THE ROLE OF THE MONOLINE REQUIREMENT IN ASSURING TITLE INSURANCE EFFECTIVENESS

By

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Report to

The American Land Title Association

December 1, 2004

Updated June 20, 2007

EXECUTIVE SUMMARY

A "monoline" requirement, i.e., the statutory restriction of companies writing a particular line of insurance to writing ***only*** that line, occurs today in just two property-casualty lines: title insurance and mortgage guaranty/financial guaranty insurance. In light of the current trend toward the elimination of specialization for all types of financial institutions, we have investigated whether the monoline restriction still makes sense for title insurance. Our principal findings are that:

- The cyclical history of monoline vs. multiline insurance practice demonstrates that these different modes of regulation are popular at different times. Monoline restrictions gain popularity as a "flight to safety" in the wake of some disaster. Multiline permissions gain popularity as a "flight to convenience" as the memory of disaster fades, and remain in effect until the next disaster strikes.

- Multiline authority is not universal. The separation between life insurance and property-casualty insurance continues today, and is universally recognized as good public policy.

- The term covered by the single premium collected for a title insurance policy is the duration of property ownership or the term of a real estate loan. The failure of a title insurance company affects not just insureds who have recently paid a premium, but all title insurance customers for decades past. In this respect, the title insurer is much more like a life insurer than a property-casualty insurer, and requires a similar level of solvency protection.

- ***Monoline*** title insurers have had about the same 1% to 2% insolvency rate as other property-casualty insurers. ***Mutliline*** title insurers, which wrote title and mortgage guaranty insurance, suffered a 72% insolvency rate during the Great Depression.

- A Great Depression is extremely unlikely to recur, but the experience of the 1980s shows that periods of financial instability and plunging real estate prices were not a one-time Depression occurrence. The relative debt load borne by today's economy is very close to that of the period immediately preceding the Depression. Foreclosure rates have increased by a factor of 3 since 1980. Bankruptcies per capita have increased by a factor of 4 since 1980. During the 1980s, mortgage guaranty insurers experienced a 203% loss ratio and a 72% drop in their contingency reserves. Accordingly, writing title insurance in conjunction with mortgage guaranty insurance under today's highly stressed financial conditions would put title insurers and their insureds at great risk.

- The non-title insurance companies who have attempted to offer title insurance products specialize in high-risk lines, have no title insurance underwriting experience, and have a much lower aggregate surplus than the title insurance industry. They can neither increase the insured's safety nor deliver the same quality of product as can a title insurer.

- In summary, the monoline restriction for title insurance continues to constitute sound economic and regulatory policy.

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His work in title insurance includes the development of statistical and financial reporting systems adopted as the basis of title insurance regulation in dozens of states. He has testified on title insurance issues before state insurance departments, legislative committees, and the US Department of Housing and Urban Development. During 1993, he served as Coordinator of industry and consumer advisors to the Title Insurance Working Group of the National Association of Insurance Commissioners. He also serves as a consultant to various individual title insurance underwriters and underwritten title companies in areas including loss control, reserve analysis, strategic planning, and mergers and acquisitions. He is a frequent contributor to ALTA publications, and is the author of a book on the industry, ***The Regulatory Economics of Title Insurance***, published in March of 1994 by Praeger Publishers and now in its second printing.

In addition to his work in the title insurance area, Dr. Lipshutz has studied the economics of many other industries, including the pulp and paper industry, the pesticide industry, the automobile industry, and the mortgage insurance industry. He has presented testimony on economic issues before the President's Council on Wage and Price Stability, the US International Trade Commission, the US Environmental Protection Agency, Federal and State courts, and the American Arbitration Association.

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I. INTRODUCTION

A "monoline" requirement, i.e., the statutory restriction of companies writing a particular line of insurance to writing ***only*** that line, occurs today in only two property-casualty lines: title insurance and mortgage guaranty/financial guaranty insurance. In light of the current trend toward the elimination of specialization for all types of financial intermediaries, from commercial banks to mortgage lenders to insurance companies to investment houses, it is important to examine whether the monoline restrictions still make sense. The present study examines this important question for the case of title insurance.

We first examine the evolution of monoline requirements over time in the context of the economic and institutional conditions prevailing then and now. We next identify the crucial factors that militate for or against monoline restrictions. We then project the consequences that would be likely to follow from the elimination of the monoline requirement for title insurance, drawing on historical experience in title insurance and in other financial industry sectors. Based on these analyses, we draw some conclusions on the advisability of maintaining the monoline requirement for title insurers.

II. HISTORY OF MONOLINE RESTRICTIONS

The number of different coverages that U.S. insurance companies have been permitted to offer exhibits a cyclical pattern over time, with alternating waves of specialization and generalization.

Until the end of the 18^{th} century, U.S. insurance was generally restricted to Lloyds-like underwriting syndicates to provide marine insurance. There were two exceptions. In 1736, the Friendly Society was organized as a mutual fire insurance company in Charleston, South

Carolina. The company failed and was unable to pay all its claims when a conflagration occurred in 1740. In 1752, the Philadelphia Contributorship for the Insurance of Houses from Loss by Fire was organized by Benjamin Franklin, and is still in business today.[1]

This initial monoline structure was quickly augmented by multiline companies. In 1792, the Insurance Company of North America was organized to insure fire and marine risks and also to provide life insurance.[2] In 1798, similar multiline charters were granted to the United Insurance Company of the City of New York and to the New York Insurance Company for Maritime Insurance, Houses, Goods, and Lives.[3] Over the next 37 years, a large number of multiline insurers were chartered as the U.S. economy grew.

