

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 695 Title Insurance
SPONSOR(S): Regulatory Affairs Committee; Boyd
TIED BILLS: **IDEN./SIM. BILLS:** CS/SB 940

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	9 Y, 0 N	Lloyd	Luczynski
2) Regulatory Affairs Committee	16 Y, 0 N, As CS	Lloyd	Hamon

SUMMARY ANALYSIS

Purchasers of real property and lenders utilize title insurance to protect their interests against claims by others to be the rightful owner of the property. Most lenders require title insurance when they underwrite loans for real property. Title insurance provides a duty to defend against adverse claims on the subject property's title, and also promises to indemnify the policyholder for damage to the lender's security interest created by a cloud on title, unmarketable title, or adverse title that was not discovered by the insurer.

Title insurers are regulated by the Office of Insurance Regulation (OIR) and are subject to the Insurance Code. Among other things, Florida law sets a statutory unearned premium reserve for title insurers to guaranty the interests of policyholders in case of insurer insolvency. The reserve is based on the amount of surplus held by the insurer. Title insurers with surplus under \$50 million must put \$0.30 for every \$1,000 of risk they retain into reserve. Those with \$50 million or more in surplus must put 6.5 percent of premium into reserve. Both must supplement their reserve with any additional amount deemed necessary by a qualified actuary. It is notable that the two calculations are based on different factors, the first on retained risk and the second on premiums written. For smaller transactions, there is little difference in the amounts that must be reserved. However, on larger value transactions, there can be significantly lower reserve requirements applicable to the title insurers with \$50 million or more in surplus. These larger surplus insurers also benefit from a reserve retention schedule that releases the reserve earlier than for the smaller surplus insurers.

Florida insurers are permitted to arrange themselves into insurance holding companies, also known as insurance holding company systems. An insurance holding company system consists of two or more affiliated entities, at least one of which is an insurer.

There are multiple private organizations that engage in the evaluation and rating of insurance companies for the purposes of identifying the financial strength of insurers. These financial strength ratings allow potential investors to make informed decisions regarding possible investment in the rated insurer. The various rating companies use similar terminology, but each has a proprietary method to establish their rating results.

The bill allows a title insurer that is a member of an insurance holding company system that has \$1 billion or more in surplus to set its guaranty fund reserve in the same manner as a title insurer that on its own has \$50 million or more in surplus. However, this exception will only be available if the insurance holding company system has a financial strength rating of "superior," "excellent," "exceptional," or an equivalent financial strength rating by a rating agency acceptable to the OIR. This allows a smaller title insurer with access to capital from its holding company to set the reserve in the same way as a larger title insurer. This sets lower guaranty fund reserve amounts on higher value policies and allows the reserve to be released earlier. Also, the bill requires title insurers that move their domicile to Florida to reset the guaranty fund reserve that they bring into Florida to the amount that would have been required if the reserve was always held in Florida, rather than maintaining and releasing the newly domesticated reserve pursuant to the law of their former state.

The bill has no impact on state revenues and local government. The bill has an indeterminate impact on state expenditures. It has an indeterminate positive impact on the private sector.

The bill is effective July 1, 2016.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Title Insurance

Title insurance insures owners of real property or others having an interest in real property, such as lenders, against loss by: encumbrance; defective title; invalidity; or adverse claim to title.¹ Title insurance is a policy issued by a title insurer that, after evaluating a search of title, insures against certain covered risks including: forgery; fraud; liens; and encumbrances on a title. It is usually taken out by the purchaser of property or an entity that is loaning money on a mortgage.

Purchasers of real property and lenders utilize title insurance to protect themselves against claims by others to be the rightful owner of the property. Most lenders require title insurance when they underwrite loans for real property. Title insurance provides a duty by the title insurer to defend against adverse claims on the subject property's title, and also promises to indemnify the policyholder for damage to the lender's security interest created by a cloud on title, unmarketable title, or adverse title that was not discovered by the insurer.²

Title insurers³ are regulated by the Office of Insurance Regulation (OIR) and are subject to the Insurance Code.⁴ Among other things, Florida law requires a title insurer to report its reserves to the OIR.⁵ An insurer's reserve is a fund of capital that it keeps to meet its best estimate of known or expected losses for claims on policies it has written or assumed.^{6, 7} In addition to reserves for known or expected losses,⁸ title insurers are required to maintain a separate unearned premium reserve fund as a guaranty against insolvency.⁹ This is because title insurers are excluded from participating in the Florida Insurance Guaranty Association¹⁰ and there is no guaranty association unique to title insurers.

