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February 13, 2024

Mr. David Bolduc
Public Counsel
Office of Public Insurance Counsel
Barbara Jordan Building
1601 Congress Ave., Suite 3.500
Austin, TX 78701

Re: Texas Title Insurance Industry Rate Analysis

Dear Mr. Bolduc:

In accordance with your request, we have performed an analysis of Texas Title Insurance experience for the purpose of deriving an actuarially sound rate indication.

In performing our analysis, we relied on the information supplied by the Office of Public Insurance Counsel (“OPIC”) which included statistical data as well as analyses by the Texas Land Title Association (“TLTA”) and the Texas Department of Insurance (“TDI”).

Summary of Overall Results

Based upon our analysis, we concluded that a rate decrease in the range of -11.1% to -15.1% is reasonable. The mid-point of this range is -13.1%, which is an actuarially sound rate decrease for Texas Title Insurance.

A summary of range indications based on various periods for historical experience is shown in the following table.

<u>Component</u>	<u>5-Year (2017–2021)</u>	<u>10-Year (2012–2021)</u>	<u>15-Year (2007–2021)</u>	<u>20-Year (2002–2021)</u>
(1) Loss & loss adjustment expense ratio	1.7%	1.9%	2.4%	2.5%
(2) Expense ratio	74.5%	76.5%	79.7%	82.8%
(3) Catastrophe loss provision	1.0%	1.0%	1.0%	1.0%
(4) Total	77.1%	79.4%	83.1%	86.4%
(5) Profit provision	6.5%	6.5%	6.5%	6.5%
(6) Indicated rate change	-17.5%	-15.1%	-11.1%	-7.6%
(7) All period average rate change	-12.8%			

There are five main components that determine the indicated rate change. Those are: (i) projected loss and loss adjustment expense ratio, (ii) expense ratio, (iii) catastrophe loss provision, (iv) profit provision and (v) historical experience period.

There is no disagreement between the rate proposals with respect to the first three items given a specified historical period. There is disagreement with respect to both the profit provision and the historical period to use.

These two items of disagreement are discussed in more detail in the remainder of this letter.

1. Underwriting Profit Provision

We used an underwriting profit provision of 6.5% compared to 10.9% by TDI and 11.3% by TLTA.

The profit provision is dependent on a number of factors including the cost of capital, amount of investable funds and investment rate of return. In our analysis, we used a cost of capital lower than that used by TLTA and TDI.

Based on our analysis, the cost of capital should be no more than 12%, although a lower value would also be appropriate. By contrast, both TLTA and TDI used excessive and unreasonable cost of capital values. TLTA used a cost of capital of 15.8%. TDI used a cost of capital of 18.2% for agents and 14.7% for underwriters & direct operations.

The TLTA and TDI cost of capital values are excessive for two reasons. First, they start with an inflated base cost of capital and then add in a superfluous size premium. The base cost

of capital used by TLTA and TDI, before the unneeded size premium are 11.2% and 13.4%, respectively.

There are many sources indicating that the target cost of capital values used by TLTA and TDI are clearly excessive. These include the following:

- For the 20-year period from 2002 to 2021, the average rate of return on net worth for the property casualty insurance industry was 6.4% and exceeded 10% in only one of these twenty years (with a value of 12.2%).¹
- The California Insurance Department's maximum permitted rate of return for insurance rate filings as of January 2024 was 10.74%.²
- Various rate filings by insurance industry-controlled rating bureaus have used rate of return values in the range from about 8.9% to 10.2%.
 - A Dwelling Fire and Extended Coverage Insurance Rate Filing by the North Carolina Rate Bureau³ showed an average for the weighted average cost of capital of about 8.9%.⁴
 - A filing by the Delaware Workers Compensation Rating Bureau used a cost of capital of 10.17%.⁵
 - A filing by the Workers' Compensation Rating and Inspection Bureau of Massachusetts used a Weighted Average Cost of Capital of 9.48%.⁶

¹ NAIC Profitability Report by Line by State, 2021 and 2011 reports. The latest values available from the NAIC are through 2021.

² <http://www.insurance.ca.gov/0250-insurers/0800-rate-filings/0200-prior-approval-factors/> ; "Maximum Permitted Rate of Return & Yields for Investment Income Calculation – January 2024".

³ The North Carolina Rate Bureau, inter alia, files property insurance rate on behalf of the insurance industry in North Carolina. NCGS § 58-36-1 et seq.

⁴ SERFF Tracking #: NCRI-133707850; Exhibit RB-21, Page 10. The range shown was from 7.5% to 13.6%. The median value is 8.2%.

⁵ https://www.dcrb.com/dcrb/industry-resources/filings/dcrb-filing-no-2304/#Amendment_2304a, DCRB Filing No. 2304, Exhibit 9, Table 1, Line (11).

⁶ https://www.wcribma.org/mass/IndustryInformation/RateFiling/2024/WCRIBMA_Filing/Filing_2024.pdf, 12/22/2023 Filing, Page VII-20, Line (11).

