2015 HOUSE INDUSTRY, BUSINESS AND LABOR

HB 1312

2015 HOUSE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee
Peace Garden Room, State Capitol

HB 1312
2/4/2015
23200
☐ Subcommittee
☐ Conference Committee

Donna Whetham

Explanation or reason for introduction of bill/resolution:

Title insurance limitation on risks.

Attachment #1.

Minutes:

Chairman Keiser: opened the hearing on HB 1312.

Pat Ward: North Dakota Land and Title Association: Introduces HB 1312 relates to title insurance and reinsurance. This is different that property and casualty reinsurance. There is one minor language change to the bill that we are suggesting and that is on line 13. It reads" ninety percent of the company's combined surplus" and we would replace the word" combined" with " sum of the" "it would read sum of the companies surplus." This bill deals with title insurance for extremely large projects where a lot of money is involved in the project.

Nick Hacker~Legislative Director of North Dakota Land and Title Association: (3:31) You will hear from underwriters insurers. We don't have any domicile providers in North Dakota. There are very few in the marketplace. We do three major things. We do abstracting and we conduct real-estate closings and issue title insurance. We will talk about the title insurance in this bill. What we do in the title insurance industry different than the property and casualty industry is we insure risks of the past. We protect for anything in the past. We look backwards and not forward. What the bill before you does is change the cap to allow large transactions to be insured. It will raise that cap from 50% to 90%. It is a reverse calculation in your mind so this would allow us to insure much larger transactions. The other part of the bill increases competition in the reinsurance market place. So we can access more reinsurance from non -admitted insurers. That would allow us to reduce the cost. Those are the two major changes in the bill.

Representative M Nelson: They can go up to 90% of their surplus and carry the risk themselves but if they go above the 90% then they can reinsure, is that the way this is?

Hacker: Exactly. Today we can insure up to 90% of the combined surplus and reserves of a transaction. Title insurers are very well capitalized companies that are publically traded

many times. So we insure on a single transaction. When this is a large wind farm that could be $300 to $400 million. That insurance allows us to insure up to 90% of the premium and reserves. Over that amount we need to seek reinsurance or participative insurance so we can a co-insure as well. We could have two underwriters insuring the same transaction. Today, we can't do that, today we have to use other admitted insurers, title insurance insurers. It becomes very expensive to use reinsurance from other title insurance companies. We are looking to spread the risk out within a larger marketplace.

Chairman Keiser: Right now you can insure up to 50% of the cap?

Hacker: The insurance underwriters can insure up to 50% of the cap.

Chairman Keiser: If you wanted to insure the other 50% what would you do?

Hacker: You would purchase reinsurance from other title insurance companies.

Chairman Keiser: They have to get that 50% from other title insurance companies. This will allow you to go up to 90% from yourself?

Hacker: From the individual title insurance company they can go up to 90% Then anything over that they can get reinsurance. They spread out the risk by reinsuring but this will allow them to access a whole new marketplace of reinsurance. We have only 4 major underwriter, so we need to access the marketplace to reduce the cost.

Representative M Nelson: With the title re-insurance, with the company i know your company bears the cost up to your limit and then the reinsurance kicks in. If you were carrying the 90% you would pay the percent out before the reinsurance kicks in or is it different with title?

Hacker: It's different, it is based on the single risk transaction liability and what the reinsurance agreement state.

Pat Ward introduces Margaret Redman:

Margaret Redman~Vice President, Reinsurance Counsel-First American Title Insurance Company. (12:07-19:39). In support of HB 1312. (See Attachment # 1).

Representative Lefor: Is this done in other states, how many and for how long?

Redman: North Dakota is the most conservative states in the country. There is about 10 states that have a 50% surplus limit or below. There is about 23 states that have no limit at all. The reason why title insurance gets special rules is we are a risk prevention insurance and we aren't subject to the aggregation of losses. So North Dakota is one of the lowest limits in the country.

Chairman Keiser: What this bill does is changes the cap from 50% to 90% for the collective purchasing power on the surplus side. This bill allows us to combine surplus at

the 90%, plus reserves and reinsurance to cover the title insurance and put together a package . Is that what we are doing here?

Redman: Yes, and I feel that would situate the title industry in such a way we would be able to absorb these billion dollar deals that are slated to come into North Dakota. Either by using reinsurance or co-insurance. The title industry will have enough capacity to write a policy for full coverage which will hopefully attract that investment in North Dakota.

