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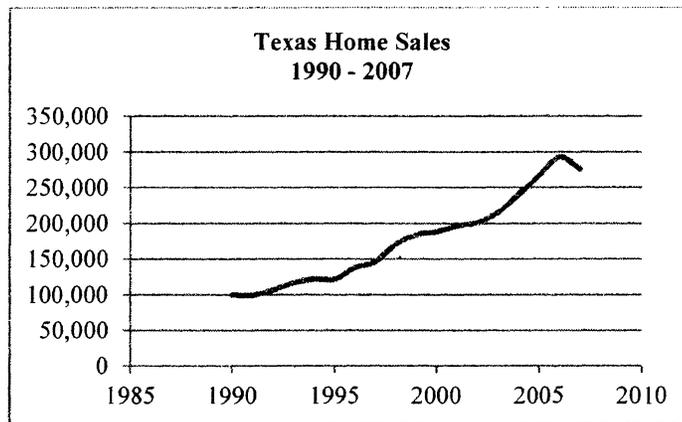
Title Insurance Preliminary Rate Analysis 2012

Introduction:

The following discussion is based on a preliminary analysis subject to change as additional information becomes available. This analysis is not intended or represented to be a comprehensive review.

Summary:

After emerging from the S&L enabled real estate bust in the late 1980's, Texas entered into a secular housing bull market that lasted until 2007-08 when the national financial crisis sharply curtailed lending.



Source: Texas A&M Real Estate Center Data

During that time, title insurance rates decreased about 18% because expense ratios declined as the title transaction volume, both from home sales and refinance, soared. During this time, it became conventional wisdom that expense ratios were predominately determined by transaction volume.

The last Commissioner's Order 10-0960 on title rates noted explicitly:

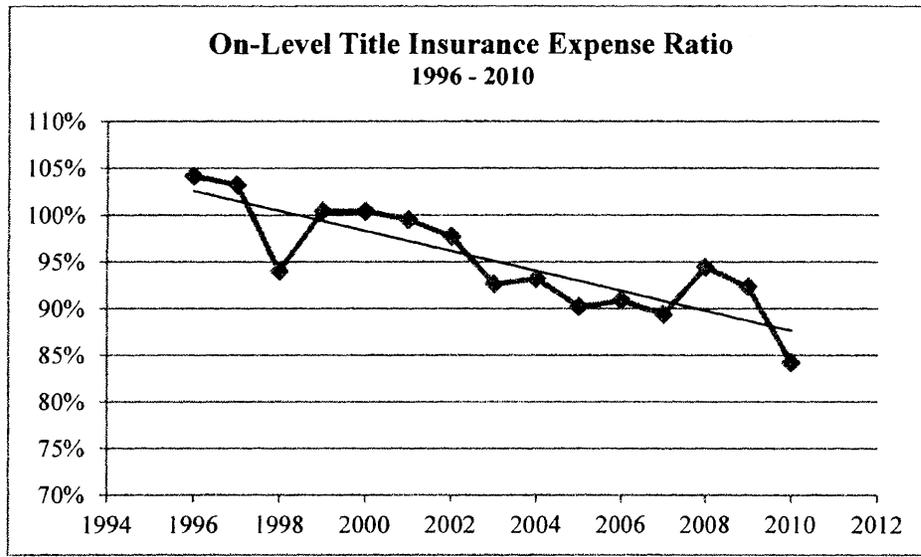
“as the number of policies and the dollars of premium increase, the expense ratio would tend to decrease; conversely, as the number of policies and the dollars of premium decrease, the expense ratio would tend to increase..”¹

This belief was based on the assumption that a considerable degree of title expenses were fixed and not easily adjusted to address a poor economic climate. The three years of title insurance data compiled since 2007² suggest this theory has flaws.

¹ FOF # 53

² 2007 was the last year of experience available for the most recent Biennial Title Rate Hearing.

Given that both title policy transactions and premium declined precipitously from 2007-2010, the expectation was for title expense ratios to increase as a result. The following chart illustrates what actually happened.