With regard to the purported size premium, we do not contest that it could be applicable to stock market returns for the economy in general. However, there is no evidence that small insurance companies earn higher profits than larger insurance companies. Therefore, for the purpose of deriving rates that include a profit provision, we do not believe there is a supportable basis for including such an extra profit amount to be paid by Texas policyholders.

We also looked at the relative riskiness of industries that could be considered to have some relationship to title insurance to the overall market. As shown in the enclosed exhibit, title insurance related industries on average are less risky than the overall market. Therefore, a lower cost of capital could be justified for the title insurance industry.

Taking these considerations into account, we believe that the highest reasonable cost of capital to use is 12%. However, we believe a lower cost of capital in the range of 10% would also be reasonable and justified.

The next step is to convert the cost of capital into an underwriting profit provision. Using a 12% cost of capital with the TLTA and TDI underwriting profit calculations, gives indicated underwriting profit provisions of 6.0% and 6.6%, respectively.

For our rate calculation, we used a 6.5% underwriting profit provision.

2. Historical Experience Period

We used historical experience periods of 5, 10, 15 and 20 years, all ending in 2021. TDI used the same experience periods. TLTA used the same 15 and 20 year periods. TLTA also did calculations based on a five year period ending in 2019, a regression analysis and an “expense adjustment”. Those three alternative calculations by TLTA are actuarially unsound and should not be given any consideration.

Our conclusion is that time periods of 10 years and 15 years ending in 2021 are fair to both policyholders and the title insurance industry, give actuarially sound results and are reasonable to use.

In selecting an experience period, we considered the tradeoff between responsiveness and stability. A shorter period could be more responsive to current conditions. However, if the period is too short, it may not represent a full spectrum of conditions and could cause instability in rates. We believe the 10 year and 15 year periods strike a reasonable balance between responsiveness and stability, and represents a reasonable sample of economic conditions that could prevail during the prospective rate period, which based on past experience could last for

several years. In reaching our conclusion, we took into account the historical pattern of US Business Cycle Expansions and Contractions.⁷

With regard to TLTA's alternative experience period calculations:

- The 5-year period ending in 2019 is not responsive as it ignores the most recent two years of experience that is available.
- The regression analysis depends on "Projected CY2023 Premiums". TLTA has not shown that the projected CY 2023 premiums it used are a reasonable projection of premiums during the rate period.
- The "expense adjustment" analysis is based on an incomplete and flawed "survey", which is not credible and cannot reasonably be relied upon.

3. Conclusion

In summary, based upon our analysis, a reasonable overall rate change for Texas Title Insurance should be in the range of -11.1% to -15.1%, which has a mid-point rate decrease of -13.1%.

If you have any questions, please do not hesitate to contact me.

Sincerely,



Allan I. Schwartz
FCAS,MAAA,ARE,AIC
APA,AU,AIAF,ARM,API,ACS,CRRA
President

Enclosure

⁷ <https://www.nber.org/research/business-cycle-dating>

Date updated:	5-Jan-24
Created by:	Aswath Damodaran, adamodar@stern.nyu.edu
What is this data?	Cost of equity and capital (updateable)
Home Page:	http://www.damodaran.com
Data website:	https://pages.stern.nyu.edu/~adamodar/New_Home_Page/data.html
Companies in each industry:	https://pages.stern.nyu.edu/~adamodar/pc/datasets/indname.xls
Variable definitions:	https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/variable.htm

To update this spreadsheet, enter the following

Long Term Treasury bond rate =

3.88%

Risk Premium to Use for Equity =

4.60%

Global Default Spread to add to cost of debt =

0.00%

Do you want to use the marginal tax rate for cost of debt?

If yes, enter the marginal tax rate to use

These costs of capital are in US\$. To convert to a different currency, please enter

Expected inflation rate in local currency =

1.50%

Expected inflation rate in US \$ =

1.50%

Industry Name	Number of Firms	Beta	Cost of Equity	Cost of Capital
Bank (Money Center)	15	1.06	8.76%	5.08%
Banks (Regional)	625	0.46	6.00%	4.68%
Brokerage & Investment Banking	27	1.12	9.03%	5.41%
Homebuilding	32	1.37	10.18%	9.28%
Insurance (General)	21	1.03	8.63%	7.64%
Insurance (Life)	23	0.77	7.40%	5.68%
Insurance (Prop/Cas.)	50	0.74	7.28%	6.72%
Investments & Asset Management	334	0.46	5.98%	5.23%
R.E.I.T.	181	1.02	8.59%	6.28%
Real Estate (Development)	17	0.67	6.96%	5.43%
Real Estate (General/Diversified)	11	0.56	6.47%	5.83%
Real Estate (Operations & Services)	60	1.08	8.85%	7.30%
Total Market	6481	1.00	8.48%	7.00%
Total Market (without financials)	5194	1.10	8.93%	7.99%

Average

0.86

7.8%

6.2%

Median

0.89

8.0%

5.8%