In the event of insolvency, the statutory guaranty fund reserve held by the title insurer is used to fund claims on policies issued by the insolvent title insurer. Chapter 631, F.S., relates to insurer insolvency and guaranty payments and governs the receivership process for insurance companies in Florida. Federal law specifies that insurance companies cannot file for bankruptcy.¹¹ Instead, they are either "rehabilitated" or "liquidated" by the state. In Florida, the Division of Rehabilitation and Liquidation of the Department of Financial Services is responsible for rehabilitating or liquidating insurance companies as the "receiver."¹² Because of the nature of title insurance and the lack of a title insurance

¹ s. 624.608, F.S. Title insurance is also insurance of owners and secured parties of the existence, attachment, perfection and priority of security interests in personal property under the Uniform Commercial Code.

² See, e.g., AMERICAN LAND TITLE ASSOCIATION (ALTA), <http://www.alta.org> (last visited Nov. 25, 2015). ALTA is the national trade association of the abstract and title insurance industry. There are currently six basic ALTA policies of title insurance: Lenders, Lenders Leasehold, Owners, Owners Leasehold, Residential, and Construction Loan Policies. AMERICAN LAND TITLE ASSOCIATION, *Title Insurance: A Comprehensive Overview*, <http://www.alta.org/about/TitleInsuranceOverview.pdf> (last visited Nov. 25, 2015).

³ There are 18 title insurance companies participating in the state according to the OIR web site. FLORIDA OFFICE OF INSURANCE REGULATION, *Active Company Search*, <http://www.floir.com/CompanySearch/> (last visited Dec. 3, 2015), "Company Type" search term limited to "Title Insurance."

⁴ Chapters 624-632, 634, 635, 636, 641, 642, 648, and 651, F.S., constitute the "Florida Insurance Code." s. 624.01, F.S.

⁵ s. 624.424, F.S.

⁶ INSURANCE INFORMATION INSTITUTE, *Glossary*, <http://www.iii.org/services/glossary> (last viewed Nov. 25, 2015).

⁷ According to financial data published by the ALTA, nationwide aggregate statutory surplus is approximately \$3.81 billion and statutory reserve is \$3.76 billion. AMERICAN LAND TITLE ASSOCIATION (ALTA), *Industry Financial Data*, <http://www.alta.org/industry/financial.cfm> (last visited Nov. 25, 2015).

⁸ s. 625.041, F.S.

⁹ s. 625.111, F.S.

¹⁰ s. 631.52(12), F.S.

¹¹ The Bankruptcy Code expressly provides that "a domestic insurance company" may not be the subject of a federal bankruptcy proceeding. 11 U.S.C. § 109(b)(2). The exclusion of insurers from the federal bankruptcy court process is consistent with federal policy generally allowing states to regulate the business of insurance. See 15 U.S.C. § 1012 (McCarran-Ferguson Act).

¹² Typically, insurers are put into liquidation when the company is insolvent whereas insurers are put into rehabilitation for numerous reasons, one of which is an unsound financial condition. The goal of rehabilitation is to return the insurer to a sound financial

guaranty association, the receiver does not liquidate the insurer nor transfer the policy liabilities to another entity; rather, the title insurer remains in rehabilitation under the control of the receiver.

Subsection 625.111(1), F.S., sets the statutory guaranty fund reserve for title insurers based on the amount of surplus¹³ held by the insurer. For title insurers with less than \$50 million in surplus, the insurer must maintain the following reserve:¹⁴

- 30 cents for every \$1,000 of net retained liability,¹⁵ plus
- Any additional amount deemed necessary by a qualified actuary¹⁶ to meet known and anticipated losses.

