

No. 2385

**Official Order
of the
Texas Commissioner of Insurance**

Date: MAR 22 2013

Subject Considered:

**2013 Texas Title Insurance Rate Hearing
Docket No. 2749**

The commissioner of insurance considers the rate change request filed by the Texas Land Title Association on November 26, 2012, under Insurance Code §2703.202, regarding title insurance premium rates. The Texas Department of Insurance published notice of the hearing to consider the rate change request in the December 21, 2012, issue of the *Texas Register* (37 TexReg 10030).

After considering TLTA's rate change request and exhibits, the Office of Public Insurance Counsel's analysis, TDI staff's analysis, and all other written and oral testimony and comments, the commissioner adopts the following findings of fact and conclusions of law.

FINDINGS OF FACT

Procedural History

1. On September 13, 2012, TLTA submitted to TDI staff an informal draft proposal requesting an increase in title insurance premium rates. To streamline the ratemaking process and to promote transparency, TDI staff gave public notice and held three informal public meetings to discuss and receive stakeholder input on TLTA's proposal.
2. Public meetings to discuss the proposed rate changes occurred on October 10, October 24, and November 13, 2012. At the last public meeting, TLTA and OPIC agreed on a rate increase of 3.8 percent. This rate increase was within TDI staff's acceptable range.

3. On February 19, 2013, the commissioner's designee conducted the public hearing required by Insurance Code §2703.202(b) under Docket No. 2749. In accord with Insurance Code §2703.202(c), the hearing was not a contested case hearing under Government Code Chapter 2001. Interested persons attended the hearing and had the opportunity to present written and oral testimony. TLTA, OPIC, and TDI staff testified and presented exhibits, analyses, and rate calculations at the hearing.

TLTA Proposal

4. TLTA proposed a rate increase of 6.5 percent for the current schedule of basic premium rates for title insurance.
5. TLTA's proposal included detailed and summary information to support the proposed 6.5 percent increase. The information provided was based on data and analysis from TLTA's two consulting actuaries and a consulting economist.
6. TLTA also used historical title industry data collected by TDI to form its proposal. TDI collects and publishes this data annually, and posts it on the TDI website at www.tdi.texas.gov/reports/report8.html.

Public Meetings

7. At the October 10, 2012, public meeting, TLTA presented its analysis and proposal. The resulting discussion ranged from the current state of the Texas title industry to how and why TLTA arrived at the assumptions in its analysis.
8. TDI staff reviewed the methodologies and assumptions used in TLTA's indication, and examined the files for accuracy.
9. At the October 24, 2012, public meeting, OPIC presented its preliminary analysis and indications. The resulting discussion revealed both similarities and differences in OPIC and TLTA's assumptions, methodologies, and results.
10. At the November 13, 2012, meeting, TDI staff presented its assumption analysis. TDI staff briefly addressed similarities in the parties' key assumptions and methodologies. The representatives from TLTA and OPIC, and TDI staff discussed the differences.
11. The parties debated the assumptions and discussed the effect of changes on the final indications.

12. The parties agreed that there is a range of reasonable assumptions that could be used in the analysis.
13. TLTA and OPIC negotiated a final proposed rate change of 3.8 percent, which was within TDI staff's acceptable range.

Written Public Comment

14. The commissioner received one written comment for the hearing. The commenter objected to a rate increase when title insurance premium rates are promulgated.
15. The commissioner considered the comment and determined that it was an objection against the statutory system that requires the commissioner to promulgate title insurance premium rates, rather than an argument against the actuarial analysis or reasonableness of the proposed rate increase.

Ratemaking Process and Objectives

16. Insurance Code §2703.152 requires that premium rates must be reasonable as to the public and nonconfiscatory as to title insurance companies and title insurance agents. When fixing the rates, the commissioner must consider all relevant income and expenses of title insurance companies and title insurance agents attributable to engaging in the business of title insurance in Texas.
17. The ratemaking process incorporates historical experience, market shifts, the economic state, and other relevant information. The commissioner assimilates all the information and makes assumptions about future market behavior.
18. Qualified actuaries using accepted ratemaking principles and methodologies often arrive at different results, all of which may be reasonable. This is because actuaries use their professional judgment in selecting methodologies and assumptions that are appropriate to the situation.