Source: TLTA Analysis, Attachment 2, Exhibit 1, Page 8

After an initial spike in 2008, title insurance cost controls and consolidation set in and by 2010 expense ratios had resumed their long-term downward trend. OPIC's testimony in the 2008 title rate case raised the issue of dramatic cost cutting measures which were being initiated even then.³ OPIC also pointed out that expense per policy trends with premium over the long term although there is some initial lag time before expenses decline after premiums do.⁴ Further, OPIC alone proposed a predictive model that was independent of premium and transaction volume. Our model predicted an expense ratio of 85.3% by the end of 2010. The actual 2010 expense ratio was 84.2%. All the other models predicted expense ratios above 90%.

The most recent available TDI statistical data shows that 2010 pre-tax profit margins were: 1) Underwriters 6.8%; 2) Affiliated agencies 12.9%; and 3) Independent agencies 7.0%. We have seen that declining premiums and transaction totals did not correlate to higher expense ratios as predicted. There are many reasons however to believe a sharply increasing transaction volume will yield much higher profitability, during the rating period, as expenses rise more slowly than premiums.

³ OPIC Rebuttal, pgs. 2-3

⁴ OPIC Rebuttal, pg. 3 (Chart)

Table 1 provides some basic context on the recent state of the Texas real estate market. Though 2011 home sales volume declined from 2010 levels, during the first seven months of 2012, both sales and median home prices showed sharp improvement from 2011. As a result, both median home value and total sales are at levels significantly above 2010. Keep in mind, these numbers do not reflect the impact of re-finance transactions which, given historically low interest rates, should be considerable.

TABLE 1

**Home Sales / Median Value
January through July**

	<u>Sales</u>	<u>Median Value</u>	<u>Sales Change Year to Year</u>	<u>Value Change Year to Year</u>
2008	146,531	\$147,571		
2009	121,093	\$144,314	-17.4%	-2.2%
2010	126,919	\$146,214	4.8%	1.3%
2011	119,713	\$147,400	-5.7%	0.8%
2012	136,364	\$155,271	13.9%	5.3%

Source: Texas A&M Real Estate Center

Based upon these findings, our initial analysis suggests a range of rate indications around zero, even with only a minimal expense reduction (1%) for reverse competition. All of the indications shown use a 5% loading for loss and LAE and a 7% profit provision. For additional context, the prior Commissioner's Order used 5% for loss and LAE and a 6% profit provision. The following table summarizes the indications.

TABLE 2

Scenario	Rate Indication	Method Used
1	+3.8%	Ten-year average expense ratio
2	+1.5%	Five-year average expense ratio
3	+1.5%	Three-year average expense ratio
4	-0.6%	Two-year average expense ratio
5	-3.6%	15-year average, trended to 12/31/12
6	-5.3%	15-year average, trended to 6/30/14
Average	-0.5%	

OPIC Schedules 1-9 provide additional detail underlying the above rate indications and support for the selected loss ratio and profit provision.

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Title Insurance Rate Indication

Scenario 1: Ten Year Average Expense Ratio

(1) : Selected Historical Expense Ratio Projection	92.5%
(2) : Adjustment for Expense Limitation	0.99
(3) : Rate Level Expense Ratio Projection	91.5%
(4) : Rate Level Loss and LAE Ratio Projection	5.0%
(5) : Underwriting Profit Factor	7.0%
(6) : Indicated Rate Level Change	3.8%

Notes:

- (1) OPIC-7, Column (5), Row (A)
- (2) Past studies / judgment.
- (3) [(1) x (2)]
- (4) Commissioner's Order 10-0960, Finding of Fact 36 and OPIC-1.
- (5) OPIC-8
- (6) [((3) + (4)) / (1 - (5))]

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Title Insurance Rate Indication

Scenario 2: Five Year Average Expense Ratio

(1) : Selected Historical Expense Ratio Projection	90.3%
(2) : Adjustment for Expense Limitation	0.99
(3) : Rate Level Expense Ratio Projection	89.4%
(4) : Rate Level Loss Ratio Projection	5.0%
(5) : Underwriting Profit Factor	7.0%
(6) : Indicated Rate Level Change	1.5%