For title insurers with \$50 million or more in surplus, the insurer must maintain the following reserve:

- At least 6.5 percent of direct written premiums, plus other income and reinsurance assumed, plus
- Any additional amount deemed necessary by a qualified actuary to meet known and anticipated losses.¹⁷

For title insurers from other states that choose to move their operations to Florida and become domestic title insurers in this state, the reserve requirement for reserves held at the time of the change of state is based upon the law of their prior state.¹⁸ This applies to both the timing of the releases and the amounts to be released.

In the two statutory reserve categories described above, the amount of the reserve is tied to a different base. For the smaller surplus insurers, it is a percent of the face value of the policy. For the larger surplus insurers, it is a percentage of the premium.¹⁹ The following examples highlight the difference in guaranty fund reserve requirements based on the insurer's level of surplus:²⁰

Example A: an owner's title insurance policy on a \$750,000 real estate transaction.

Statutory reserve for an insurer with less than \$50 million in surplus (based on retained liability):

Net retained liability: \$750,000 (if no premium is ceded through reinsurance)

Statutory reserve: $(\$750,000 / 1,000) \times \$0.30 = \mathbf{\$225}$

condition and release them as a going concern. The goal of liquidation, however, is to dissolve the insurer. See s. 631.051, F.S., for the grounds for rehabilitation and s. 631.061, F.S., for the grounds for liquidation.

¹³ "Surplus" is the remainder after an insurer's liabilities are subtracted from its assets. It is the financial cushion that protects policyholders in case of unexpectedly high claims. INSURANCE INFORMATION INSTITUTE, *Glossary*, <http://www.iii.org/services/glossary> (last viewed Nov. 25, 2015).

¹⁴ For unearned premiums on policies written or assumed before July 1, 1999, the amount of reserve established on June 30, 1999, applies. s. 625.111(1)(a), F.S. This is in addition to any additional amount deemed necessary by a qualified actuary. s. 625.111(1)(d), F.S.

¹⁵ "Net retained liability" means the total liability retained by a title insurer for a single risk, after taking into account the deduction for ceded liability, if any. s. 625.111(6)(b), F.S.

¹⁶ "Qualified actuary" means a person who is, as detailed in the National Association of Insurance Commissioners' Annual Statement Instructions: 1. A member in good standing of the Casualty Actuarial Society; 2. A member in good standing of the American Academy of Actuaries who has been approved as qualified for signing casualty loss reserve opinions by the Casualty Practice Council of the American Academy of Actuaries; or 3. A person who otherwise has competency in loss reserve evaluation as demonstrated to the satisfaction of the insurance regulatory official of the domiciliary state. In such case, at least 90 days before filing its annual statement, the insurer must request that the person be deemed qualified and that request must be approved or denied. The request must include the National Association of Insurance Commissioners' Biographical Form and a list of all loss reserve opinions issued in the last 3 years by this person. s. 625.111(6)(c), F.S.

¹⁷ s. 625.111(1), F.S.

¹⁸ s. 625.111(3), F.S.

¹⁹ The amount of premium is established by applying the OIR approved title insurance rate to the amount of liability written. The OIR approved rates are found in Rule 690-186.003, F.A.C.

²⁰ These examples are based exclusively on the application of the OIR approved rate to a hypothetical real estate property value, exclusive of any premium discounts, credits, or other factors.

Statutory reserve for an insurer with \$50 million or more in surplus (based on premium):

Calculated premium: \$3,825

Statutory reserve: $\$3,825 \times 6.5\% = \mathbf{\$248.63}$

Example B: an owner's title insurance policy on a \$20,000,000 real estate transaction.

Statutory reserve for an insurer with less than \$50 million in surplus (based on retained liability):

Net retained liability: \$20,000,000 (if no premium is ceded through reinsurance)

Statutory reserve: $(\$20,000,000 / 1,000) \times \$0.30 = \mathbf{\$6,000}$

Statutory reserve for an insurer with \$50 million or more in surplus (based on premium):

Calculated premium: \$46,325

Statutory reserve: $\$46,325 \times 6.5\% = \mathbf{\$3,011.03}$

As illustrated, in Example A the two reserve amounts are similar. The smaller surplus company's reserve requirement is approximately 90 percent of the amount required of the larger surplus company. In Example B, however, the larger surplus company is only required to reserve about half as much as the smaller surplus company.

