loss ratios (i.e., the ratio of losses to premiums during a particular year) mixes the trend in losses with the trend in premiums. In contrast, the trend in policy year loss ratios (i.e., the ratio of losses on policies written in a particular year to premium in the year in which the policies were written) reflects only the trend in the fraction of the premium dollar which is being used to pay losses.[3]

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1 The Annual Statement is prepared using a standard form and associated Instructions for Completion promulgated by the National Association of Insurance Commissioners.
2 Policy year loss data are provided on Form 9 Schedule P. Calendar year loss data by state are provided on Form 9 Schedule T.
3 For a thorough discussion of loss ratios, see e.g. Peterson, Timothy M., "Loss Reserving – Property/Casualty Insurance," New York, Ernst & Whinney, 1981, passim.

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MELTDOWN...

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There is, of course, some impact of current-year conditions on current losses on prior policy years. In buoyant markets, old title issues may be overlooked in the frenzy of trading. In times of economic stress, various parties may look to title claims as a "deep pocket" source of financial relief. Nevertheless, the policy year loss ratio is the best guide to what is really going on.

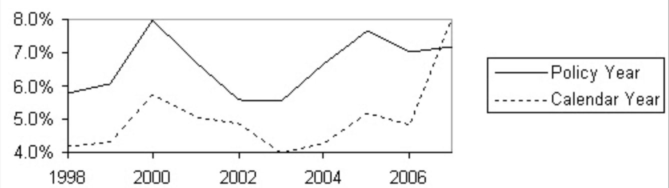
THE NATIONAL PICTURE

Table 1 and Figure 1 present the ratio of losses to premiums for title insurers for the ten-year period 1998 to 2007 on both a calendar year and a fully-developed[4] policy year basis. The calendar year ratio increased dramatically from 2006 to 2007, rising from a level of 4.8% to a level of 8%, an increase of 67%. Over the same period, bankruptcies increased by 37%,[5] foreclosures increased by 75%,[6] and stories of falling home prices and bank asset write-downs filled the newspapers.[7] It is tempting to conclude that a sharp increase in national title insurance losses has occurred in response to these dismal facts. But that does not appear to be the case.

This optimistic assessment is based on an analysis of policy year loss ratios. The policy year loss ratios reported in the industry's Annual Statements exhibit a

Figure 1

Loss Ratios 1998-2007



SOURCE: American Land Title Association Form 9 Compilation

TABLE 1

TITLE INSURANCE INDUSTRY NATIONAL LOSS RATIOS 1998-2007

	[1]	[2]	[3]=[2]/[1]	[4]	[5]=[4]/[1]
	Gross Premium Written	Loss and Loss Adjustment Expense Incurred	Calendar Year Loss Ratio	Fully Developed Policy Year Loss and Loss Adjustment Expense	Policy Year Loss Ratio
1998	7,548,040,743	317,300,000	4.2%	430,705 ,000	5.7%
1999	8,129,855,066	350,000,000	4.3%	487,253,000	6.0%
2000	7,291,124,454	419,213,066	5.7%	571,875,000	7.8%
2001	9,148,964,241	465,130,855	5.1%	613,868,000	6.7%
2002	11,990,240,281	582,714,796	4.9%	669,027 ,000	5.6%
2003	15,693,471,476	628,632,057	4.0%	870,739,000	5.5%
2004	15,531,157,223	666,328,820	4.3%	1,036,008,000	6.7%
2005	16,938,674,395	881,589,952	5.2%	1,294,253,000	7.6%
2006	16,567,969,897	803,531,680	4.8%	1,164,661,000	7.0%
2007	14,227,110,670	1,145,075,812	8.0%	1,018,640,000	7.2%

SOURCE: American Land Title Association compilation of Annual Statements (Form 9) for all U.S. title insurers.

4 Fully developed policy year losses are the actuarial estimate of total losses that will ultimately be paid on policies written in a given year, extrapolated from losses reported to date. Fully developed losses are reported on Form 9 Schedule P Part 2. For a full discussion of these issues, see Peterson, op. cit., Chapters 8 and 12.

5 See Federal Judiciary Quarterly Bankruptcy Reports, available at http://www.uscourts.gov/bnkrpctystats/bankruptcystats.htm.

6 For example, see "U.S. Foreclosure Activity Increases 75 Percent In 2007," Realty Trac, January 29, 2008, available at http://www.realtytrac.com/ContentManagement/-pressrelease.aspx?ChannelID=9&ItemID=3988&accnt=64847.