Overview of Indications

19. TLTA and OPIC used historical experience as the basis for their respective assumptions in their rate indications.

20. TLTA and OPIC developed indications based on varying sets of assumptions. Each set of assumptions yielded a different indication. Within their respective assumption sets, the assumptions varied by
 - i. the number of included years of experience data, and
 - ii. the professional judgment used by TLTA and OPIC.
21. By varying their assumption sets, TLTA and OPIC developed ranges of indications.
22. TLTA developed three assumption sets, using five, 10, and 26 years of historical data, respectively. TLTA's range of indications was 5.66 percent to 10.16 percent. TLTA selected its indication based on its calculation of the average of the five-year and 10-year indications. TLTA's selected indication was 6.5 percent.
23. OPIC developed seven assumption sets, using two, three, five, 10, and 15 years of historical data, trended to December 31, 2012; and 15 years of historical data trended to June 30, 2014. OPIC's range of indications was -5.3 percent to 3.8 percent. OPIC did not select a final indication from this range.
24. TDI staff indicated that a range of reasonable indications is 0 percent to 4 percent.

Ratemaking Components

25. The operative formula for TLTA's ratemaking indication is:

$$I = \text{Indication} = (L + E) / (1 - P) - 1$$

The components are:

L = Loss ratio = Losses / Premium

E = Expense ratio = Expenses / Premium

P = Profit provision = Profit / Premium

26. Each component is a ratio to premium, and it is customary to express each component as a percent of premium. Instead of provisions, some people call these components "ratios" or "loads."

Loss Ratio

27. The loss ratio provides for expected losses and loss adjustment expenses (LAE) for policies that are effective during the rating period. TLTA and OPIC based their projected loss and LAE provisions on calendar year data.
28. TLTA separated losses into catastrophic and noncatastrophic categories. Catastrophic losses are unusually large and do not typically occur on a regular basis. Even so, they do occur, and it is reasonable to provide for them.
29. TLTA based its noncatastrophic projected loss and LAE on the average of historical noncatastrophic loss ratios over five, 10, and 26 years. The resulting loss ratios were 4.0 percent, 3.5 percent, and 4.5 percent, respectively.
30. TLTA added a provision for catastrophic losses of 1 percent. The average catastrophic losses over the last five and 10 years were 0.04 percent and 0.02 percent, respectively, and the 26-year average was 2.09 percent.
31. By averaging its five-year and 10-year indications, TLTA effectively selected a 3.8 percent provision for noncatastrophic losses and LAE, and a 1 percent provision for catastrophic losses. Therefore, TLTA effectively selected a 4.8 percent loss ratio.
32. OPIC presented noncatastrophic projected losses and LAE over two, three, five, and 10 years. The resulting averages were 4.10 percent, 4.29 percent, 4.11 percent, and 3.54 percent, respectively. OPIC selected a loss ratio of 5 percent for all six scenarios. Although OPIC did not explicitly make an assumption for catastrophic losses, it stated that the 5 percent assumption implicitly included catastrophic losses.
33. TDI staff found both parties' loss provisions reasonable.

Expense Ratio

Introduction

34. The expense ratio accounts for all reasonable costs associated with a title insurance policy issued during the rating period except for those costs associated with the profit and loss provisions.
35. The expense ratio is a projection of the ratio of expenses to premium to be incurred under policies effective during the rating period.

Data Considerations

36. The title insurance industry reports income and expense data to TDI annually. TLTA and OPIC used this data as the basis of their analyses.
37. TLTA and OPIC excluded damages arising from bad faith claims, fines and penalties, donation and lobbying expenses, and trade association fees from expenses used to calculate the expense ratio.
38. TLTA and OPIC excluded both recording fees and tax certificates, which are pass-through items.
39. TLTA and OPIC adjusted the income and expenses used in their projections to eliminate double counting of income and expenses when underwriters or agents pay another agent for title services.
40. TLTA and OPIC allocated expenses between rate-regulated and nonrate-regulated operations. They allocated expenses to rate-regulated operations in the same proportion as the ratio of rate-regulated revenue to total revenue.

Indicated Expense Ratios

41. TLTA based its projected expense ratios on the average of historical expense ratios over five, 10, and 26 years. The resulting ratios were 90.31 percent, 92.30 percent, and 94.87 percent, respectively.
42. By averaging its five-year and 10-year indications, TLTA effectively selected a 91.3 percent expense ratio.
43. OPIC provided a range of indications based on six different sets of expense assumptions. The first four sets assumed expense ratios based on the past two, three, five, and 10 years of experience. OPIC based its last two sets of expense assumptions on 10-year and 15-year regression models.
44. In each assumption set, OPIC then applied a 1 percent reduction to adjust expense ratios to account for reverse competition.
45. The expense ratios for the six expense assumption sets before the 1 percent reduction were 88.3 percent, 90.3 percent, 90.3 percent, 92.5 percent, 85.5 percent, and 83.9 percent, respectively.