The trend toward multiline insurers began to slow on December 16, 1835 when a massive fire destroyed 648 buildings in the New York City business district. The aggregate loss was $18 million (equivalent to $248 million today), and 23 of the 26 insurance companies in New York went insolvent.[4] Over the next 15 years, a series of fire and marine disasters struck the insurance industry, driving a large number of multiline insurers into insolvency and rendering worthless the life insurance policies they had issued. In consequence, in 1849, New York passed a statute precluding any insurer writing fire and/or marine insurance from writing life insurance. In 1853, another statute was enacted splitting fire and marine insurers.[5]

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[1] Bogardus, John, "Spreading the Risks – Insuring the American Experience," Chevy Chase, Posterity Press, 2003, pp. 13-18

[2] Pugh, William, "Multiple Line Regulation," Chapter 22 in Kimball, S. and Denenberg, H, eds., "Insurance, Government, and Social Policy," Homewood, Irwin, 1969, pg. 244

[3] Harbison, Hugh, "Legal Environment for All Lines Insurance," Chapter II in "All Lines Insurance," Homewood, Irwin, 1960, pp.14-15

[4] Ibid., pg. 15

[5] Bogardus, op. cit., pg. 43

As liability insurance and other casualty lines developed over the next half century, the monoline approach was extended to separate casualty companies as well.[6] In fact, the general need for monoline restrictions was adopted by the National Convention of Insurance Commissioners (later the National Association of Insurance Commissioners or NAIC) in 1891 as their fifth recommendation:

> "The principle embodied in the laws of many of the States, that an insurance company organized under the laws should confine its transactions to one kind of business, your committee believe to be a safe and wise one, and that there is an abundance of business of any of the kinds, that now employ the attentions of the various companies, to occupy the energy and vigilance of any one set of officers. And especially should no two kinds of business be allowed in any one company, except such as are now akin, and in which the maturity of the policy depends upon the happening of similar events."[7]

This monoline principle was no sooner enunciated than pressures began to build to break it down. The NAIC, then as now, could recommend but it could not legislate. Insurance legislation in most states generally preserved the tripartite division of life & health, fire and marine, and casualty. Some other states did not require such a separation. However, the variation in state practice was vitiated in large part because New York, which was firmly in the monoline camp, required that companies doing business in New York abide by New York's monoline rules for their entire nationwide business. This requirement was known as the Appleton Rule in honor of Deputy Superintendent Henry D. Appleton during whose tenure it was promulgated, and is now incorporated in Section 1106 of the New York Insurance Code.[8] Operating on a monoline basis

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[6] Pugh, op. cit., p. 244

[7] "Proceedings of the 22nd National Convention of Insurance Commissioners of the United States," St. Louis, Daly, 1891, p. 53

[8] Harbison, op. cit., p. 18. Section 1106 Subsection 3(c) reads:" No foreign insurer shall be licensed to do in this state any kind of insurance business, or combination of kinds of insurance business, which are not permitted to be done by domestic insurers hereafter to be licensed under the provisions of this chapter. No foreign insurer shall be authorized to do business in this state if it does in this state ***or elsewhere*** any kind of business, other than an

became known as the "American system," in contrast to the multiline approach that was universal in England and continental Europe.[9]

Over the ensuing thirty years, the American system continued in effect. As new lines of insurance developed, they were incorporated into one of the three general categories on a more or less arbitrary basis. Public inconvenience attendant on having to buy several policies to cover what seemed a single risk (e.g., separate fire and windstorm policies for a home, or separate property damage and liability policies for an automobile) were somewhat ameliorated by the development of special policies incorporating multiple coverages, or by the simultaneous issuance of two policies by separate monoline companies under common ownership (known as members of an insurance "fleet.") [10]

By 1943, the fact that the monoline requirement was being overwhelmed by commercial realities led to the formation of a special NAIC study committee which recommended that the regulatory barrier between fire insurers and casualty insurers be dissolved. This recommendation was adopted by the NAIC in 1947, and incorporated into New York law in 1949.[11] Thus, 1949 marks the beginning of multiline insurance in the modern era, which continues to today.

Keep in mind, however, that multiline authority has not become universal. The separation between life insurance and property-casualty insurance has been maintained. In addition, the monoline restriction was maintained for title insurance. Further, when private mortgage

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insurance business and such business as is necessarily or properly incidental to the kind or kinds of insurance business which it is licensed to do in this state." (emphasis added) Subsection 3(d) imposes the same restriction on alien insurers.

[9] Interestingly, the term "American system" was something of a misnomer, since the Appleton rule contained a grandfather clause exception that permitted several of the largest U.S. insurers to ignore it.

[10] Harbison, op. cit. p. 24

[11] Ibid., p. 25.

insurance, which had vanished during the 1930s, was reintroduced in 1956, it, too, was subjected to a monoline requirement in most states.[12]

III. ARGUMENTS FOR AND AGAINST MONOLINE REQUIREMENTS

The primary justifications for monoline insurance are derived from considerations of solvency and equity:

- A monoline requirement for a high-risk line of insurance protects policyholders of other, inherently safer lines. This point was made particularly eloquently in 1860 by the Insurance Department of the State of New York:

  > "Life insurance in particular is a specialty; and the accumulated funds which are held by a company for a lifetime as a savings bank, in sacred trust for the widow and orphan, should never be liable to be swept away by a storm at sea or a conflagration on land."[13]

- A monoline requirement for a very safe line of insurance protects its policyholders from the risks presented by other, higher-risk lines.[14]

These overall solvency considerations give rise to a variety of other technical arguments.

- Unusual insurance lines require special expertise distinct from that needed to conduct most property-liability lines, and these skills are best maintained and developed in a monoline organization.[15]

- Only a monoline firm can isolate its surplus for the protection of policyholders.[16]

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[12] Jaffe, Dwight, "Monoline Restrictions, with Applications to Mortgage Insurance and Title Insurance," University of California at Berkeley preprint, January 27, 2004
[13] First Annual Report of the Insurance Department of the State of New York, March 1, 1860
[14] Jaffe, loc. cit.
[15] National Conference of Insurance Commissioners, Proceedings of the 22nd National Convention, Report of the Committee on the President's Address, Recommendation 5, p. 53
[16] Ibid., p. 54

- Unusual insurance lines need a special asset structure to match their special liability structure.[17]

There are two primary arguments against monoline restrictions:

- The diversification of a multiline insurer decreases its overall risk, which leads both to greater policyholder protection and to lower premiums.[18]
- A multiline insurer can develop broad coverage products that simplify the purchasing of insurance, and guarantee that there are no gaps in coverage as might occur if consumers had to purchase several different policies to cover different but related risks. The best illustrations are homeowner's and automobile insurance.[19]

In order to see how these arguments play out in practice for title insurance, it is illuminating to examine the solvency history of the title industry.