7 Office of Federal Housing Enterprise Oversight, Press release February 26, 2008.

TABLE 2

CALENDAR YEAR LOSS RATIOS BY STATE

State	2006	2007
Alabama	7%	7%
Alaska	2%	7%
Arizona	3%	6%
Arkansas	6%	12%
California	5%	12%
Colorado	6%	9%
Connecticut	5%	9%
Delaware	1%	3%
District of Columbia	7%	10%
Florida	4%	8%
Georgia	8%	11%
Hawaii	5%	15%
Idaho	2%	8%
Illinois	9%	12%
Indiana	9%	11%
Iowa	9%	7%
Kansas	4%	15%
Kentucky	11%	9%
Louisiana	4%	3%
Maine	7%	10%
Maryland	4%	7%
Massachusetts	9%	9%
Michigan	16%	18%
Minnesota	9%	23%
Mississippi	6%	31%
Missouri	25%	25%
Montana	4%	4%
Nebraska	7%	5%
Nevada	1 %	5%
New Hampshire	5%	11%
New Jersey	6%	6%
New Mexico	6%	2%
New York	4%	4%
North Carolina	10%	15%
North Dakota	2%	59%
Ohio	5%	6%
Oklahoma	3%	4%
Oregon	2%	3%
Pennsylvania	3%	5%
Rhode Island	4%	12%
South Carolina	5%	7%
South Dakota	1 %	28%
Tennessee	5%	4%
Texas	3%	3%
Utah	2%	3%
Vermont	14%	6%
Virginia	3%	7%
Washington	5%	8%
West Virginia	3%	11%
Wisconsin	5%	14%
Wyoming	1 %	2%

SOURCE: American Land Title Association compilations of Annual Statements (Form 9) for all U.S. title insurers.

strikingly different picture from the calendar year figures. These figures demonstrate that, rather than rising sharply from 2006 to 2007, the national policy year loss ratio remained virtually unchanged (i.e., 7.2% vs. 7.0%, or only a 3% increase). The sharp increase in the calendar year loss ratio was produced primarily by the interaction of a drop in premiums in 2007 with the long series of rapidly increasing annual premiums in the immediately prior years.

A large divergence between policy year and calendar year loss ratios can occur in title insurance because it is a "long tail" line of insurance, that is, a line in which claims can and do arise over many years after the policy is written. (This differs from, say, automobile insurance where the policy term is usually one year, and claims are made almost entirely within that year.) Large premium volume years mean large volumes of transactions, and so such years generate large volumes of losses (although not necessarily large compared to the volume of transactions). When losses from a high volume year get reported in a later low volume year, the calendar year loss ratio increases, even if the policy year loss ratio has remained constant.

Press reports greatly exaggerate the severity of the problems facing the mortgage markets. Falling home prices? In fact, for the U.S. overall, home prices ***increased*** during 2007 by about 0.84%. Skyrocketing bankruptcies? Bankruptcies are still ***down*** 60% from their level in 2005, due in large part to changes in the bankruptcy laws. Foreclosures are certainly at an extraordinarily high level, but not everywhere.[8] Mortgage market problems are highly geographically concentrated. Unfortunately, the

FIGURE 2

2006 Loss Ratio

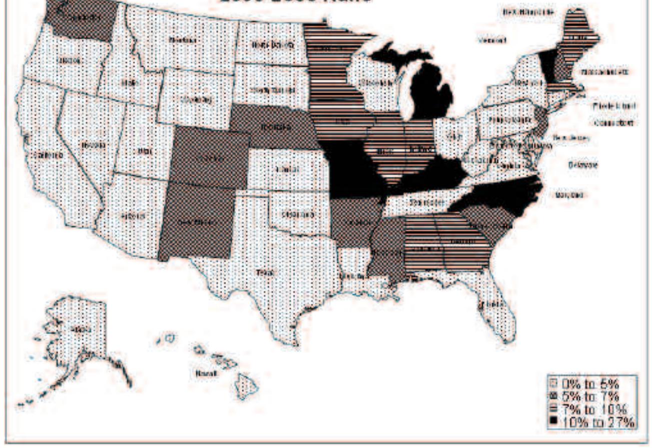
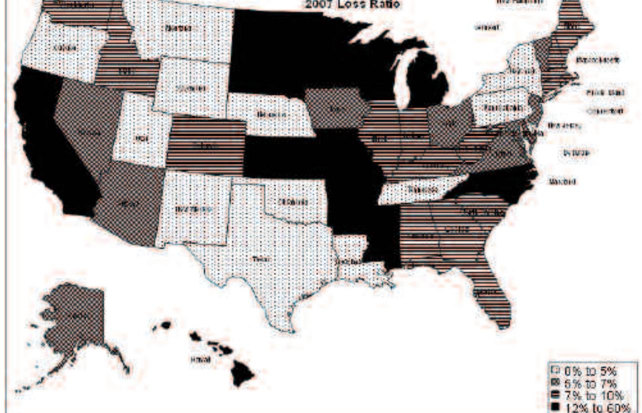