Chairman Keiser: So this is a capacity issue. This is a concern for the state and I think at 50% we are a lot more protected than at 90%. What is the risk with that magnitude of change?

Redman: It's a big jump. We have the right to pay the amount of money that causes us to deliver the title as insured. That may be the valuation of the property, but in any event when we look at the actuarial data. The vast majority of our policies have losses of less than 25% of the policy limit. So when you are talking about giving us a limit of 90% of our surplus that doesn't mean that the losses will reach 90% of our surplus.

Chairman Keiser: Any other support of HB 1312? Any one in opposition of HB 1312? Any neutral testimony on HB 1312?

Edward Moody: Director of Insurance Company Licensing and Examination: The Insurance Department is neutral on HB 1312.

Chairman Keiser: Is there any other testimony on HB 1312? Seeing none. Closed the hearing on HB 1312.

Representative Ruby: Motion to adopt the amendment to change language on page 1 line 13 to read " to ninety percent sum of the company's surplus as regards to policy holders".

Representative Sukut: seconded.

Voice Vote: All Ayes. Motion carried.

Representative Ruby: Do Pass as Amended on HB 1312.

Representative Beadle: seconded.

A Roll Call Vote was taken. Yes: 13 No: 0 Absent: 2. Motion carries.

Representative Boschee: will carry the bill.

15.0709.01001
Title.02000

Adopted by the Industry, Business and Labor Committee

February 4, 2015

SB 2-4-15

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1312

Page 1, line 13, after "the" insert "sum of the"

Page 1, line 13, remove "combined"

Renumber accordingly

Date: Feb 4, 2015

Roll Call Vote: 1

2015 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. HB 1312

House Industry, Business & Labor Committee

☐ Subcommittee ☐ Conference Committee

Amendment LC# or Description: pg 1 line 13 add "sum" 15.0709.01001

Recommendation: ☒ Adopt Amendment
☐ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations

Other Actions: ☐ Reconsider ☐

Motion Made By Rep. Ruby Seconded By Rep. Sukut

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser			Representative Lefor		
Vice Chairman Sukut			Representative Louser		
Representative Beadle			Representative Ruby		
Representative Becker			Represenative Amerman		
Representative Devlin			Representative Boschee		
Representative Frantsvog			Representative Hanson		
Representative Kasper			Representative M Nelson		
Representative Laning					

Voice Vote. Motion Carries.

Total (Yes) _____ No _____

Absent _____

Floor Assignment _____

If the vote is on an amendment, briefly indicate intent:

pg 1 line 13
add sum
voice vote.

Date: Feb 4, 2015

Roll Call Vote: 2

2015 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. HB 1312

House Industry, Business & Labor Committee

☐ Subcommittee ☐ Conference Committee

Amendment LC# or Description: 15.0709.01001

Recommendation: ☐ Adopt Amendment
☒ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☒ As Amended ☐ Rerefer to Appropriations
Other Actions: ☐ Reconsider ☐

Motion Made By Rep. Ruby Seconded By Rep. Beadle

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser	X		Representative Lefor	X	
Vice Chairman Sukut	X		Representative Louser	X	
Representative Beadle	X		Representative Ruby	X	
Representative Becker	X		Represenative Amerman	X	
Representative Devlin	X		Representative Boschee	X	
Representative Frantsvog	Ab		Representative Hanson	X	
Representative Kasper	Ab		Representative M Nelson	Y	
Representative Laning	X				

Total (Yes) 13 No 0

Absent 2

Floor Assignment Rep. Boschee

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1312: Industry, Business and Labor Committee (Rep. Keiser, Chairman) recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends **DO PASS** (13 YEAS, 0 NAYS, 2 ABSENT AND NOT VOTING). HB 1312 was placed on the Sixth order on the calendar.

Page 1, line 13, after "the" insert "sum of the"

Page 1, line 13, remove "combined"

Renumber accordingly

2015 SENATE INDUSTRY, BUSINESS AND LABOR

HB 1312

2015 SENATE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee
Roosevelt Park Room, State Capitol

HB 1312 Engrossed
3/17/2015
Job Number 24967

☐ Subcommittee
☐ Conference Committee

Committee Clerk Signature	Era Lickelt

Explanation or reason for introduction of bill/resolution:

Relating to title insurance limitation on risks

Minutes: Attachment

Chairman Klein: Called the committee back to order.