IV. INSOLVENCY RISK IN THE TITLE INSURANCE INDUSTRY

Insolvency in the insurance industry overall is rare. A recent study by A.M. Best covering the period 1969 to 2002 indicates that in prosperous times, about 1 in 200 insurance companies fail each year. In times of stress, 1 in 50 companies fail each year.[20] This performance is similar to the experience of monoline title insurers. In 1969 there were 81 title insurers operating in the United States,[21]and in 2002 there were 84.[22] Over this period, there were three title insurer insolvencies.[23]

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[17] For example, mortgage guaranty insurers invest their contingency reserves in special tax and loss bonds that permit the tax-free accumulation of large reserves. See Internal Revenue Code Section 343.3 Subpart B.
[18] This effect is incorporated in the covariance adjustment in the NAIC property-casualty risk based capital formula.
[19] Mowbray, A., Blanchard, R., and Williams, C., "Insurance," New York, McGraw-Hill, 1969, p. 273
[20] A.M. Best, "Best's Insolvency Study –Property/Casualty U.S. Insurers 1969-2002," May 2004, p. 12
[21] American Land Title Association, "1969 NAIC Form 9 Data"
[22] Corporate Development Services, "CDS Performance of Title Insurance Companies – 2003 Edition"
[23] Peninsular Title Insurance Company and Owners Title Insurance Company in Florida, and USLife Title Insurance Company of Dallas in Texas.

It is particularly important to maintain solvency for title insurers, even more than for other property-casualty lines. Most property-casualty lines write insurance for a short period of time, during which all claims occur. In contrast, the term covered by the single premium collected for a title insurance policy is the duration of property ownership or the term of a real estate loan. In consequence, the failure of a title insurance company affects not just insureds who have recently paid a premium, but all title insurance customers for decades past. This long-term obligation is reflected in the fact that most state statutes require the restoration of title insurance unearned premium reserves to income over a period of 20 years.[24] In this respect, the title insurer is much more like a life insurer than a property-casualty insurer, and it is universally accepted that separating life insurance from property-casualty insurance is sound regulatory policy.

A. Title Insurance in the Multiline Environment

Title insurers had a very different experience when they were parts of multiline companies. In the early 1930's, there were about 84 companies in the title insurance and mortgage guaranty business.[25] Of these companies, 32 were domiciled in New York. The New York domiciliary companies dominated the industry, and had a surplus as regards policyholders which constituted 67% of the industry total (see Table 1).

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[24] A.M. Best, "Title Insurance Industry Statistics," November 2000, p. 17. of the 39 states on which Best's reports, 32 have a 20 year requirement; 3 have a 15 year requirement; 2 have a 10 year requirement; and 2 have a 25 year requirement.

[25] A. M. Best & Co., "Best's Insurance Reports," 1931 – 1934 editions. The Best's Reports do not appear to report all existing title and mortgage guaranty companies in any given year. We have included all companies listed in the four additions cited. In addition, we have also included the other companies listed in Van Schieck, George S., "The Administration of the Delinquent Title and Mortgage Guaranty Companies by the New York Insurance Department," May 10, 1935, p. 18 ff.

Table 1

Title and Mortgage Guaranty Companies 1931-1933

Domiciliary State	Number of Companies	As % of Total	Surplus as Regards Policyholders	As % of Total
California	9	10.7%	39,943,530	11.7%
Illinois	1	1.2%	29,630,227	8.7%
Kentucky	3	3.6%	5,076,259	1.5%
Louisiana	1	1.2%	682,152	0.2%
Maryland	1	1.2%	1,644,174	0.5%
Massachusetts	1	1.2%	2,365,281	0.7%
Michigan	2	2.4%	2,009,294	0.6%
Minnesota	1	1.2%	1,800,000	0.5%
Missouri	1	1.2%	1,097,925	0.3%
New Jersey	21	25.0%	20,277,962	5.9%
New York	32	38.1%	228,162,812	66.8%
Oregon	2	2.4%	1,484,583	0.4%
Texas	1	1.2%	1,901,936	0.6%
Utah	1	1.2%	320,979	0.1%
Virginia	1	1.2%	957,008	0.3%
Washington	5	6.0%	3,367,961	1.0%
Wisconsin	1	1.2%	644,122	0.2%
	84	100.0%	341,366,205	100.0%

SOURCES:
Best's Insurance Reports - Casualty and Miscellaneous, 1931-1933
Additional New York companies not listed in Best's identified from Van Schiek, George S., "The Administration of the Delinquent Title and Mortgage Guaranty Companies by the New York Insurance Department," May 10th, 1935

The title and mortgage guaranty companies subject to New York law had actually started out as monoline title insurers.[26] While the 1885 legislation authorizing title insurers had somewhat ambiguous language, the 1892 New York Insurance Law clarified the monoline nature of the coverage:

> "To examine titles to real property and chattels real, to procure and furnish information in relation thereto, make and guarantee the correctness of searches for all instruments, liens or charges affecting the same; and guarantee or insure bonds and mortgages and the owners of real property and chattels real and others interested therein against loss by reason of defective titles thereto and other encumbrances thereon, which shall be known as a title guaranty corporation;"[27]

[26] Alger, George W., "Alger Report," Moreland Commissioner's Report, October 5, 1934, p. 7
[27] New York Statutes, Insurance Law of 1892, c. 690

However, in 1904, the law was revised to add the power to insure the ***payment*** of bonds and mortgages.[28] This turned out to be a catastrophic legislative error.

The legislature exacerbated its error in 1911 when it changed the requirements for investment activities of title and mortgage guaranty insurers to include trading in mortgages.[29] The title and mortgage guaranty companies immediately expanded their activities to include the mortgage banking business, and were the issuers and guarantors of mortgage participation certificates that worked exactly like the mortgage-backed securities (MBS's) which play such an important role in mortgage finance today.

The onset of the Great Depression in 1929 had little impact on the title and mortgage guaranty insurers. However, by 1931 spiraling unemployment produced a blizzard of mortgage defaults, and real estate prices began to plummet. The unemployment rate rose from 3.2% in 1929 to 16.3% in 1931, to 24% in 1932 and 25% in 1933.[30] The number of foreclosures more than tripled, from 68,100 in 1926 to 252,400 in 1933. [31] The value of the foreclosed properties dropped by 20%.[32] Understandably, the holders of mortgage participation certificates attempted to cash them in. But, as the New York Insurance Commissioner noted later:

> "And yet, as it is seen in retrospect, the danger was ever present that if a great number of investors at the same time refused to renew their mortgages or certificates when they became due and demanded payment, there must develop the same crisis that occurs when there is a run on a bank."[33]

Develop it did.