Notes:

- (1) OPIC-7, Column (5), Row (B)
- (2) Past studies / judgment.
- (3) $[(1) \times (2)]$
- (4) Commissioner's Order 10-0960, Finding of Fact 36 and OPIC-1.
- (5) OPIC-8
- (6) $[(3) + (4)] / (1 - (5))$

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Title Insurance Rate Indication

Scenario 3: Three Year Average Expense Ratio

(1) : Selected Historical Expense Ratio Projection	90.3%
(2) : Adjustment for Expense Limitation	0.99
(3) : Rate Level Expense Ratio Projection	89.4%
(4) : Rate Level Loss Ratio Projection	5.0%
(5) : Underwriting Profit Factor	7.0%
(6) : Indicated Rate Level Change	1.5%

Notes:

- (1) OPIC-7, Column (5), Row (C)
- (2) Past studies / judgment.
- (3) [(1) x (2)]
- (4) Commissioner's Order 10-0960, Finding of Fact 36 and OPIC-1.
- (5) OPIC-8
- (6) [(3) + (4)] / (1 - (5))

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Title Insurance Rate Indication

Scenario 4: Two Year Average Expense Ratio

(1) : Selected Historical Expense Ratio Projection	88.3%
(2) : Adjustment for Expense Limitation	0.99
(3) : Rate Level Expense Ratio Projection	87.4%
(4) : Rate Level Loss Ratio Projection	5.0%
(5) : Underwriting Profit Factor	7.0%
(6) : Indicated Rate Level Change	-0.6%

Notes:

- (1) OPIC-7, Column (5), Row (D)
- (2) Past studies / judgment.
- (3) $[(1) \times (2)]$
- (4) Commissioner's Order 10-0960, Finding of Fact 36 and OPIC-1.
- (5) OPIC-8
- (6) $[\frac{((3) + (4))}{(1 - (5))}]$

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Title Insurance Rate Indication

Scenario 5: 15 Year Trended Expense Ratio to 12/31/2012

(1) : Selected Historical Expense Ratio Projection	85.5%
(2) : Adjustment for Expense Limitation	0.99
(3) : Rate Level Expense Ratio Projection	84.7%
(4) : Rate Level Loss Ratio Projection	5.0%
(5) : Underwriting Profit Factor	7.0%
(6) : Indicated Rate Level Change	-3.6%

Notes:

(1) OPIC-7, Column (5), Row (E)

(2) Past studies / judgment.

(3) [(1) x (2)]

(4) Commissioner's Order 10-0960, Finding of Fact 36 and OPIC-1.

(5) OPIC-8

(6) [((3) + (4)) / (1 - (5))]

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Title Insurance Rate Indication

Scenario 5: 15 Year Trended Expense Ratio to 6/30/14

(1) : Selected Historical Expense Ratio Projection	83.9%
(2) : Adjustment for Expense Limitation	0.99
(3) : Rate Level Expense Ratio Projection	83.1%
(4) : Rate Level Loss Ratio Projection	5.0%
(5) : Underwriting Profit Factor	7.0%
(6) : Indicated Rate Level Change	-5.3%

Notes:

(1) OPIC-7, Column (5), Row (F)

(2) Past studies / judgment.

(3) $[(1) \times (2)]$

(4) Commissioner's Order 10-0960, Finding of Fact 36 and OPIC-1.