Representative Keiser: This is an important bill. It deals with title insurance. The bill simply says it that the title insurers in the state may establish relationships with title insurers not domiciled in our state and collectively they could surpass the fifty percent and go up to ninety percent collectively on insuring projects that would exceed that capacity. Those companies do have to meet certain standards. (:10-3:12)

Nick Hacker, North Dakota Land Title Association: The North Dakota land title association is made up of the abstractors, real estate closers as well as title insurance agents across the state of North Dakota. We have reached capacity in the current statute. (3:38-5:18)

Margaret E. Redman, Vice President of Reinsurance Counsel for First American Title Insurance Company: Written Testimony Attached (1). (5:26-11:39)

Senator Murphy: Asked if she had any idea how many states were hamstrung like North Dakota is?

Margaret E. Redman: Said she thought there were between ten and twenty states that have a fifty percent surplus rule. We actively working with Texas to change their rule and we will address the other states in order of the size of eh real estate investment. (11:55-12:45)

Chad E. Novak, Vice President, Agency Manager and Counsel for Old Republic National Title Insurance Company: Said he would like to go over a couple of points, one being our loss experience in the state of North Dakota is extraordinarily low given the protections that are in place here in the state for those examining title, including the title plant law requirements as well as the attorney title opinion requirements. Increasing the

retention limits on any given title insurer and opening up the market to insurers for reinsurance purpose outside of our market will certainly lower the cost that the consumer of the insurance product would have to pay. It affords them the ability to shop around more for the product and greater competition in the market place may very well drive down prices. There are a dozen states that are equally restrictive as North Dakota or more restrictive. When we are looking at the large dollar projects the likelihood of a catastrophic failure is extraordinarily low especially given that the bulk of the development in this state is related to energy projects. We are aggregating multiple different parcels so if we have a failure as to one parcel that doesn't mean the whole project results in a large title claim instead that one parcel is the claim and the loss payable clause under a title insurance policy is the difference between the interest as insured and the interest as subject to the defect. (13:14-15:56)

Senator Murphy: Asked what if any types of risk are we taking by allowing this to happen if we pass this bill and how lucrative is this business for you guys?

Chad E. Novak: The risks you are undertaking by passing the bill are that in the event of a catastrophic failure of title, that a title insurer would be potentially deemed, I wouldn't say insolvent because you are not going to the full extent of our assets but in the event of multiple catastrophic claims around the country all at the same time there is that remote possibility that the insurer could be rendered insolvent. We are a highly regulated industry and there are four major title insurers that operate to insurer about 85% of the national market. (16:10-18:30)

Senator Murphy: Said that the state kind buy the type of insurance they need to do these big projects so is our cost per million or per billion going down as we get into bigger companies?

Chad E. Novak: Yes that would be the anticipation. Given greater access to capital might make it more likely that the cost would go down. We have four companies trading amongst themselves and we set our price for the product, each company sets it independently of one another, having very little competition in the market place there is not a lot of control on those prices unless one company sets it much lower there might be more likelihood for the others to reinsure through that company and that could very well aggregate risk disproportionately on one of the four title insurance underwriters who are active in this market place. (19:15-20:09)

Senator Sinner: Asked how many states were at 90% and also have this reinsurance provision.

Chad E. Novak: No state is at 90% that is at the exact calculation that North Dakota is looking at.

Senator Sinner: In the states with massive projects California and New York, no limits?

Chad E. Novak: Yes for example California there are no current limits so it is up to the insurers to determine what they can take on and what kind of risk they are willing to assume.

Chairman Klein: You are regulated by the North Dakota insurance department?

Chad E. Novak: Yes they do as a title insurance underwriter and as an insurance provider operating in the state of North Dakota. We are a licensed provider and the state insurance department does oversee our activities in the state.

Chairman Klein: Closed the hearing.

Senator Sinner: Moved a do pass.

Senator Poolman: Seconded the motion.

Roll Call Vote: Yes-6 No-0 Absent-1

Senator Sinner will carry the bill.