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[28] Alger, op.cit., p 7
[29] New York Statutes, Insurance Law of 1911 c. 525, Section 170
[30] U.S. Bureau of the Census, "Historical Statistics of the United States – Colonial Times to 1970," p. 126, Series D 1-10
[31] Ibid., p. 651, Series N 310.
[32] Ibid., p. 647, Series N 259-261
[33] Van Schieck, op. cit., p.3

Pursuant to emergency legislation passed during 1933, the New York Commissioner seized 21 companies out of the 32 title insurance and mortgage guaranty companies doing business in New York, companies which represented 74% of the total surplus as regards policyholders of the New York industry (see Table 2).[34] Most of the companies were ultimately liquidated for the benefit of the investors in mortgage participation certificates. However, in six cases, the title insurance pieces of the businesses were split off as monoline title insurers that continued in business.[35]

Table 2

Status of New York Domiciliary Title and Mortgage Guaranty Insurers 1935

	Number of Companies	As % of Total	Surplus as Regards Policyholders	As % of Total
All Companies	32	100%	228,162,812	100%
In rehabilitation or liquidation	23	72%	169,562,537	74%
Solvent	9	28%	58,600,275	26%

SOURCE: Van Schiek, George S., "The Administration of the Delinquent Title and Mortgage Guaranty Companies by the New York Insurance Department," May 10th, 1935

It would be easy to dismiss this experience as an anomaly of the Great Depression, inconceivable today. Unfortunately, that is not the case. In the absence of monoline regulation of title insurers, we would have come perilously close to similar disasters during the S&L crisis of the 1980's and even as recently as two years ago.

[34] Ibid., p. 18 ff.
[35] Ibid., table following p. 18

B. Financial Crises of the 1980's

The basic economic process that led to the collapse of the multiline title insurance-mortgage guaranty companies in the 1930's was an explosion of mortgage foreclosures driven by surging unemployment followed by a precipitous decline in the value of the seized collateral as home prices plummeted and bank credit became unavailable. A similar scenario played out in the U.S. in the 1980's, particularly in the Southwest.

From 1986 to 1988, the unemployment rate rose from 6% to 9% in Texas, to 13% in Louisiana, to 8.5% in Oklahoma, to 7.5% in Arkansas, and to 9% in New Mexico.[36] Housing prices in the West South Central region dropped by 14% between the second quarter of 1986 and the fourth quarter of 1988.[37] This drop in value was sufficient to extinguish the equity of many homeowners with high loan-to-value mortgages who defaulted on these mortgages and simply walked away from their properties, leaving lenders and the mortgage insurers holding the bag. This situation is identical to what happened during the Great Depression. In describing the collapse of the title and mortgage guaranty insurers in the early 1930's, the Alger Report noted:

> "The practice of not setting up proper reserves is objectionable at all times, but ***it becomes one of real danger in the case of these companies in times of depression of real estate values, when some mortgagors prefer to discontinue interest and tax payments and lose their sometimes non-existent equity in the property***, in order to benefit from the income from it."(emphasis added) [38]

As the S&L collapse proceeded, the loss ratio of mortgage guaranty insurers rose to 203%, and 72% of the industry's contingency reserve was exhausted.[39]

[36] Bureau of Labor Statistics, Seasonally Adjusted Unemployment Rates
[37] Office of Federal Housing Enterprise Oversight housing price index
[38] Alger, op.cit., p. 41
[39] Mortgage Insurance Companies of America, "Fact Book," 1980-2003. The industry's contingency reserve dropped from $1.158 billion in 1984 to $321 million in 1987.

The mortgage guaranty industry survived the crisis, but it was a difficult period. Had title insurance been combined with mortgage guaranty insurance, the situation would have been even worse. During the 1980's, the title insurance industry suffered two outright insolvencies, those of Owner's Title Insurance Company and USLife Title Insurance Company of Dallas. In addition, the then largest title insurer, Ticor, suffered such severe surplus depletion that it had to be rescued by acquisition.[40]

C. Dodging the Bullet – The Reliance Insurance Debacle

From 1975 until 1998, Commonwealth Land Title Insurance Company was a subsidiary of the Reliance Insurance Company.[41] Commonwealth is one of the oldest and largest title insurers. When Reliance sold off Commonwealth and Comonwealth's wholly owned subsidiary, Transnation Title Insurance Company, Commonwealth had a consolidated annual volume of about $1 billion in premium out of an industry total of $8 billion. Its overall market share of about 12% understates the company's importance, since its share of market was much higher in individual states (e.g., 45% in Delaware, 40% in Rhode Island, 20% in Maryland, and 19% in Pennsylvania).[42] At the same time, Reliance also divested itself of Commonwealth Mortgage Assurance Company, a monoline mortgage guaranty insurer.

Within two years of the divestiture of Commonwealth, Reliance was in desperate trouble. In response to a downgrade from A.M. Best, Reliance merged all its subsidiaries into the parent in a fruitless attempt to buttress its surplus. The Pennsylvania Insurance Department seized the company on May 29, 2001; and on October 3, 2001 the company was placed in liquidation.[43]

[40] Ticor was acquired by Chicago Title Insurance Company in 1991.
[41] National Title –Duluth website, "Title Insurance – An American Tradition"
[42] Corporate Development Services, "CDS Performance of Title Insurance Companies – 1999 Edition"
[43] Philadelphia Inquirer, October 4, 2001

The list of companies Reliance Insurance absorbed in desperation is illuminating. In addition to several diversified property-liability insurers, Reliance also absorbed its surety company and its indemnity company.[44] The Order of Liquidation did not unroll the subsidiary mergers, but applied to all the merged subsidiaries. Once the subsidiaries were in the pool, they were all doomed.

What would the consequences for title insurance have been if Reliance had held onto Commonwealth for two more years? In the actual monoline environment, Reliance would have been prohibited from merging a title insurer into the parent, and nothing would have happened to the title insurance market. But if no monoline statute were in place, Reliance would have merged its title insurer in as well, would have dragged 12% of the national title insurance business into confusion, and would have devastated the markets in states in which Commonwealth had a high market share.

The risk to the real estate markets from a single title insurer failure is not confined to the case of Commonwealth. There are 2,850 property-casualty insurance companies,[45] but only about 84 title insurers. Further, industry consolidation over the past two decades has placed the companies covering about 90% of all title insurance risks into only five ownership groups.[46] Even the small companies outside the three major groups can play a very large role in particular

[44] Pennsylvania Insurance Department, Order of Liquidation, October 3, 2001. The merged companies included Reliance National Indemnity Company, Reliance National Insurance Company, United Pacific Insurance Company, Reliance Direct Company, Reliance Surety Company, Reliance Universal Insurance Company, United Pacific Insurance Company of New York, and Reliance Insurance Company of Illinois.
[45] A. M. Best & Co., “Best’s Insolvency Study,” May 2004, p. i
[46] Demotech, “Performance of Title Insurance Companies – 2007 Edition,” p. 120. The five company groups are Fidelity National Financial, First American Financial; LandAmerica, Old Republic; and Stewart Information Systems.

states. For example, in 2006 Investor's Title Insurance Company had a 20% share of the North Carolina market; and the Attorney's Title Insurance Fund had a 19% market share in Florida.[47]

V. EXPECTED IMPACTS OF REMOVING THE MONOLINE RESTRICTION FOR TITLE INSURANCE

The cyclical history of monoline vs. multiline insurance practice demonstrates that these different modes of regulation are popular at different times. Monoline restrictions gain popularity as a "flight to safety" in the wake of some disaster. Multiline permissions gain popularity as a "flight to convenience" as the memory of disaster fades, and remain in effect until the next disaster strikes. Accordingly, in considering the advisability of continuing monoline regulation for title insurance at the present moment, it is important to consider the current economic situation (including both macroeconomic factors and institutional factors) to determine whether present conditions would present a high or low risk of difficulties for multiline title insurers.