FIGURE 3

2007 Loss Ratio



[8] While the U.S. average foreclosure rate per household was 1.033% in 2007, individual states ranged from a low of .007% in South Dakota to a high of 3.376% in Nevada. Statistics from Realty Trac, available at http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=4586&accnt=6484.

TABLE 3

PERCENTAGE CHANGE IN LOSS RATIOS
2006-2007 BY STATE

State	
Alabama	-2%
Alaska	167%
Arizona	97%
Arkansas	117%
California	165%
Colorado	65%
Connecticut	78%
Delaware	253%
District of Columbia	51%
Florida	121%
Georgia	47%
Hawaii	208%
Idaho	212%
Illinois	22%
Indiana	23%
Iowa	-29%
Kansas	269%
Kentucky	-21%
Louisiana	-24%
Maine	40%
Maryland	53%
Massachusetts	1%
Michigan	8%
Minnesota	154%
Mississippi	448%
Missouri	-3%
Montana	5%
Nebraska	-26%
Nevada	458%
New Hampshire	100%
New Jersey	15%
New Mexico	-59%
New York	16%
North Carolina	46%
North Dakota	3031%
Ohio	27%
Oklahoma	33%
Oregon	52%
Pennsylvania	61%
Rhode Island	170%
South Carolina	28%
South Dakota	2799%
Tennessee	-17%
Texas	14%
Utah	69%
Vermont	-57%
Virginia	95%
Washington	57%
West Virginia	331%
Wisconsin	213%
Wyoming	180%

SOURCE:American Land Title Association compilations of Annual Statements (Form 9) for all U.S. title insurers.

FIGURE 4

Change in Loss Ratio 2006 to 2007

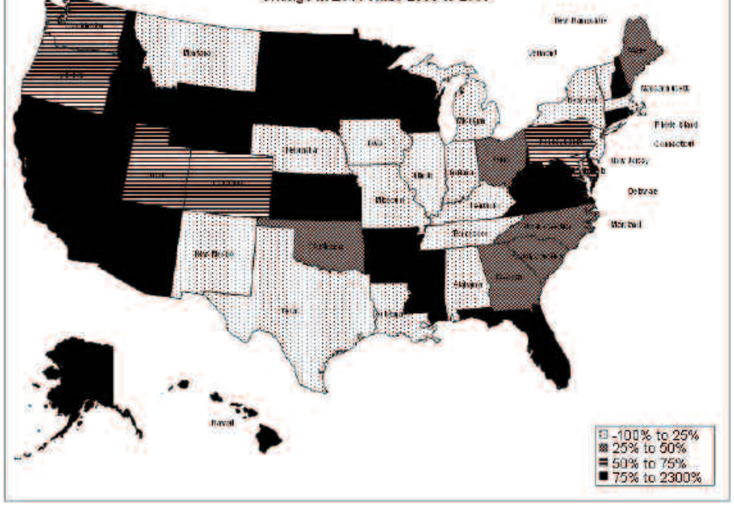
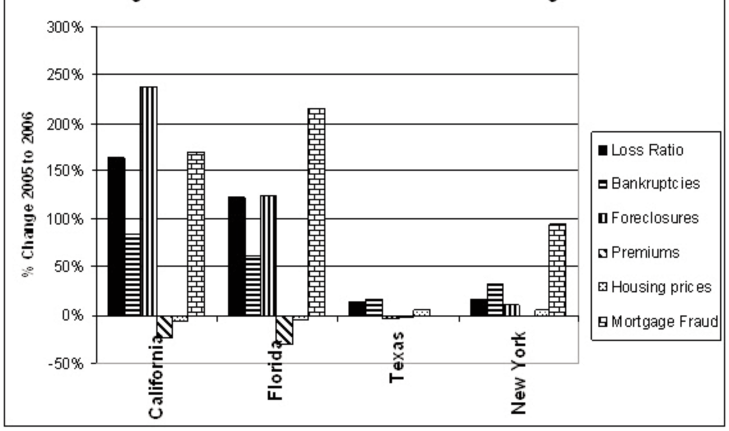


FIGURE 5

Relationship of Changes in Calendar Year Loss Ratio and Changes in Indicators of Economic Stress - Four Largest States



problems are concentrated in markets which are heavily infested with news organizations. Chicken Little is on a rampage.