Date: 3/17/2015
Roll Call Vote #:1

2015 SENATE STANDING COMMITTEE
ROLL CALL VOTES
HB 1312 Engrossed

Senate Industry, Business and Labor Committee

☐ Subcommittee

Amendment LC# or Description: _____

Recommendation: ☐ Adopt Amendment
☒ Do Pass ☐ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
☐ Place on Consent Calendar

Other Actions: ☐ Reconsider ☐ _____

Motion Made By Senator Sinner Seconded By Senator Poolman

Senators	Yes	No	Senators	Yes	No
Chairman Klein	x		Senator Murphy	x	
Vice Chairman Campbell	x		Senator Sinner	x	
Senator Burckhard	x				
Senator Miller	-				
Senator Poolman	x				

Total (Yes) 6 No 0

Absent 1

Floor Assignment Senator Sinner

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1312, as engrossed: Industry, Business and Labor Committee (Sen. Klein, Chairman) recommends **DO PASS** (6 YEAS, 0 NAYS, 1 ABSENT AND NOT VOTING). Engrossed HB 1312 was placed on the Fourteenth order on the calendar.

2015 TESTIMONY

HB 1312

#1
HB1312
2/4/15

ND House of Representatives Industry Business and Labor Committee
Committee Hearing on HB 1312
Testimony from the ND Land Title Association
2/4/14

STATEMENT IN SUPPORT OF INCREASE TO NORTH DAKOTA'S TITLE INSURANCE RISK LIMIT

Introduction

Real estate is one of the nation's largest markets, and it is therefore essential for thriving states' economies to attract and retain real estate investment. The title insurance industry supports and facilitates the efficient operation of the real estate market by insuring owners and lenders against loss or damage arising out of a defect in title, in accordance with the requirements, conditions, exclusions and endorsements of the particular policy issued. In order to fully support North Dakota's rapidly-growing real estate market, thereby continuing to attract and retain investment, single risk limitations should be changed to provide enough capacity to fully insure large commercial real estate transactions, and the rules on taking credit for reinsurance should allow credit for programs external to the title insurance industry.

How Does the Proposed Bill Change the Law?

- Increases the limit from 50% of surplus to 90% of the sum of surplus plus reserves for the reasons discussed below; and

- Allows for credit in calculating the single risk limit for treaty reinsurance programs external to the title industry in calculating the single risk limit, provided that the participating reinsurers have a minimum rating standard of A.M. Best of B+ or above.

Why Should the Title Insurance Industry Have Higher Single Risk Limitations?

Title insurance differs from property and casualty insurance in some very important ways. First, title insurance can be characterized as risk prevention insurance whereas property and casualty is risk-assumption insurance. Through the search and examination process, title professionals take a backward look at the chain of title, and any eventual policy insures title as it exists at that time the policy is issued, subject to encumbrances listed as exceptions to the policy's coverage. Title insurance may also provide coverage for past items that are not readily discoverable from a search of the public records, including forgery or fraud. As a result, title insurers are generally not insuring against the uncertain, unknowable risk that a future, damaging event will occur, but rather, title insurers protect against loss arising from past events which the title insurer works to unearth and understand. In contrast, property and casualty insurance insures against eventual accidents, which are most certainly going to occur. The wind is going to blow and the earth is going to shake, and other than sophisticated modeling designed to predict the scope of damage, there is nothing property and casualty insurers can do to prevent eventual losses. Property and casualty insurers assume this risk of loss, while title insurers work to prevent loss to the

extent possible. When title insurers perform due diligence through examining title and potentially setting forth any necessary curative action prior to closing, title insurers significantly reduce the risk of loss under title insurance policies. It is for this reason that we term title insurance risk prevention insurance. The highly-reduced probability of loss due to the risk-prevention nature of title insurance means that a much higher single-risk limit is prudent for title insurance, as opposed to risk-assumption insurance lines like property and casualty.