A. Solvency Risk Prospects in the Current Economy of Multiline Combinations of Title Insurance with Mortgage Insurance and Financial Guaranty Insurance

Title insurance products have been offered in recent years by at least eight non-title insurers.[48] The most widely known product is the so-called "lien protection policy" offered by Radian Guaranty, Inc., which is primarily a mortgage insurance and financial guaranty insurance company. Regulators in a large number of jurisdictions have disapproved the product, based on the existing monoline restriction on title insurance. Accordingly, it is worth re-examining whether the legal monoline restriction also makes economic sense today when applied to a title insurance-mortgage guaranty insurance combination.

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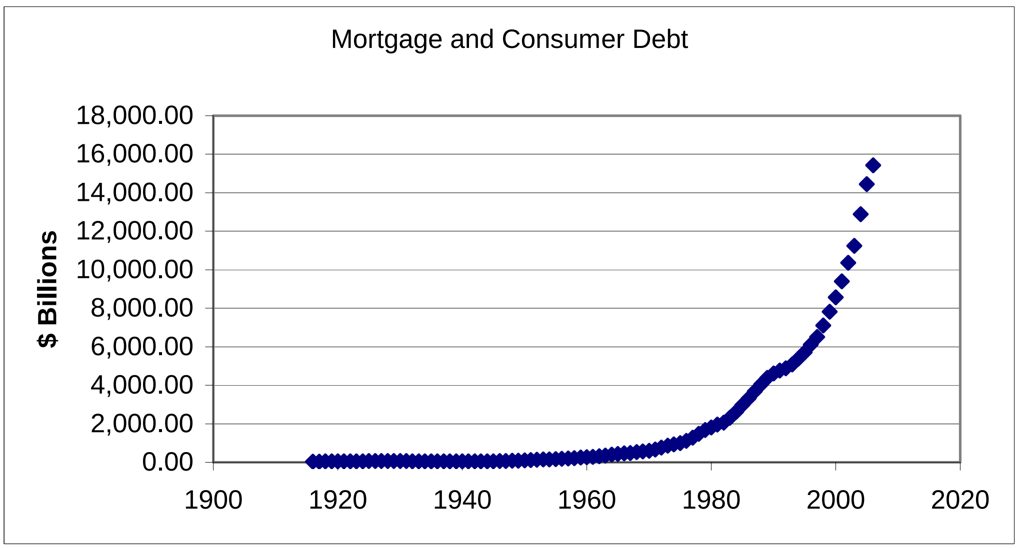
[47] Ibid., Section Three

[48] See American Land Title Association website. The companies include Norwest Mortgage, Radian Guaranty, Chubb Custom Insurance, Great American, BancInsure, St. Paul Medical Liability, Fidelity and Deposit of Maryland, and United States Liability Insurance.

The cause of economic downturns is a subject of continuing debate. But no matter which theory of business cycles one adopts, the heart of the financial consequences of such downturns is the inability of borrowers to service their debt.

The debt load in the U.S. economy has reached truly astounding proportions. Figure 1 presents total mortgage debt and consumer credit over the period 1961 to 2006.[49] Since 1961, this debt has grown by a factor of 42.

FIGURE 1



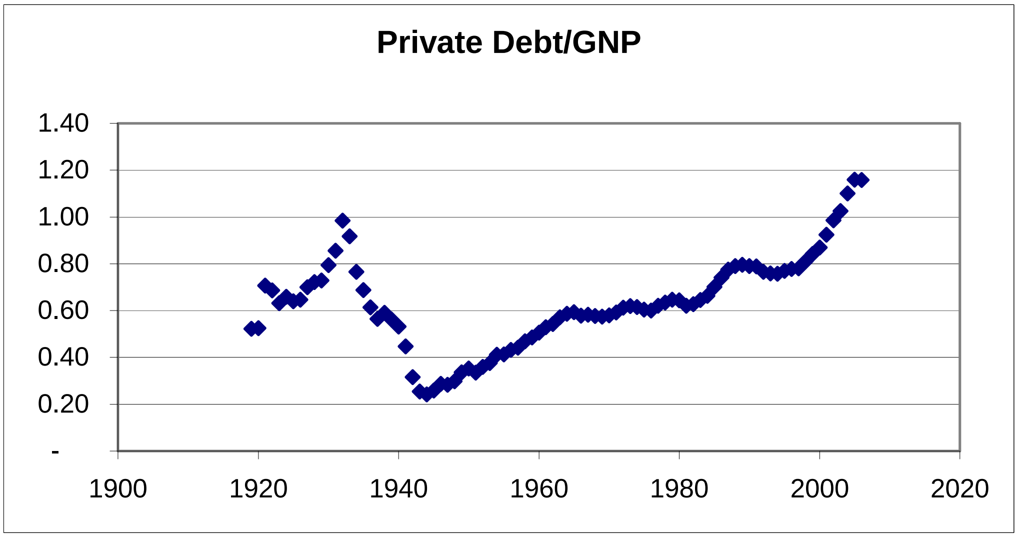
Of course, the economy has also grown enormously over the same period.[50] A better measure of the relative private debt load being born by real property purchasers is the ratio of mortgage and consumer debt to the gross national product. In terms of this metric, the current debt level is not unprecedented. Unfortunately, this is not a cause for rejoicing. Figure 2 presents the ratio of total

[49] Bureau of the Census, "Historical Statistics of the United States Colonial Times to 1970," U.S. GPO, Series X 393-409 p. 989 and Council of Economic Advisors, "Economic Report of The President 2007," U.S. GPO, Tables B-75 and B-77

[50] Bureau of the Census, "Historical Statistics of the United States Colonial Times to 1970," U.S. GPO, Series F 1-5 p. 224 and Council of Economic Advisors, "Economic Report of The President 2007," U.S. GPO, Table 1

mortgage debt and consumer credit to gross national product over the period 1916-2006. ***It is sobering to note that debt compared to GDP is now 60% higher than it was in 1929.***

FIGURE 2



Signs of strain have already emerged. Through 2005, personal bankruptcies constituted over 95% of all bankruptcy filings.[51] Since 1950, the annual number of bankruptcies had increased by a factor of 50 (see Figure 3). Since 1980, the number of bankruptcies per capita had been growing at an average rate of 7.6% per year (see Figure 4).