The title insurer's premium reserve is released over time based on a schedule set by statute.²¹ Since title insurance policies cover an exceptionally long period of risk, the conversion of reserve to surplus occurs over a period of 20 years. The amount released from reserve each year is done quarterly in equal amounts. The statutory reserve release schedule for each of the two sizes of insurer is shown below.

For title insurers with less than \$50 million in surplus, the portion of the reserve based on retained liability is released as follows:²²

Year(s)	Percent released
1	30%
2	15%
3, 4	10%, each year
5, 6	5%, each year
7, 8	3%, each year
9 through 15	2%, each year
16 through 20	1%, each year

For title insurers with \$50 million or more in surplus, the reserve is released as follows:

Year(s)	Percent released
1	35%
2, 3	15%, each year
4	10%
5, 6, 7	3%, each year
8, 9, 10	2%, each year
11 through 20	1%, each year

²¹ s. 625.111(2), F.S.

²² The amount of reserve that is based on the additional amount needed to meet the opinion of the qualified actuary regarding necessary reserves is released on the same schedule as that provided for insurers with \$50 million or more in surplus. s. 625.111(2)(d), F.S.

The release of reserves by title insurers with \$50 million or more in surplus is somewhat more frontloaded than the other title insurers. They will have released 75 percent of the reserved amount after the first four years where the insurer with less than \$50 million in surplus will have only released 65 percent of the reserve. Following the 15th year of release, the two will have released an equal amount of reserve.

Insurance Holding Companies

Florida insurers are permitted to arrange themselves into insurance holding companies, also known as insurance holding company systems. An insurance holding company system consists of two or more affiliated entities that are subsidiaries of the holding company. One of the members must be an insurer. They are regulated by the OIR under ch. 628, Part IV, F.S. This allows the OIR to have an oversight role in the shared financial risks of the members of the insurance holding company.

Financial Strength Ratings

There are multiple private organizations that engage in the evaluation and rating of insurance companies for the purposes of identifying the financial strength of insurers.²³ These financial strength ratings allow potential investors to make informed decisions regarding possible investment in the rated insurer. The rating companies use similar terminology, but each has a proprietary method to establish their rating results. While the rating results are similar, one should review the rating organization's own explanation of its approach and methods to understand the subtle differences that occur when a particular insurer is rated by multiple rating organizations. A.M. Best's Financial Strength Rating is divided between "Secure," with ratings between A++ and B+, or "Vulnerable," with ratings of B or lower. Among the "Secure" ratings, A++ and A+ are described as "Superior," A and A- are described as "Excellent," and B++ and B+ are described as "Good" in terms of A.M. Best's opinion of the company's ability to meet financial obligations.²⁴ Additionally, an insurer may not be rated by every rating company as some rating companies may focus on particular markets or entities that are not served by the other rating companies.

Effect of the Bill

The bill allows a title insurer that is a member of an insurance holding company system that has \$1 billion or more in surplus to set its guaranty fund reserve in the same manner as a title insurer that on its own has \$50 million or more in surplus. This allows smaller title insurers with access to large amounts of capital to set reserves as if it had a higher surplus of its own. This exception will only be available if the insurance holding company system has a financial strength rating of "superior," "excellent," "exceptional," or an equivalent financial strength rating by a rating agency acceptable to the OIR.

This has two effects. First, it sets a lower amount of reserve on higher value policies and, second, the insurer's reserve is released earlier. Together, this allows the insurer earlier access to capital by placing funds in surplus, rather than reserves.

The bill also revises the requirements governing the insurer's statutory guaranty fund reserve when the insurer changes its state of domicile from another state to Florida. The bill implements the provisions of the National Association of Insurance Commissioner's Title Insurance Model Act regarding the amount of the reserve following a domicile change. The insurer is required to reset the reserve to the amount that would have been required had the insurer been domiciled in Florida for the previous twenty years. It requires increases, in six equal annual reserve increases, and authorizes excess reserve to be converted to surplus depending on the outcome of a comparison between the amount of reserve due

²³ Financial strength rating organizations include: A.M. Best (www.ambest.com), Fitch (www.fitchratings.com), Moody's Investor Services (www.moody.com), Standard & Poor's (www.standardandpoors.com), and Demotech (www.demotech.com).