GEOGRAPHIC VARIATION

Table 2 presents individual state calendar year loss ratios for the years 2006 and 2007. Figures 2 and 3 present maps of the 2006 and 2007 data, respectively. Table 3 and Figure 4 present the percentage changes in the loss ratios between these years. The data indicate that there are a number of state "hot spots" where calendar year loss ratios increased much more sharply than did the national average. These extreme changes suggest that losses have increased in those states on a policy year basis as well.

Table 4 presents the changes from 2006 to 2007 in the economic indicators most closely associated with the mortgage meltdown, along with the loss ratio changes from Table 3. There is no statistically significant relationship, positive or

TABLE 4

ECONOMIC FACTORS GENERALLY RELATED TO "MORTGAGE MELTDOWN"

State	Change in Loss Ratio 2006 to 2007	Change in Bankruptcies	Change in Foreclosures	Change in Revenue	% Change in House Prices During 2007
Alabama	-2%	21%	82%	-2%	5.97
Alaska	167%	12%	55%	-8%	4.45
Arizona	97%	40%	151%	-23%	3.63
Arkansas	117%	24%	26%	-18%	-2.4
California	165%	85%	238%	-23%	-6.65
Colorado	65%	55%	30%	-8%	1.37
Connecticut	78%	17%	100%	-8%	0.81
Delaware	253%	30%	225%	12%	1.87
District of Columbia	51%	30%	608%	-3%	1.95
Florida	121%	61%	124%	-30%	-4.69
Georgia	47%	22%	31%	-11%	2.55
Hawaii	208%	44%	89%	-20%	2.01
Idaho	212%	31%	141%	-15%	2.73
Illinois	22%	34%	25%	-13%	4.55
Indiana	23%	38%	11%	-6%	1.95
Iowa	-29%	44%	115%	0%	1.47
Kansas	269%	27%	21%	-5%	2.54
Kentucky	-21%	39%	23%	4%	3.51
Louisiana	-24%	27%	152%	10%	4.14
Maryland	53%	43%	455%	-19%	0.8
Massachusetts	1%	63%	161%	-11%	1.91
Michigan	8%	36%	68%	-20%	-4.27
Minnesota	154%	48%	127%	-23%	-1.15
Mississippi	448%	27%	92%	6%	2.46
Missouri	-3%	36%	81%	-4%	4.12
Montana	5%	2%	29%	0%	6.9
Nebraska	-26%	29%	31%	-6%	4.85
Nevada	458%	98%	215%	-26%	7.87
New Jersey	15%	42%	34%	-15%	-0.61
New Mexico	-59%	35%	-26%	-15%	-0.27
New York	16%	33%	10%	0%	5.39
North Carolina	46%	14%	67%	4%	-5.86
Ohio	27%	43%	88%	-16%	-0.42
Oklahoma	33%	28%	-13%	3%	5.13
Oregon	52%	19%	12%	-10%	3.85
Pennsylvania	61%	25%	-11%	-8%	2.83
Rhode Island	170%	73%	154%	-18%	-2.56
South Carolina	28%	18%	-28%	-5%	3.77
Tennessee	-17%	20%	25%	0%	4.14
Texas	14%	17%	-5%	-3%	5.21
Utah	69%	20%	-26%	0%	9.27
Vermont	-57%	37%	36%	-6%	0.81
Virginia	95%	47%	456%	-17%	2.41
Washington	57%	30%	28%	-10%	5.44
West Virginia	331%	48%	30%	-2%	1.94
Wisconsin	213%	38%	131%	-15%	3.04
Wyoming	180%	15%	22%	13%	8.27

SOURCES: Change in loss ratios from Table 3.
Change in bankruptcies from Federal Judiciary Quarterly Bankruptcy Reports
Change in foreclosures from Realty Trac
Change in premiums from ALTA Annual Statement (Form 9) composites
Change in housing prices from Office of Federal Housing Enterprise Oversight

negative, between the change in the state-level calendar year loss ratio and the change in foreclosures or the decline in home prices, and there is only a marginally statistically significant relationship between the change in the loss ratio and the change in the number of bankruptcies.