[51] Hansen, Bradley A. and Hansen, Mary Eschelbach, "The Transformation of Bankruptcy in the United States," American University preprint, 2004

FIGURE 3

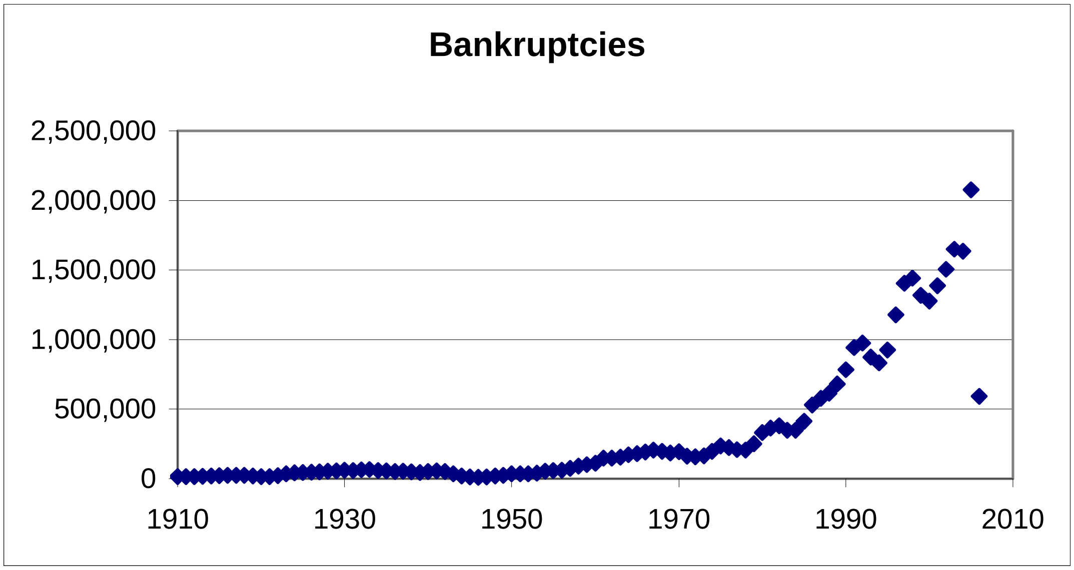
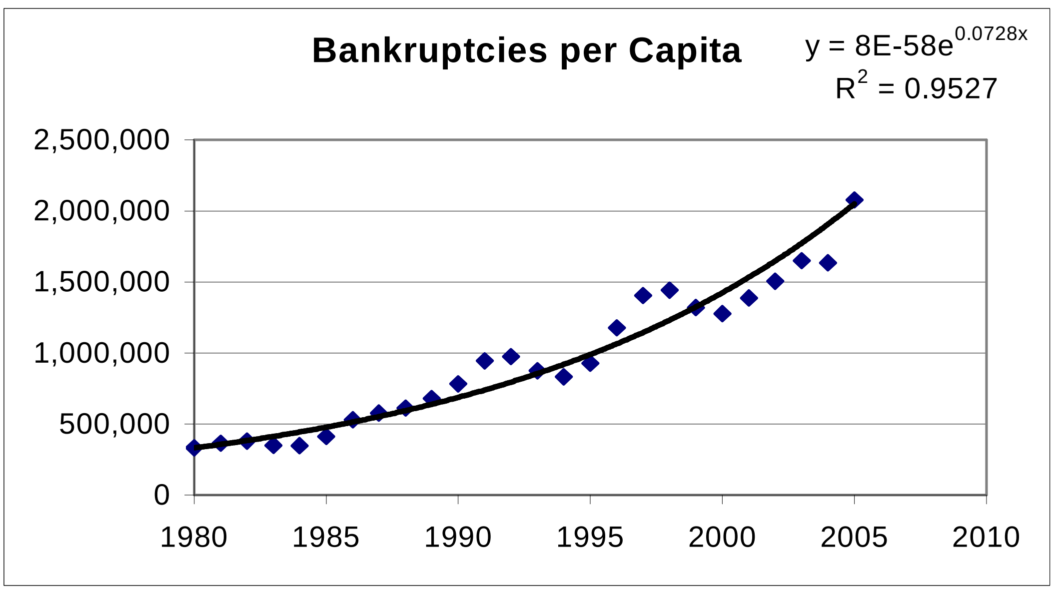
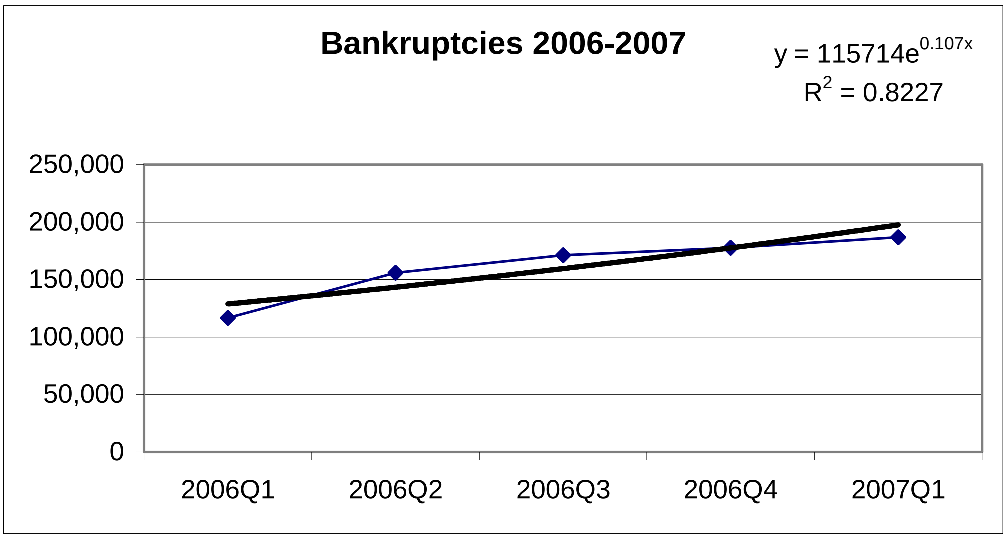


FIGURE 4



The revision of the bankruptcy laws effective in 2006 led to a precipitous drop in the number of bankruptcy filings, as demonstrated by Figure 3. This reduction, of course did not indicate any lessening of the financial strains affecting the economy. In fact, financial strains continue to increase, and the number of bankruptcies immediately began to increase again. Figure 5 shows that since the first quarter of 2006, bankruptcy filings have been increasing at an annual rate of 53%.