Second, title insurance policies are not subject to catastrophe losses in the truest sense. In the property and casualty context, a "catastrophe" refers to a single event that causes losses across many policies. The best examples of catastrophe losses are losses arising from a single storm. Multiple properties and policies are impacted by a single hurricane, which losses aggregate to significant sums. Title insurance is not subject to these types of aggregated losses except in a very narrow set of circumstances described in further detail below. Each policy issued is on a separate chain of title, with separate ownership, so a single event is extremely unlikely to cause losses across multiple policies. The exception to this rule is an authority failure, for example, a multi-site policy with common ownership where the entity or individual conveying title did not have adequate authority to do so. This so called "authority" issue can create losses across an entire portfolio, but authority is also a heavily-underwritten risk, and as a result, these types of aggregated losses are rare. Further, the facts of most title policy claims allow the title insurer to pay a sum of money that is less than policy limits to cure the defect and deliver the title as insured. As a result, the majority of title policy losses are some lesser percentage of the total liability amount insured, and complete title failures, resulting in full payment of the entire liability amount, are rare. In short, because title policy losses do not aggregate in the same manner as property and casualty policies, a higher single risk limit is warranted.

Third, taking into account the separate financial assets of both surplus and reserves will provide a more complete picture of title insurers' financial condition. Surplus is calculated by subtracting an insurer's liabilities from its assets. Reserves are separate assets that do not form a part of the surplus calculation. Reserves are a percentage of premium set aside to cover incurred, but not yet paid losses. The current statute does not take into account this significant part of a title insurer's balance sheet, the very purpose of which is claims-paying. As a result, the current statute underestimates title insurers' claims-paying ability. Changing the limit to a percentage of the sum of both surplus and reserves will account for a complete and accurate view of a title insurer's financial strength by taking into account these additional and separate balance sheet assets. This type of accounting will further permit the title insurance industry to prudently and fully insure the high-liability transactions that are now a part of North Dakota's real estate marketplace.

Additionally, this change will directly benefit North Dakota title insurance agents, which are an important segment of the business community. As the single risk limit stands today, the title industry as a whole would not have sufficient capacity to insure large transactions in excess of approximately $1.5B; and, several large, North Dakota projects in excess of this industry limit are slated for 2015.

In sum, considering the differences between title insurance and casualty insurance, and properly accounting for the separate balance sheet assets of surplus and reserves, are compelling reasons to support the real estate industry in North Dakota by raising the single risk limit.

Why Should the Credit for Reinsurance Rules Change?

Historically, reinsurance was traded primarily within the title insurance industry, either in the form of a treaty (a reinsurance agreement covering an entire portfolio of policies), or in the form of a facultative agreement (a reinsurance agreement covering a single policy or transaction). In the more recent past, the title industry moved away from treaty arrangements between title underwriters and towards reliance upon facultative reinsurance agreements covering a single policy or transaction. Because facultative reinsurance is transaction-by-transaction and there are limited numbers of potential counterparties within the title insurance industry, this supply-and-demand dynamic has impacted the availability and cost of facultative reinsurance for both large and small underwriters. Therefore, the modern trend is towards reliance upon treaties with professional reinsurers that exist outside the title industry. There are several beneficial features associated with this type of reinsurance. While each underwriter has its own reasons for deciding to pursue or not pursue reinsurance relationships external to the title industry, in the rest of the insurance industry, a fundamental concept associated with reinsurance is diversification of loss exposures. Professional reinsurers spread a variety of loss exposures across a diversified book of business, knowing that they are unlikely to have losses across each category of assumed liability in a given year. This protects their balance sheet and their long-term claims paying ability – forcefully evidenced by the fact that professional reinsurers are among the strongest insurers in the world, and often have deep historical roots. No such diversification of loss exposures exists within the title industry, as we are all subject to losses from title risks such as mechanics' liens, fraud, mineral rights claims, etc. Additionally, most of the reinsurers that participate in the external reinsurance market have ratings stronger than those that exist inside the title industry, and in this way, it is a simple and objective test to evaluate the overall strength of a particular reinsurer. Finally, this form of reinsurance usually comes through a treaty agreement, which applies to the particular title insurers' entire portfolio of policies within the limits set by the treaty. This is in stark contrast to facultative reinsurance, which only applies to a single policy or transaction, and which therefore gives negotiating leverage to the assuming party and often results in costs that are passed on to the customer. Because of the value of these types of diversified, highly-rated treaty and portfolio-wide programs, the law on crediting reinsurance in calculating single risk limits should be changed to permit not only reinsurance traded inside the title industry, but also to allow such credit for external treaty programs, provided the external reinsurers meet certain minimum ratings. This will create a level playing field among all insurers while enabling risk-ceding to some of the largest and most stable insurance institutions in the world.