²⁴ See A.M. BEST COMPANY, *Guide to Best's Financial Strength Ratings*, <http://www.ambest.com/ratings/guide.pdf> (Last viewed Nov. 25, 2015).

under Florida law and the amount actually held at the time of the domicile change. The bill does not specify when this newly domesticated reserve will be released to surplus or in what amounts.²⁵

B. SECTION DIRECTORY:

Section 1: Amends s. 625.111, F.S., relating to title insurance reserve.

Section 2: Provides an effective date of July 1, 2016.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

The OIR is not currently required to monitor the financial strength rating of a title insurer's holding company. The bill sets reserve requirements for certain title insurers based on the financial strength and surplus size of its insurance holding company. The fiscal impact section of the OIR bill analysis was not completed. Accordingly, the impact on state resources is indeterminate, but it could be negative.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill has a positive impact on the private sector. It frees up capital that title insurers can use to write additional coverage or make new investments.

D. FISCAL COMMENTS:

None.

²⁵ Subsections 625.111(1) and (2), F.S., establish the “guaranty fund or unearned premium reserve” that a title insurer must maintain to protect its insured’s against the possibility of insurer insolvency. They also specify when and how much of the reserve can be converted from reserve into surplus. The substantive portions of s. 625.111(3), F.S., which provides that guaranty fund reserves brought into this state are to be held and released consistent with the law of the insurer’s former state of domicile, is stricken from statute by the bill. This provision is replaced with the portion of the NAIC Title Insurance Model Act that governs the conversion of the amount of the reserve following redomestication. Section 10 B(2)(e), Title Insurers Model Act, MDL-628, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, *Products & Services*, <http://www.naic.org/store/free/MDL-628.pdf> (last visited Jan. 21, 2016). While the Model Act provides for releasing the newly domesticated reserve pursuant to the usual reserve release schedule, Florida law differs from the Model Act in substantive ways. The portion of Florida law that generally governs the release of reserves does not address reserves that were brought into the state as part of a change in domicile. The revision in the bill does not specify the timing and amounts of releases of the newly domesticated reserve. Arguably, there is no authority under the bill for an insurer to release it into surplus. This could be corrected by incorporating a specific provision that specifies the timing and amounts of releases of this reserve into surplus.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not Applicable. This bill does not appear to affect county or municipal governments.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

Subsections 625.111(1) and (2), F.S., establish the “guaranty fund or unearned premium reserve” that a title insurer must maintain to protect its insured’s against the possibility of insurer insolvency. They also specify when and how much of the reserve can be converted from reserve into surplus. The substantive portions of s. 625.111(3), F.S., which provides that guaranty fund reserves brought into this state are to be held and released consistent with the law of the insurer’s former state of domicile, is stricken from statute by the bill. This provision is replaced with the portion of the NAIC Title Insurance Model Act that governs the conversion of the amount of the reserve following redomestication.²⁶

While the Model Act provides for releasing the newly domesticated reserve pursuant to the usual reserve release schedule, Florida law differs from the Model Act in substantive ways. The portion of Florida law that generally governs the release of reserves does not address reserves that were brought into the state as part of a change in domicile. The revision in the bill does not specify the timing and amounts of releases of the newly domesticated reserve. Arguably, there is no authority under the bill for an insurer to release it into surplus. This could be corrected by incorporating a specific provision that specifies the timing and amounts of releases of this reserve into surplus.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On January 21, 2016, the Regulatory Affairs Committee considered the bill, adopted a strike all amendment, and reported the bill favorably with a committee substitute. The amendment allows title insurers that are members of a holding company system with a superior, excellent, exceptional, or an equivalent financial strength rating by a rating agency acceptable to the Office of Insurance Regulation to qualify for the premium reserve provision created by the bill. It also replaces the provisions of the bill related to the maintenance of the insurer’s guaranty fund or unearned premium reserve following relocation to Florida with the newly domesticated reserve calculation provision of the National Association of Insurance Commissioner’s Title Insurance Model Act.

The staff analysis has been updated to reflect the committee substitute.

²⁶ Section 10 B(2)(e), Title Insurers Model Act, MDL-628, National Association of Insurance Commissioners, *Products & Services*, <http://www.naic.org/store/free/MDL-628.pdf> (last visited Jan. 21, 2016).