46. The expense ratios for the six expense assumption sets after the 1 percent reduction were 87.4 percent, 89.4 percent, 89.4 percent, 91.5 percent, 84.7 percent, and 83.1 percent, respectively.
47. OPIC did not select an expense ratio from its various expense assumption sets.
48. TDI staff found the five- and 10-year average historical expense ratios to be reasonable.

Profit Provision

49. The profit provision represents an amount in the rate that, together with investment and miscellaneous income, provides a sufficient return to the agent or underwriter, taking into account the capital risks.
50. The general methodology for determining the profit provision includes:
 - i. estimating the cost of capital or fair rate of return,
 - ii. determining the portion of the rate of return investments will provide, and
 - iii. calculating the amount required from premiums to achieve the fair rate of return.
51. TLTA posited a cost of capital of 13.30 percent:
 - i. 9.76 percent derived from a combination of the Discounted Cash Flow and Capital Asset Pricing Models, which are both reasonable models to use in determining the cost of capital, and
 - ii. 3.89 percent to account for the small firm size of the typical Texas title industry participant.
52. Based on historical data, TLTA selected an after-tax return on investments to capital of 6.51 percent.
53. TLTA's required after-tax return from underwriting to capital is 6.79 percent.
54. TLTA selected a 0.99 premium-to-capital leverage ratio. This yielded an after-tax return from underwriting to premium of 6.84 percent.
55. Using a 30 percent tax rate, TLTA's pre-tax return from underwriting to premium is 9.76 percent.

56. OPIC used cost of capital assumptions between 10.6 percent and 13.3 percent to determine six possible profit provisions. OPIC did not make an explicit selection for any of the components of its profit provision.
57. OPIC's after-tax return on investments to capital ranged from 4.1 percent to 6.5 percent.
58. OPIC's range of required after-tax return from underwriting to capital is 4.9 percent to 7.2 percent.
59. OPIC used a range of 1.4 to 1.75 for its premium-to-capital leverage ratio. This yielded an after-tax return from underwriting to premium ranging from 2.8 percent to 5.1 percent.
60. Using a 30 percent tax rate, OPIC's pre-tax return from underwriting to premium ranges from 4.0 percent to 9.8 percent.
61. OPIC selected a profit provision of 7.0 percent.

Debated Elements of the Profit Provision

62. The parties debated two elements of TLTA's profit provision:
 - i. a firm-size adjustment added to the cost of capital, and
 - ii. the premium-to-capital leverage ratio.
63. TLTA included a firm-size adjustment in its cost of capital. TLTA used data from *Ibbotson® 2012 Cost of Capital Yearbook* to support the premise that smaller firms tend to have a higher cost of capital than larger ones. TLTA's analysis showed that small firms constitute a substantial portion of the Texas title industry. TLTA added a 3.89 percent adjustment to its cost of capital calculation to account for the presence of small firms.
64. TLTA also selected a 0.99 premium-to-capital leverage ratio for its profit provision. The premium-to-capital leverage ratio is the ratio of premiums written to equity. The profit provision depends in part on the leverage ratio.
65. A rate maker applies a premium-to-capital leverage ratio to the required after-tax return from underwriting capital to determine the indicated after-tax return from underwriting premium.

66. As the premium-to-capital leverage ratio increases, the underwriting profit provision decreases. As the premium-to-capital leverage ratio decreases, the underwriting profit provision increases.
67. Selecting an appropriate premium-to-capital leverage ratio is difficult because capital data is not available for much of the title industry.
68. TLTA used the available data, which is primarily from underwriters, to select its leverage ratio of 0.99. Underwriters represent less than one-third of the title industry when measured by operating income. TLTA suggested that its selected leverage ratio should serve as a proxy for the industry.
69. TDI staff questioned the use of TLTA's selected leverage ratio as a proxy for the entire industry. Underwriters are typically large firms and are presumably much more capital-intensive than title agents.
70. Additionally, TDI staff indicated that using TLTA's leverage ratio as a proxy was inconsistent with the small-firm adjustment TLTA made to its cost of capital. TDI staff indicated that this inconsistency inflated TLTA's selected profit provision.
71. TDI staff analyzed the profit provisions presented by TLTA and OPIC. Staff considered the costs of capital, with and without TLTA's small-firm adjustment, and leverage ratios designed to correspond with the inclusion or exclusion of small firms.