FIGURE 5



At the same time, mortgage foreclosures have also been rising.[52] In the post-Depression period, annual foreclosure rates averaged around 0.25% until the 1980's. Since 1980, foreclosure rates have increased by a factor of 10, rising to an annualized rate of 2.43% in the first quarter of 2007 (see Figure 6).[53] The last period in which foreclosure rates were this high was the 1930's.

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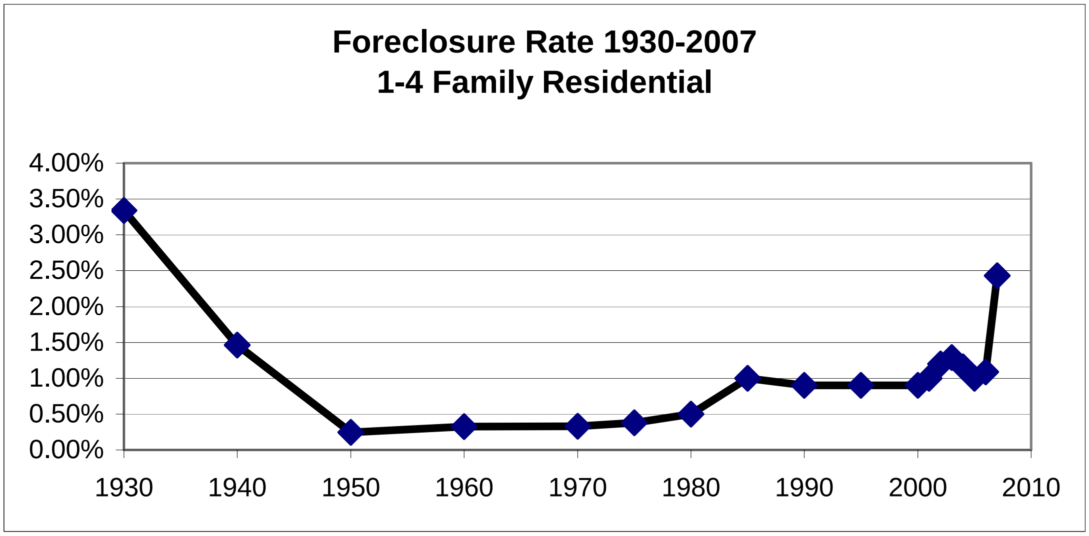
[52] Elmer, Peter. J. and Seelig, Steven A., "The Rising Long-Term Trend of Single Family Mortgage Foreclosure Rates," FDIC Working Paper 98-2, Federal Deposit Insurance Corporation, 1998

[53] Historical Statistics of the United States, Series N 301 divided by Series N 302-307, p. 651 for 1930-1970; Mortgage Bankers Association, "National Delinquency Survey," various years.

FIGURE 6



The current annual rate of foreclosures on residential mortgages is about 2.43%,[54] which corresponds to over 1 million foreclosures per year.[55] The foreclosure rate in 1933 was about 5%.[56] ***If we were to experience the 1933 rate of foreclosures today, it would correspond to two million foreclosures per year.***

No responsible observer anticipates a recurrence of the Great Depression. Techniques of public financial management and regulatory supervision have improved immeasurably since that time. But there is little question that the current level of debt is placing an enormous strain on the economy's power to generate enough income to service the rising debt level. It is in precisely these circumstances that defaults on debt rise most quickly, and the greatest strain is placed on guarantors of financial payments. ***Under current circumstances, allowing a multiline combination of title insurance and mortgage guaranty or other financial guaranty insurance would be the height of imprudence.***

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[54] Mortgage Bankers Association, National Delinquency Survey, 2nd Quarter 2004
[55] Bureau of the Census, "American Factfinder," Table QT-H15 indicates that there were 39 million home mortgages outstanding in 2000.
[56] I.e., the 253,000 foreclosures in 1933 divided by 5 million mortgages outstanding. See "Historical Statistics of the United States Colonial Times to 1970," p. 651, Series 302-307

B. Solvency Risk Prospects of Multiline Combinations of Title Insurance with Other Insurance Lines

The other companies that have attempted to offer title insurance products in a multiline environment are catchall subsidiaries of multiline insurance groups, writing a variety of specialty coverages.[57] Table 3 lists the companies. The companies have policyholders' surplus ranging from $14 million to $340 million, which makes them much smaller than the primary title insurers. ***In aggregate, these companies have about one-fifth of the surplus of the monoline title insurance industry.***

TABLE 3

NON-MORTGAGE GUARANTY COMPANIES OFFERING
ALTERNATIVE LIEN PROTECTION PRODUCTS

COMPANY	2003 Statutory SURPLUS
Chubb Custom Insurance Company	56,618,000
Great American	14,112,000
BancInsure/Matterhorn	30,237,000
St. Paul Medical Liability Company	47,622,000
Fidelity and Deposit of Maryland	165,944,000
United States Liability Insurance Co.	336,605,000
TOTAL	651,138,000
Title Industry	3,252,036,665

SOURCES:
Best's Insurance Reports - Property-Liability Edition, 2004 for property liability companies.
Demotech, Performance of Title Insurance Companies - 2004 Edition for title industry.

On the other hand, these companies are members of company groups that are much larger than most title insurers. An immediate question that arises, therefore, is whether the large size of the parent fully compensates for the small size of the subsidiary. The answer, of course, is partially but not completely. The recent A.M. Best study of insurer insolvencies indicates that

[57] The American Land Title Association website lists the companies and includes sample policy descriptions.

8% of all insurer insolvencies over the period 1991-2002 were due to the insolvency of an affiliate.[58] Being a member of a larger group is not a guarantee of safety.