(5) OPIC-8

(6) $[\frac{((3) + (4))}{(1 - (5))}]$

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Review of Expense Levels, Adjusted for Excess Underwriters Expense
All Agencies and Underwriters Combined

(1) Calendar Year	(2) Expense Included in Rate	(3) On-Level Retained Premium	(4) Loss & LAE	(5) On-Level Expense Ratio	(6) Loss and LAE Ratio
1985	\$421,888,060	\$539,752,142	\$24,143,775	78.2%	4.47%
1986	\$365,325,360	\$429,716,920	\$87,722,211	85.0%	20.41%
1987	\$309,541,913	\$347,348,204	\$52,020,418	89.1%	14.98%
1988	\$281,726,662	\$288,560,927	\$42,081,058	97.6%	14.58%
1989	\$282,201,676	\$274,691,800	\$33,782,282	102.7%	12.30%
1990	\$314,250,955	\$295,138,556	\$27,057,826	106.5%	9.17%
1991	\$339,288,756	\$310,955,715	\$28,069,039	109.1%	9.03%
1992	\$420,178,720	\$412,678,684	\$35,242,028	101.8%	8.54%
1993	\$516,762,529	\$516,179,574	\$20,799,646	100.1%	4.03%
1994	\$523,590,670	\$500,050,555	\$16,634,285	104.7%	3.33%
1995	\$478,009,531	\$437,648,453	\$18,352,514	109.2%	4.19%
1996	\$527,557,825	\$506,528,132	\$10,799,822	104.2%	2.13%
1997	\$588,517,726	\$570,118,853	\$15,292,558	103.2%	2.68%
1998	\$721,969,531	\$767,832,618	\$16,509,731	94.0%	2.15%
1999	\$800,942,914	\$797,297,294	\$21,140,434	100.5%	2.65%
2000	\$780,718,107	\$777,616,509	\$19,842,088	100.4%	2.55%
2001	\$912,065,318	\$916,426,775	\$18,335,658	99.5%	2.00%
2002	\$1,057,383,184	\$1,081,908,147	\$31,096,918	97.7%	2.87%
2003	\$1,277,260,852	\$1,378,761,284	\$40,870,014	92.6%	2.96%
2004	\$1,160,629,522	\$1,245,064,507	\$41,479,307	93.2%	3.33%
2005	\$1,185,673,231	\$1,314,640,687	\$49,224,084	90.2%	3.74%
2006	\$1,285,482,674	\$1,414,464,012	\$47,719,447	90.9%	3.37%
2007	\$1,238,989,603	\$1,386,125,877	\$51,647,343	89.4%	3.73%
2008	\$999,195,205	\$1,057,997,834	\$55,226,701	94.4%	5.22%
2009	\$838,318,603	\$907,828,755	\$35,639,008	92.3%	3.93%
2010	\$786,809,740	\$934,301,900	\$40,018,351	84.2%	4.28%
(A)	10-Year Avg.			92.5%	3.54%
(B)	5-Year Avg.			90.3%	4.11%
(C)	3-Year Avg.			90.3%	4.29%
(D)	2-Year Avg.			88.3%	4.10%
(E)	15-Year Trended to 12/31/12 (Adjusted R ² = .7)			85.5%	
(F)	15-Year Trended to 6/30/14 (Adjusted R ² = .7)			83.9%	

Notes:	(2), (3) and (4) Reconciled to Attachment 2, Exhibit 1, TLTA Analysis (Page 8)
	(5) = (2) / (3); (6) = (4) / (3)
(E)	Schedule OPIC-9, Sheet 1
(F)	Schedule OPIC-9, Sheet 2

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Profit Provision Summary

	<u>Profit Provision</u>
Schedule OPIC-8A	4.0%
Schedule OPIC-8B	5.5%
Schedule OPIC-8C	5.9%
Commissioner's Prior Decision	6.0%
Schedule OPIC-8D	7.3%
TLTA Provision	9.8%
Selected	7.0%

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Underwriting Profit Provision

(1) : Selected After-Tax Cost of Capital	10.6%
(2) : Pre-Tax Return on Invested Assets	4.9%
(3) : Tax on Investment Return	22.5%
(4) : After-Tax Return on Invested Assets	3.8%
(5) : Invested Assets / Capital Leverage factor	1.5
(6) : After-Tax Return on Investments Capital	5.7%
(7) : Required After-Tax Return From Underwriting / Capital	4.9%
(8) : Premium / Capital Leverage Factor	1.75
(9) : After-Tax Return from Underwriting / Premium	2.8%
(10) : Tax Rate on Underwriting Income	30%
(11) : Indicated Pre-Tax Underwriting Profit Provision	4.0%

