Article Title: ARCHIVE | Criteria | Insurance | Specialty: Key Credit Factors For Title Insurers Data: (EDITOR'S NOTE: —This criteria article is no longer current. It has been superseded by "Insurers Rating Methodology," published July 1, 2019.) 1. This key credit factors (KCF) criteria article comprises S&P; Global Ratings' framework for rating title insurance companies. 2. This paragraph has been deleted. 3. The methodology to rate title insurers is based on related criteria, notably "Insurers: Rating Methodology" (the "insurance framework"), published May 7, 2013, and "Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model," published June 7, 2010 (the "capital model criteria"), which should be read in conjunction with this KCF. The KCF amends the scopes of the insurance framework and of the capital model criteria, and specifies how we apply both to title insurers. The criteria constitute specific methodologies and assumptions under "Principles Of Credit Ratings," published Feb. 16, 2011. 4. Title insurance is a contract to indemnify the insured (a mortgage lender and usually the homeowner) against loss or damage caused by defects to a property's title. Properties are both residential and commercial. Indemnification covers both loss and legal fees. The underwriting process involves a search of public records relating to the property, the chain of ownership, and the discovery of liens or encumbrances. SCOPE OF THE CRITERIA 5. The criteria apply to all global-scale foreign and local currency, long-term issuer credit, financial strength, and financial enhancement ratings on title insurers. SUMMARY OF THE CRITERIA 6. In general, how we assess title insurers is similar to how we evaluate the broader insurance sector. However, certain aspects of title insurance warrant specific methodologies, in our view, including specific application of: Insurance Industry And Country Risk Assessment (IICRA), reflecting the structural aspects of the mortgage and housing markets, the regulatory environment, the products provided, and the relevant macroeconomic factors; Competitive position, taking into consideration the title industry and company-specific business and operating performance factors; Capital and earnings; Risk position; and Liquidity, which would now specifically incorporate a title insurer's liquidity ratio. 7. This paragraph has been deleted. 8. This paragraph has been deleted. 9. This paragraph has been deleted. METHODOLOGY 10. The criteria extend the scope of our insurance framework and capital model criteria to title insurers by applying the key credit factors--IICRA, competitive position, capital and earnings, risk position, and liquidity--as described below. IICRA 11. As described in section VI.B.2 of the insurance framework, IICRA is a combination of industry and country risk assessments. IICRA addresses the risks insurers typically face operating in specific industries and countries, and we generally determine the assessment at a country or regional level. In each country where we rate title insurers, we assess a "Title IICRA," which is applicable to the title insurers operating exclusively in that country. All IICRA criteria in the framework apply, with specific application to title insurers with respect to product risk and alternative metrics. 12. Some product-specific elements in title insurance can over time cause significant volatility in underwriting results, reflected by return on revenue (ROR). We may identify and assess additional industry- or country-specific sources of volatility stemming from product risk. Examples include: Fraud, for example agent defalcation; Unpredictable settlements, notably in commercial real estate. Class action and other litigation, as well as agent defalcations, can result in unpredictable settlements; and Structural aspects of the mortgage market, including volume variability, the structure of lending mechanisms, lender market domination, and borrower recourse. 13. We apply ROR, not return on equity (ROE), as the primary metric to assess the "return on equity" component of IICRA for the title insurance sector, given that we do not consider ROE to be sufficiently reliable in this sector. Title insurance companies employ various debt-financing strategies in their overall capitalization. Also, because they are typically involved in businesses outside of title insurance, it is difficult to accurately allocate earnings and capital to title and non-title businesses from the consolidated GAAP accounts. As such, we assess the ROE IICRA subfactor as "negative" for an ROR below 5%, "positive" for an ROR above 12%, and "neutral" otherwise (for more on the IICRA subfactors, see table 3 in the insurance framework article). Competitive Position 14. We assess an insurer's competitive position under six subfactors as "positive," "neutral," or "negative," as described in section VI.B.3 of the insurance framework. The six subfactors are: (1) operating performance, (2) differentiation of brand or reputation, (3) market position, (4) level of controlled distribution channels, (5) geographic diversification, and (6) other diversification. We assess a title insurer's competitive position in the framework with specific application with respect to four of the six subfactors (operating performance, market position, controlled distribution channels, and geographic diversification). 