Rate Change

72. TLTA, OPIC, and TDI staff proposed the following indicated rate changes:
 - i. TLTA: 6.5 percent
 - ii. OPIC: -5.3 percent to 3.8 percent
 - iii. TDI staff: 0.0 percent to 4.0 percent
73. Although TLTA, OPIC, and TDI staff did not agree on all assumptions, all the parties agreed that a rate increase of 3.8 percent would be reasonable and acceptable.
74. Exhibit A shows the title insurance premium rates that result from an increase of 3.8 percent over the current premium rates.

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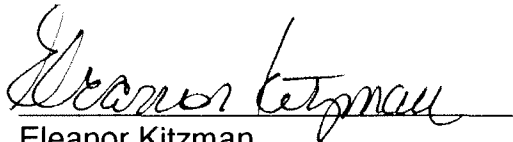
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CONCLUSIONS OF LAW

1. The commissioner has jurisdiction over this matter under Insurance Code §§31.021, 2501.001–2501.008, 2551.003, and 2703.001–2703.208.
2. TDI gave proper and timely notice of the February 19, 2013, Texas Title Insurance Rate Hearing, as required by Insurance Code §2703.203.
3. Insurance Code §2703.151 requires the commissioner to fix and promulgate the premium rates to be charged by title insurance companies and title insurance agents.
4. An increase of 3.8 percent over current premium rates is reasonable to the public and nonconfiscatory to title insurance companies and title insurance agents, as Insurance Code §2703.152 requires.

The commissioner of insurance orders that, effective 12:01 a.m., May 1, 2013, title insurance companies and title insurance agents must use the premium rates in Exhibit A.


Eleanor Kitzman
Commissioner of Insurance

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EXHIBIT A

TEXAS TITLE INSURANCE BASIC PREMIUM RATES

Rates Effective May 1, 2013

Policies Up To And Including	Basic Premium	Policies Up To And Including	Basic Premium	Policies Up To And Including	Basic Premium	Policies Up To And Including	Basic Premium
\$10,000	\$238	\$32,500	\$398	\$55,000	\$556	\$77,500	\$716
10,500	\$242	33,000	\$401	55,500	\$559	78,000	\$720
11,000	\$244	33,500	\$405	56,000	\$565	78,500	\$725
11,500	\$248	34,000	\$408	56,500	\$568	79,000	\$729
12,000	\$252	34,500	\$412	57,000	\$571	79,500	\$730
12,500	\$255	35,000	\$415	57,500	\$575	80,000	\$734
13,000	\$260	35,500	\$419	58,000	\$579	80,500	\$738
13,500	\$264	36,000	\$422	58,500	\$581	81,000	\$742
14,000	\$267	36,500	\$426	59,000	\$585	81,500	\$744
14,500	\$270	37,000	\$429	59,500	\$589	82,000	\$748
15,000	\$272	37,500	\$433	60,000	\$593	82,500	\$753
15,500	\$276	38,000	\$437	60,500	\$597	83,000	\$757
16,000	\$280	38,500	\$441	61,000	\$600	83,500	\$759
16,500	\$284	39,000	\$443	61,500	\$603	84,000	\$762
17,000	\$288	39,500	\$447	62,000	\$607	84,500	\$767
17,500	\$292	40,000	\$450	62,500	\$611	85,000	\$770
18,000	\$296	40,500	\$455	63,000	\$613	85,500	\$773
18,500	\$298	41,000	\$457	63,500	\$617	86,000	\$776
19,000	\$301	41,500	\$462	64,000	\$621	86,500	\$781
19,500	\$304	42,000	\$465	64,500	\$625	87,000	\$785
20,000	\$309	42,500	\$469	65,000	\$628	87,500	\$788
20,500	\$312	43,000	\$471	65,500	\$631	88,000	\$791
21,000	\$317	43,500	\$475	66,000	\$635	88,500	\$795
21,500	\$320	44,000	\$479	66,500	\$640	89,000	\$799
22,000	\$324	44,500	\$483	67,000	\$644	89,500	\$801
22,500	\$327	45,000	\$487	67,500	\$645	90,000	\$804
23,000	\$330	45,500	\$490	68,000	\$649	90,500	\$809
23,500	\$333	46,000	\$493	68,500	\$653	91,000	\$813
24,000	\$337	46,500	\$497	69,000	\$656	91,500	\$817
24,500	\$340	47,000	\$499	69,500	\$659	92,000	\$819
25,000	\$345	47,500	\$503	70,000	\$664	92,500	\$823
25,500	\$348	48,000	\$508	70,500	\$668	93,000	\$827
26,000	\$352	48,500	\$512	71,000	\$672	93,500	\$831
26,500	\$355	49,000	\$515	71,500	\$674	94,000	\$832