Conclusion

North Dakota is projected to experience a historic influx of real estate investment, and the title insurance industry should be poised to support and facilitate this investment with enough capacity to write liability amounts equal to the deal size. The calculation of title insurer's single risk limit should

take a complete view of a title insurers' financial strength by accounting for the separate financial assets of both surplus and reserves. Finally, the rules on crediting amounts ceded to reinsurers external to the title industry should be changed to acknowledge the value and ongoing movement toward reinsurance outside the industry. This will create increased flexibility in how reinsurance is ceded, and allow the title industry enough capacity to fully absorb the high-liability transactions that are set to become prevalent in North Dakota.

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HB1312 3/17/15 #1

STATEMENT IN SUPPORT OF INCREASE TO NORTH DAKOTA'S TITLE INSURANCE RISK LIMIT

Introduction

Real estate is one of the nation's largest markets, and it is therefore essential for thriving states' economies to attract and retain real estate investment. The title insurance industry supports and facilitates the efficient operation of the real estate market by insuring owners and lenders against loss or damage arising out of a defect in title, in accordance with the requirements, conditions, exclusions and endorsements of the particular policy issued. In order to fully support North Dakota's rapidly-growing real estate market, thereby continuing to attract and retain investment, single risk limitations should be changed to provide enough capacity to fully insure large commercial real estate transactions, and the rules on taking credit for reinsurance should allow credit for programs external to the title insurance industry.

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- Increases the limit from 50% of surplus to 90% of the sum of surplus plus reserves for the reasons discussed below; and

- Allows for credit in calculating the single risk limit for treaty reinsurance programs external to the title industry in calculating the single risk limit, provided that the participating reinsurers have a minimum rating standard of A.M. Best of B+ or above.

Why Should the Title Insurance Industry Have Higher Single Risk Limitations?

Title insurance differs from property and casualty insurance in some very important ways. First, title insurance can be characterized as risk prevention insurance whereas property and casualty is risk-assumption insurance. Through the search and examination process, title professionals take a backward look at the chain of title, and any eventual policy insures title as it exists at that time the policy is issued, subject to encumbrances listed as exceptions to the policy's coverage. Title insurance may also provide coverage for past items that are not readily discoverable from a search of the public records, including forgery or fraud. As a result, title insurers are generally not insuring against the uncertain, unknowable risk that a future, damaging event will occur, but rather, title insurers protect against loss arising from past events which the title insurer works to unearth and understand. In contrast, property and casualty insurance insures against eventual accidents, which are most certainly going to occur. The wind is going to blow and the earth is going to shake, and other than sophisticated modeling designed to predict the scope of damage, there is nothing property and casualty insurers can do to prevent eventual losses. Property and casualty insurers assume this risk of loss, while title insurers work to prevent loss to the

extent possible. When title insurers perform due diligence through examining title and potentially setting forth any necessary curative action prior to closing, title insurers significantly reduce the risk of loss under title insurance policies. It is for this reason that we term title insurance risk prevention insurance. The highly-reduced probability of loss due to the risk-prevention nature of title insurance means that a much higher single-risk limit is prudent for title insurance, as opposed to risk-assumption insurance lines like property and casualty.

Second, title insurance policies are not subject to catastrophe losses in the truest sense. In the property and casualty context, a "catastrophe" refers to a single event that causes losses across many policies. The best examples of catastrophe losses are losses arising from a single storm. Multiple properties and policies are impacted by a single hurricane, which losses aggregate to significant sums. Title insurance is not subject to these types of aggregated losses except in a very narrow set of circumstances described in further detail below. Each policy issued is on a separate chain of title, with separate ownership, so a single event is extremely unlikely to cause losses across multiple policies. The exception to this rule is an authority failure, for example, a multi-site policy with common ownership where the entity or individual conveying title did not have adequate authority to do so. This so called "authority" issue can create losses across an entire portfolio, but authority is also a heavily-underwritten risk, and as a result, these types of aggregated losses are rare. Further, the facts of most title policy claims allow the title insurer to pay a sum of money that is less than policy limits to cure the defect and deliver the title as insured. As a result, the majority of title policy losses are some lesser percentage of the total liability amount insured, and complete title failures, resulting in full payment of the entire liability amount, are rare. In short, because title policy losses do not aggregate in the same manner as property and casualty policies, a higher single risk limit is warranted.