Notes:

- (1) OPIC provision from prior hearing.
- (2) OPIC Provision from prior hearing.
- (3) TLTA Analysis, Attachment 3, Exhibit 1, Page 34, Line 4
- (4) $[(2) \times (1 - (3))]$
- (5) TLTA Analysis, Attachment 3, Exhibit 1, Page 34, Line 6
- (6) $[(4) \times (5)]$
- (7) $[(1) - (6)]$
- (8) Commissioner's Order 10-0960, Findings of Fact 96 and 97.
- (9) $[(7) / (8)]$
- (10) Commissioner's Order 10-0960, Finding of Fact 99.
- (11) $[(9) / (1 - (10))]$

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Underwriting Profit Provision

(1) : Selected After-Tax Cost of Capital	13.3%
(2) : Pre-Tax Return on Invested Assets	5.6%
(3) : Tax on Investment Return	22.5%
(4) : After-Tax Return on Invested Assets	4.3%
(5) : Invested Assets / Capital Leverage factor	1.5
(6) : After-Tax Return on Investments Capital	6.5%
(7) : Required After-Tax Return From Underwriting / Capital	6.8%
(8) : Premium / Capital Leverage Factor	1.75
(9) : After-Tax Return from Underwriting / Premium	3.9%
(10) : Tax Rate on Underwriting Income	30%
(11) : Indicated Pre-Tax Underwriting Profit Provision	5.5%

Notes:

- (1) TLTA Analysis, Attachment 3, Exhibit 1, Page 34, Line 2
- (2) TLTA Analysis, Attachment 3, Exhibit 1, Page 34, Line 3
- (3) TLTA Analysis, Attachment 3, Exhibit 1, Page 34, Line 4
- (4) $[(2) \times (1 - (3))]$
- (5) TLTA Analysis, Attachment 3, Exhibit 1, Page 34, Line 6
- (6) $[(4) \times (5)]$
- (7) $[(1) - (6)]$
- (8) Commissioner's Order 10-0960, Findings of Fact 96 and 97.
- (9) $[(7) / (8)]$
- (10) TLTA Analysis, Attachment 3, Exhibit 1, Page 34, Line 11
- (11) $[(9) / (1 - (10))]$

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Underwriting Profit Provision

(1) : Selected After-Tax Cost of Capital	11.3%
(2) : Pre-Tax Return on Invested Assets	NA
(3) : Tax on Investment Return	NA
(4) : After-Tax Return on Invested Assets	NA
(5) : Invested Assets / Capital Leverage factor	NA
(6) : After-Tax Return on Investments Capital	4.1%
(7) : Required After-Tax Return From Underwriting / Capital	7.2%
(8) : Premium / Capital Leverage Factor	1.75
(9) : After-Tax Return from Underwriting / Premium	4.1%
(10) : Tax Rate on Underwriting Income	30%
(11) : Indicated Pre-Tax Underwriting Profit Provision	5.9%

Notes:

- (1) Commissioner's Order 10-0960, Finding of Fact 91.
- (2) NA
- (3) NA
- (4) NA
- (5) NA
- (6) Commissioner's Order 10-0960, Finding of Fact 94.
- (7) [(1) - (6)]
- (8) Commissioner's Order 10-0960, Findings of Fact 96 and 97.
- (9) [(7) / (8)]
- (10) Commissioner's Order 10-0960, Finding of Fact 99.
- (11) [(9) / (1 - (10))]

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Underwriting Profit Provision

(1) : Selected After-Tax Cost of Capital	11.3%
(2) : Pre-Tax Return on Invested Assets	NA
(3) : Tax on Investment Return	NA
(4) : After-Tax Return on Invested Assets	NA
(5) : Invested Assets / Capital Leverage factor	NA
(6) : After-Tax Return on Investments Capital	4.1%
(7) : Required After-Tax Return From Underwriting / Capital	7.2%
(8) : Premium / Capital Leverage Factor	1.40
(9) : After-Tax Return from Underwriting / Premium	5.1%
(10) : Tax Rate on Underwriting Income	30%
(11) : Indicated Pre-Tax Underwriting Profit Provision	7.3%