15. We assess operating performance (paragraphs 72 and 73 in the insurance framework) as "positive" for insurers with a sustainable, prospective GAAP title-segment adjusted EBIT (adjusted to remove realized capital gains and losses and other non-recurring items) ROR in excess of 10%. We assess operating performance as "negative" for companies with a sustainable, prospective GAAP title-segment adjusted ROR of less than 5%. Otherwise, the assessment for this subfactor is "neutral." 16. We assess market position (paragraphs 80 and 81 of the framework) as "positive" for title insurers with a sustainable market share, based on total premiums written, of 30% or more, provided the recent average ROR has been, and we expect it to remain, in excess of 8%. (ROR reflects EBIT adjusted for realized and unrealized gains and losses and other non-recurring items.) We assess market share below 10% (based on total premiums written) as "negative." Otherwise, where market share is between 10% and 30%, we assess market position as "neutral." 17. We generally assess title insurers as "neutral" for controlled distribution channels (paragraphs 83 to 86 of the framework) because the benefits and risks of agent usage are already reflected in the operating performance metrics. 18. In the U.S., we assess geographic diversification (paragraphs 88 to 92 of the framework) as "neutral" if premiums from the five largest states represent 60% or less of the insurer's total premiums. Concentration of an insurer's total premiums greater than 60% in the five largest U.S. states pose significant correlated risk exposure and is assessed as "negative." Capital And Earnings 19. We apply our capital model criteria as specified below to assess capital adequacy due to the uniqueness of title insurance. 20. In the U.S., total adjusted capital (TAC) consists of statutory capital. In addition, we view claim reserves and statutory premium reserves as capital available to absorb losses and are added to TAC. Other adjustments to TAC are as per our capital model criteria. 21. Asset-related charges (commonly referred to in the U.S. as "C-1 charges") are as specified in our capital model criteria. Also, most title-specific assets, such as title plants and agent balances, are written off. 22. To calculate liability risks (C-2 charges), we incorporate 7.5% as our base case for likely losses on the insured portfolio for U.S. title insurers. The base case is based on our analysis of the relationship (from Schedule P of the statutory statements) of reserves to premiums for the industry. To stress the base case, we apply the multiples shown in table 1. Table 1 Liability Risk Calculation RATING-BASED STRESS MULTIPLE RESULTING GROSS CHARGE (% OF PREMIUMS) AAA 5 37.50 AA 3.1 23.25 A 2.1 15.75 BBB 1.5 11.25 BB 1.2 9.00 Base 1 7.50 23. The stress multiples are derived from table 5 of "Methodology And Assumptions: U.S. Second-Lien (Including HELOC, Closed-End, and HCLTV) RMBS Surveillance Credit And Cash Flow Analysis For Pre-2009 Originations," published March 12, 2013. 24. To determine interest rate risk (C-3 charges), we apply the interest rate risk methodology described in our capital model criteria. 25. In view of the revenue volatility inherent in the title industry, the C-4 charge (operating risk) reflects a scenario in which revenue falls while expense reductions lag. In our experience, the largest year-to-year increases in statutory expense ratios are about 5%. We view this as an 'A' level of stress and calibrate capital charges at other stress levels from that level. 26. We multiply the charges for U.S. title insurers by operating income (see table 2). Table 2 Operating Risk Calculations RATING-BASED STRESS MULTIPLE* C-4 (% OF OPERATING INCOME) AAA (5.0/2.1) = 2.38 11.90 AA (3.1/2.1) = 1.48 7.40 A (2.1/2.1) = 1.0 5.00 BBB (1.5/2.1) = 0.71 3.60 *Stress multiples are derived from table 5 of “Methodology And Assumptions: U.S. Second-Lien (Including HELOC, Closed-End, And HCLTV) RMBS Surveillance Credit And Cash Flow Analysis For Pre-2009 Originations,” published March 12, 2013. Risk Position 27. We assess additional sources of capital and earnings volatility (paragraph 148 of the framework criteria) as "negative" in all cases, in view of the industry's monoline status as well as the volatility associated with housing markets. Liquidity 28. We define the liquidity ratio (paragraph 197 of the framework criteria) as follows, in order to capture unique title insurance risks: Stressed liquid assets + back-up facilities / {claim reserve liquidity needs (claim reserves / duration)} + insurance operating risk charge (C-4 capital model) and insurance premium risk charge (C-2 capital model) + other analytical adjustments REVISIONS AND UPDATES This article was originally published on Sept. 22, 2014. The criteria became effective immediately on the date of publication. Changes introduced after original publication: Following our periodic review completed on Dec. 2, 2016, we updated contact information and deleted paragraphs 2 and 7-9, which were related to the initial publication of our criteria and no longer relevant. Following our periodic review completed on Nov. 27, 2017, we updated the contact information. RELATED CRITERIA AND RESEARCH Related Criteria Insurers: Rating Methodology, May 7, 2013 Principles Of Credit Ratings, Feb. 16, 2011 Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010 These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by issuer- or issue-specific attributes as well as Standard & Poor's Ratings Services' assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.