Third, taking into account the separate financial assets of both surplus and reserves will provide a more complete picture of title insurers' financial condition. Surplus is calculated by subtracting an insurer's liabilities from its assets. Reserves are separate assets that do not form a part of the surplus calculation. Reserves are a percentage of premium set aside to cover incurred, but not yet paid losses. The current statute does not take into account this significant part of a title insurer's balance sheet, the very purpose of which is claims-paying. As a result, the current statute underestimates title insurers' claims-paying ability. Changing the limit to a percentage of the sum of both surplus and reserves will account for a complete and accurate view of a title insurer's financial strength by taking into account these additional and separate balance sheet assets. This type of accounting will further permit the title insurance industry to prudently and fully insure the high-liability transactions that are now a part of North Dakota's real estate marketplace.

Additionally, this change will directly benefit North Dakota title insurance agents, which are an important segment of the business community. As the single risk limit stands today, the title industry as a whole would not have sufficient capacity to insure large transactions in excess of approximately $1.5B; and, several large, North Dakota projects in excess of this industry limit are slated for 2015.

In sum, considering the differences between title insurance and casualty insurance, and properly accounting for the separate balance sheet assets of surplus and reserves, are compelling reasons to support the real estate industry in North Dakota by raising the single risk limit.

Why Should the Credit for Reinsurance Rules Change?

Historically, reinsurance was traded primarily within the title insurance industry, either in the form of a treaty (a reinsurance agreement covering an entire portfolio of policies), or in the form of a facultative agreement (a reinsurance agreement covering a single policy or transaction). In the more recent past, the title industry moved away from treaty arrangements between title underwriters and towards reliance upon facultative reinsurance agreements covering a single policy or transaction. Because facultative reinsurance is transaction-by-transaction and there are limited numbers of potential counterparties within the title insurance industry, this supply-and-demand dynamic has impacted the availability and cost of facultative reinsurance for both large and small underwriters. Therefore, the modern trend is towards reliance upon treaties with professional reinsurers that exist outside the title industry. There are several beneficial features associated with this type of reinsurance. While each underwriter has its own reasons for deciding to pursue or not pursue reinsurance relationships external to the title industry, in the rest of the insurance industry, a fundamental concept associated with reinsurance is diversification of loss exposures. Professional reinsurers spread a variety of loss exposures across a diversified book of business, knowing that they are unlikely to have losses across each category of assumed liability in a given year. This protects their balance sheet and their long-term claims paying ability – forcefully evidenced by the fact that professional reinsurers are among the strongest insurers in the world, and often have deep historical roots. No such diversification of loss exposures exists within the title industry, as we are all subject to losses from title risks such as mechanics' liens, fraud, mineral rights claims, etc. Additionally, most of the reinsurers that participate in the external reinsurance market have ratings stronger than those that exist inside the title industry, and in this way, it is a simple and objective test to evaluate the overall strength of a particular reinsurer. Finally, this form of reinsurance usually comes through a treaty agreement, which applies to the particular title insurers' entire portfolio of policies within the limits set by the treaty. This is in stark contrast to facultative reinsurance, which only applies to a single policy or transaction, and which therefore gives negotiating leverage to the assuming party and often results in costs that are passed on to the customer. Because of the value of these types of diversified, highly-rated treaty and portfolio-wide programs, the law on crediting reinsurance in calculating single risk limits should be changed to permit not only reinsurance traded inside the title industry, but also to allow such credit for external treaty programs, provided the external reinsurers meet certain minimum ratings. This will create a level playing field among all insurers while enabling risk-ceding to some of the largest and most stable insurance institutions in the world.

Conclusion

North Dakota is projected to experience a historic influx of real estate investment, and the title insurance industry should be poised to support and facilitate this investment with enough capacity to write liability amounts equal to the deal size. The calculation of title insurer's single risk limit should

take a complete view of a title insurers' financial strength by accounting for the separate financial assets of both surplus and reserves. Finally, the rules on crediting amounts ceded to reinsurers external to the title industry should be changed to acknowledge the value and ongoing movement toward reinsurance outside the industry. This will create increased flexibility in how reinsurance is ceded, and allow the title industry enough capacity to fully absorb the high-liability transactions that are set to become prevalent in North Dakota.

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