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Policies Up To And Including	Basic Premium	Policies Up To And Including	Basic Premium	Policies Up To And Including	Basic Premium	Policies Up To And Including	Basic Premium
27,000	\$358	49,500	\$518	72,000	\$677	94,500	\$837
27,500	\$361	50,000	\$522	72,500	\$681	95,000	\$842
28,000	\$365	50,500	\$525	73,000	\$685	95,500	\$845
28,500	\$368	51,000	\$527	73,500	\$688	96,000	\$847
29,000	\$373	51,500	\$531	74,000	\$692	96,500	\$851
29,500	\$376	52,000	\$536	74,500	\$696	97,000	\$855
30,000	\$380	52,500	\$540	75,000	\$700	97,500	\$859
30,500	\$383	53,000	\$543	75,500	\$702	98,000	\$862
31,000	\$387	53,500	\$547	76,000	\$706	98,500	\$866
31,500	\$390	54,000	\$550	76,500	\$709	99,000	\$870
32,000	\$393	54,500	\$553	77,000	\$713	99,500	\$873
						100,000	\$875

Title Basic Premium Calculation for Policies in Excess of \$100,000

Using the table below, apply these steps to determine basic premium for policies above \$100,000:

- Step 1 In column (1), find the range that includes the policy's face value.
- Step 2 Subtract the value in column (2) from the policy's face value.
- Step 3 Multiply the result in Step 2 by the value in column (3), and round to the nearest dollar.
- Step 4 Add the value in column (4) to the result of the value from Step 3.

(See examples provided following the table.)

(1) Policy Range	(2) Subtract	(3) Multiply by	(4) Add
[\$100,001 - \$1,000,000]	100,000	0.00554	\$ 875
[\$1,000,001 - \$5,000,000]	1,000,000	0.00456	\$ 5,861
[\$5,000,001 - \$15,000,000]	5,000,000	0.00376	\$ 24,101
[\$15,000,001 - \$25,000,000]	15,000,000	0.00267	\$ 61,701
[Greater than \$25,000,000]	25,000,000	0.00160	\$ 88,401

Examples for Policies in Excess of \$100,000

Example 1:

- (1) Policy is \$268,500
- (2) Subtract \$100,000 ==> $\$268,500 - \$100,000$ ==> Result = \$168,500
- (3) Multiply by 0.00554 ==> $\$168,500 \times 0.00554$ ==> \$933.49 ==> Result = \$933
- (4) Add \$875 ==> $\$933 + \875 ==> Final Result = \$1,808

Example 2:

- (1) Policy is \$4,826,600
- (2) Subtract \$1,000,000 ==> $\$4,826,600 - \$1,000,000$ ==> Result = \$3,826,600
- (3) Multiply by 0.00456 ==> $\$3,826,600 \times 0.00456$ ==> \$17,449.30 ==> Result = \$17,449
- (4) Add \$5,861 ==> $\$17,449 + \$5,861$ ==> Final Result = \$23,310

Example 3:

- (1) Policy is \$10,902,800
- (2) Subtract \$5,000,000 ==> $\$10,902,800 - \$5,000,000$ ==> Result = \$5,902,800
- (3) Multiply by 0.00376 ==> $\$5,902,800 \times 0.00376$ ==> \$22,194.53 ==> Result = \$22,195
- (4) Add \$24,101 ==> $\$22,195 + \$24,101$ ==> Final Result = \$46,296

Example 4:

- (1) Policy is \$17,295,100
- (2) Subtract \$15,000,000 ==> $\$17,295,100 - \$15,000,000$ ==> Result = \$2,295,100
- (3) Multiply by 0.00267 ==> $\$2,295,100 \times 0.00267$ ==> \$6,127.92 ==> Result = \$6,128
- (4) Add \$61,701 ==> $\$6,128 + \$61,701$ ==> Final Result = \$67,829

Example 5:

- (1) Policy is \$39,351,800
- (2) Subtract \$25,000,000 ==> $\$39,351,800 - \$25,000,000$ ==> Result = \$14,351,800
- (3) Multiply by 0.00160 ==> $\$14,351,800 \times 0.00160$ ==> \$22,962.88 ==> Result = \$22,963
- (4) Add \$88,401 ==> $\$22,963 + \$88,401$ ==> Final Result = \$111,364