But correlation coefficients do not tell the whole story. When only the largest title insurance states are considered, a somewhat different picture emerges. The four largest states in terms of title insurance premiums are California, Florida, Texas and New York, in that order. Together they account for 47% of total U.S. title insurance premiums. The next largest state has only half the premiums of New York. Figure 5 charts the data of Table 4 for these four states. The results are striking:

1. Two states, California and Florida, have loss ratios that increased well over 100%, compared to the U.S. average of 67%. Two others, Texas and New York, have loss ratios that increased by only about 15%, well below the U.S. average.

2. The two states with large loss ratio increases experienced a 60% to 85% increase in bankruptcies, a doubling or tripling in foreclosures, a 20% to 30% decline in premiums, a 4% to 6% decline in housing prices and a rate of mortgage fraud about twice the national average. The two states with small increases in loss ratios experienced small changes in bankruptcies and foreclosures, almost no change in premiums, an increase in housing prices and below average levels of mortgage fraud.[9]

Many smaller states have experienced the same combinations of high loss ratios with high economic distress indices and low loss ratios with low economic distress indices. Table 5 lists the states with these expected combinations. Thus, while the

[9] Mortgage fraud statistics are analyzed by the Mortgage Asset Research Institute (MARI) on an annual basis. MARI computes a mortgage fraud index which compares the fraction of total U.S. mortgage frauds occurring in a given state with the fraction of all U.S. mortgage loans originated in that state during the year. See Sharick, M., Butts, Donahue, M., and Larson, N., "Tenth Periodic Mortgage Fraud Case Report to the Mortgage Bankers Association," March 2008.

TABLE 5

STATES WITH EXPECTED RELATIONSHIP BETWEEN LOSS RATIO CHANGES AND ECONOMIC STRESS

High Loss High Stress	**Low Loss Low Stress**
Arizona	Colorado
California	Illinois
Connecticut	Indiana
Delaware	Kentucky
Florida	Maine
Hawaii	Michigan
Idaho	Montana
Minnesota	Nebraska
Mississippi	New Jersey
Nevada	New Mexico
New Hampshire	New York
Rhode Island	Oklahoma
South Dakota	Oregon
Virginia	Pennsylvania
Wisconsin	South Carolina
	Tennessee
	Texas
	Utah
	Vermont
	Washington

TABLE 6

STATES WITH ANOMALOUS RELATIONSHIP BETWEEN LOSS RATIO CHANGES AND ECONOMIC STRESS

High Loss Low Stress	**Low Loss High Stress**
Alaska	Alabama
Arkansas	District of Columbia
Kansas	Georgia
North Dakota	Iowa
West Virginia	Louisiana
Wyoming	Maryland
	Massachusetts
	Missouri
	North Carolina
	Ohio

country as a whole has not experienced a great increase in losses, losses in many title insurance states, including the two largest, appear to have been adversely affected by the collapse of their localized housing bubbles.

Thirty-five states exhibit this expected relationship between loss ratios and economic conditions, but sixteen do not. Table 6 lists the states exhibiting anomalous behavior. This behavior raises two interesting questions:

1. Why have six states with no economic indices of economic stress experienced large increases in their loss ratio, and

2. Why have ten states with strong indices of economic distress experienced little if any increase in their loss ratios?

The answers are not clear. Indeed, there may be no answer. These sixteen states together account for only about 13% of total premiums, and each state individually experiences few enough losses that an increase in any given year may reflect nothing more than a statistical fluctuation. For the great preponderance of U.S. title insurance state markets, representing 87% of premiums, the expected relationship between increased economic stress and increased loss ratios holds.

THE FUTURE

So what happens next?

Mark Twain observed that "It is difficult to make predictions, especially about the future." However, economic history does provide at least some guidance. Periods of loose credit recur frequently, and are always followed by periods of financial retreat. The agricultural panic of 1893, the banking crisis of 1907, the Great Depression, the farm bankruptcy epidemic and the S&L collapse of the 1980's all have their roots in too much debt. The U.S. economy is now in hock again.

Fortunately, this doesn't mean that another Great Depression is at hand. We have learned a great deal about managing financial crises since the 1930's. The stock market crashed 25% overnight in 1987, and nothing much happened. Virtually all S&L's went out of business in the 1980's, and breadlines failed to appear. It is highly unlikely that claims attorneys will be selling apples on the street corners.

What we can anticipate is a return to financial prudence – at least temporarily. But experience also teaches that flights to safety are always followed by flights to avarice. Keep your seat belts fastened.

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