It is unclear why these particular companies were selected by their company groups. In several cases, it appears to have been a mere subterfuge, designed to conceal the fact that the coverage is, in fact, title insurance.[59] But it is also noteworthy that these policies were placed in companies carrying primarily errors and omissions, surety, and other specialty commercial lines, which have historically been the lines most subject to major fluctuations in rates and loss experience. Based on data compiled in Best's Aggregates and Averages, over the period 1976-2004 the operating ratio of property casualty insurance as a whole had a standard deviation of 9.1%. In contrast, medical malpractice had a standard deviation of 20.8%, allied lines had a standard deviation of 33.1%, surety had a standard deviation of 15.2%, and fidelity had a standard deviation of 15.1%.[60]

C. Impact of Multiline Writing of Title Insurance on the Quality of the Title Insurance Product

Another important issue is the quality of the title work that a multi-product casualty company would tend to produce. Underwriting a title policy is much more complicated than underwriting a casualty risk.[61] It takes only a small underwriting lapse to produce an enormous title loss, and ***36% of all titles require active underwriting intervention to cure an existing defect and prevent a loss***.[62] In recognition of this fact, title agents and escrow agents in most

[58] A.M. Best, op. cit, p. 34, Exhibit 28
[59] For example, the Great American policy and United States Liability policy are described as errors and omissions policies, and the BancInsure/Matterhorn policy is described as a performance bond.
[60] Schwartz, Alan I., Pre-Filed Rebuttal Testimony in Docket 2601, Texas Department of Insurance, August 4, 2006, Exhibit AIS-27.
[61] Lipshutz, Nelson R., "The Regulatory Economics of Title Insurance, Westport, Praeger, 1994, pp. 6-7
[62] American Land Title Association Research Committee, *Abstractor and Title Agent Operations Survey 2005*, American Land Title Association, 2006, Washington, DC

states are licensed separately from property-casualty insurance agents and, in the states with the largest title insurance markets, are required to pass specialized examinations and complete title-insurance-specific continuing education.[63] In some states, the specialized examination and licensure requirements also extend to the employees of the title insurer itself who are actively engaged in closing transactions.[64]

Whether the title underwriter is monoline or multiline would have relatively little impact on the work product of independent title insurance agents. However, about 36% of all title insurance is written by title insurer branch offices and agency subsidiaries.[65] There is certainly no theoretical barrier to a multiline insurer requiring specialized title insurance training for some of its employees. However, the practical consequence of treating title insurance as just another casualty line will inevitably be to produce mounting pressure to change licensure requirements to subsume title insurance into general casualty insurance practice. The concomitant diminution of title insurance underwriting expertise will inevitably lead to higher title losses and a progressively degrading public record.[66]

The next issue that requires some consideration is the security of the assets backing the title insurer's reserves. There are two primary classes of title insurance reserves: case-basis loss reserves and unearned premium reserves. Case-basis loss reserves need no further comment. However, it is important to keep in mind that the so-called "unearned premium reserve" for title insurers is something of a misnomer, since it actually serves the economic function of an IBNR

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[63] Palomar, Joyce, "Title Insurance Law," Thomson-West, 2004, Chapter 18

[64] Cf., e.g., Texas Insurance Code, Chapter 9, Articles 9.41, 9.58 and Texas Department of Insurance Procedural Rule P-28.

[65] Demotech, Inc., "Performance of Title Insurance Companies – 2007
4 Edition," p. 54

[66] Lipshutz, Nelson R., "The Role of Title Insurance in Mortgage Finance," Washington, D.C., ALTA, 2004

reserve. In contrast to all other property-casualty lines other than mortgage guaranty and financial guaranty, most state statutes require that the assets supporting the unearned premium reserve be sequestered and used solely for the purchase of reinsurance in the event of disaster.[67] No such special title policyholder protection would be available if title insurance were treated as simply another casualty line; the title policyholder would simply become part of the general group of casualty insureds, and would sink or swim depending on the adequacy of the overall reserves the insuring company established for all its lines. This change would represent a significant increase in the risk faced by title insurance policyholders. The A.M. Best insolvency study indicates that over the period 1991 to 2002, 49% of all insurance insolvencies were attributable to inadequate loss reserves.[68]

D. The Impact of Multiline Writing of Title Insurance on the Price of Title Insurance

Finally, we must address the real source of the developing pressure for multiline title insurers: the claim that it will reduce the cost of title insurance. The Title Insurance Working Group of the NAIC is currently studying issues including:

> "…whether monoline laws and regulations needlessly diminish competition; whether greater price competition among title insurers can be encouraged;…"[69]

In a previous study, we demonstrated that the particular title insurance product marketed by Radian Guaranty, Inc. produces no true consumer savings.[70] Here, we must address the broader question of the price impact, if any, of writing title insurance by any type of multiline company.

[67] Cf., e.g., California Insurance Code, Sections 12380-12388
[68] A.M. Best, op. cit., p. 34, Exhibit 28
[69] National Association of Insurance Commissioners Title Insurance Working Group 2005 Charges, charge d.
[70] Lipshutz, Nelson R., "Consumer Impacts Of Substituting Radian Lien Protection Coverage For Refinance Lender's Title Insurance," ALTA, 2003

Title insurance is a loss prevention line, so that rates are driven primarily by production expenses, not by loss payments.[71] Title insurance riskiness is caused primarily by the interaction of its very volatile premium stream with its high fixed costs. Therefore, any anti-covariance of title insurance losses with losses in other lines (see note 18) would produce negligible reduction in the riskiness of title insurance, and would have no impact on title insurance prices.

More importantly, the search, examination, and closing activities of the title insurance process would be the same no matter what the business mix of the insurer. While economies of scale may exist in some administrative functions, administrative expenses make up only 15% to 30% of the title insurer's cost mix.[72] Accordingly, any scale economies in overhead functions that might be produced by multiline operations would not lead to significant title insurance price declines.

VI. IMPLICATIONS FOR PUBLIC POLICY

The monoline restriction for title insurance continues to make economic and regulatory sense. Our analysis of recent insurance industry history proves that the hazards of multiline operation that caused the demise of multiline title insurers in the 1930's and the institution of monoline requirements for title insurance still exist today. Our analysis of economic history demonstrates that the combination of rapid growth and excessive debt levels that exacerbated the Great Depression is being reconstructed in the contemporary economy. If title insurers are to be immune to the problems that any substantial economic downturn will produce in this environment, it is important that the monoline requirement be maintained.

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[71] Lipshutz, Nelson R., "The Regulatory Economics of Title Insurance," Westport, Praeger, 1994, Chapter 1

[72] Title Insurance Rating Bureau of Pennsylvania, 2003 Statistical Report Results, p. 17 shows a ratio of 14%; Title Insurance Rate Service Association (New York), 2003 Statistical Report Composite, Schedules U-3, U-4, and U-5 show a ratio of 28%.