Notes:

- (1) Commissioner's Order 10-0960, Finding of Fact 91.
- (2) NA
- (3) NA
- (4) NA
- (5) NA
- (6) Commissioner's Order 10-0960, Finding of Fact 94.
- (7) [(1) - (6)]
- (8) Judgment
- (9) [(7) / (8)]
- (10) Commissioner's Order 10-0960, Finding of Fact 99.
- (11) [(9) / (1 - (10))]

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Agent Underwriting Profit

<u>Year</u>	<u>Affiliated Agent</u>	<u>Independent Agent</u>
1994	1.9%	3.7%
1995	-1.4%	0.3%
1996	9.3%	4.2%
1997	7.3%	7.3%
1998	15.5%	9.7%
1999	8.7%	6.8%
2000	10.3%	7.2%
2001	11.2%	10.7%
2002	12.8%	9.0%
2003	14.7%	8.9%
2004	7.7%	9.3%
2005	7.8%	8.5%
2006	10.5%	7.4%
2007	9.5%	4.4%
2008	1.2%	-0.8%
2009	6.2%	5.4%
2010	12.9%	7.0%
All Year Average	8.6%	6.4%
10 Year Average	9.4%	7.0%
5 Year Average	8.0%	4.7%

Source: Title Insurance Statistical Reports

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Regression Analysis Output

15 Year Regression: X1 = Time

<u>Year</u>	<u>Data</u>	<u>On-Level Expense Ratio</u>	<u>Fitted On-Level Expense Ratio</u>
1996	1	104.2%	102.6%
1997	2	103.2%	101.5%
1998	3	94.0%	100.5%
1999	4	100.5%	99.4%
2000	5	100.4%	98.3%
2001	6	99.5%	97.3%
2002	7	97.7%	96.2%
2003	8	92.6%	95.1%
2004	9	93.2%	94.1%
2005	10	90.2%	93.0%
2006	11	90.9%	91.9%
2007	12	89.4%	90.9%
2008	13	94.4%	89.8%
2009	14	92.3%	88.7%
2010	15	84.2%	87.7%
2011	16		86.6%
2012	17		85.5%
2013	18		84.4%
2014-2Q	18.5		83.9%

SUMMARY OUTPUT

<i>Regression Statistics</i>				
Multiple R		0.848331747		
R Square		0.719666753		
Adjusted R Square		0.698102657		
Standard Error		0.030912157		
Observations			15	

ANOVA				
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>
Regression	1	0.031890315	0.03189	33.3734
Residual	13	0.012422299	0.00096	
Total	14	0.044312614		

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	1.036597681	0.016796373	61.7156	2E-17
X Variable 1	-0.010672112	0.001847355	-5.777	6.4E-05

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Regression Analysis Output

10 Year Regression: X1 = Time

<u>Year</u>	<u>Data</u>	<u>On-Level Expense Ratio</u>	<u>Fitted On-Level Expense Ratio</u>
2001	1	99.5%	97.3%
2002	2	97.7%	96.2%
2003	3	92.6%	95.1%
2004	4	93.2%	94.1%
2005	5	90.2%	93.0%
2006	6	90.9%	91.9%
2007	7	89.4%	90.8%
2008	8	94.4%	89.8%
2009	9	92.3%	88.7%
2010	10	84.2%	87.6%
2011	11		86.5%
2012	12		85.5%

SUMMARY OUTPUT

<i>Regression Statistics</i>	
Multiple R	0.75449767
R Square	0.569266734
Adjusted R Square	0.515425076
Standard Error	0.030018227
Observations	10

ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>
Regression	1	0.009527248	0.00953	10.573
Residual	8	0.007208752	0.0009	
Total	9	0.016736		

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	0.983673543	0.020506353	47.9692	3.9E-11
X Variable 1	-0.010746246	0.003304898	-3.2516	0.01167