

## Claims, ALTA Risk Codes and Lessons from the Great Recession

### Description

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Our story begins in the spring of 2011. I was reviewing Stewart Title Guaranty Company's Virginia claims totals for 2010 and it was clear that the recession was causing a huge increase in claims volume and losses. My colleagues at competing underwriters confirmed that they too were experiencing a surge of claims. Borrowers were defaulting in droves and, as trustees teed up foreclosures, title problems were surfacing at an alarming rate. To paraphrase Warren Buffett, "A rising tide may raise all boats—but you don't know who's swimming naked until the tide goes out." Well the tide was dead low in title land and some nasty problems were surfacing.



**How could there be so many claims? Where there any patterns to be discerned?**

I remembered from my days handling claims that underwriters categorize claims according to "ALTA Risk Codes". When claims are logged in, staffers assign an ALTA Risk Code based on the cause of

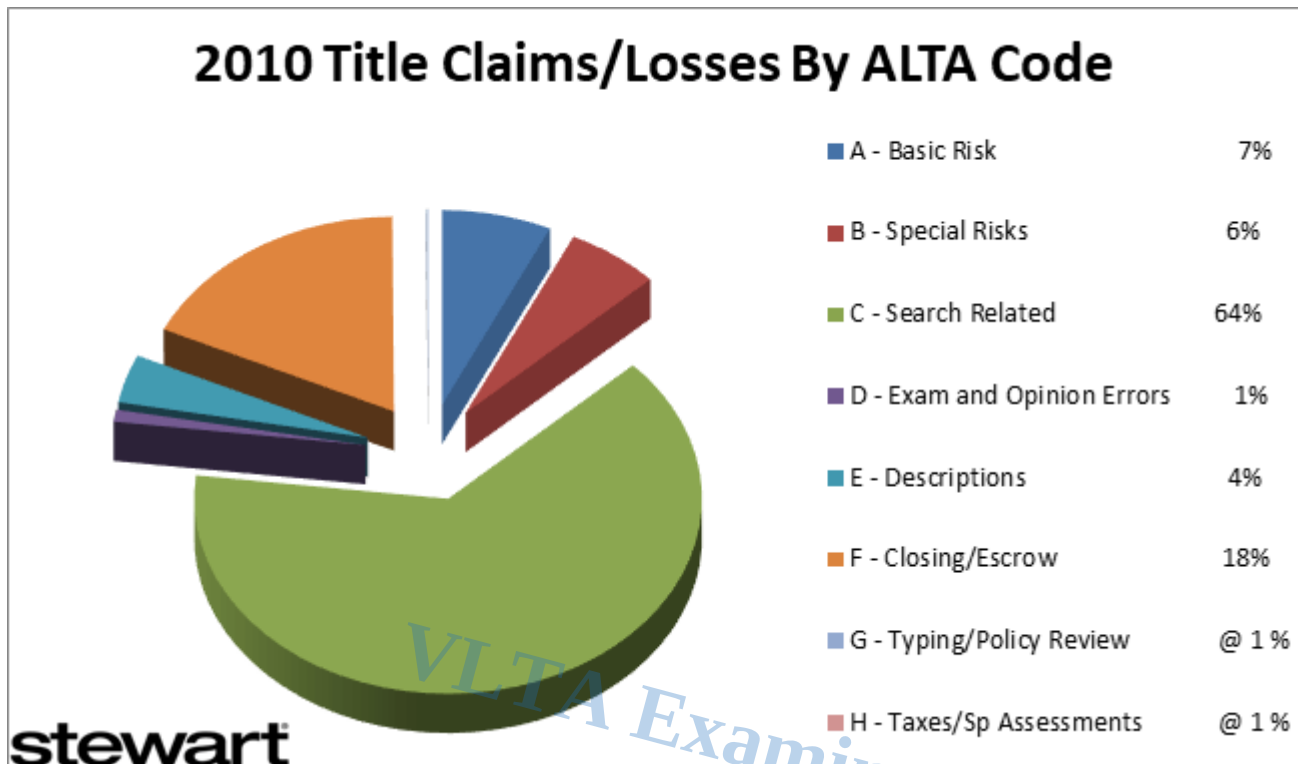
the claim. For example, ALTA Risk Code C (Plant, Searching and Abstract Procedure) would be assigned if there were an examination error. Or ALTA Risk Code F (Closing or Escrow Procedure) would apply in the event of a closing error such as failing to close a credit line.

### The ALTA Risk Codes break down as follows:

1. **Basic Risk** – what title insurance is supposed to be for – fraud, forgeries, undisclosed heirs and other title risks that cannot be uncovered by a competent title examination.
2. **Special Risks** – risks related to special coverages and endorsements such as mechanic's liens, zoning coverage or enhanced owner's policy coverages.
3. **Plant, Searching & Abstracting Procedure** – search errors, such as missed mortgages, missing ownership interests and unreported easements and restrictions.
4. **Examination and Opinion Errors** – this one is a little misleading and actually refers to what we in Virginia would call "underwriting" and would be assigned when the underwriter preparing the title commitment makes an error in analysis or judgment, such as deleting a reported lien that is still enforceable.
5. **Description Error** – generally survey matters such as encroachments, shortages in area and unrecorded easements.
6. **Closing or Escrow Procedure** – such as failure to make a payoff, insured closing letter claims for not properly following instructions or, heaven forbid! – agent fraud.
7. **Typing or Policy Review** – basically clerical errors
8. **Taxes and Special Assessments** – such as property taxes, estate taxes, association dues and special assessments.

It is important to note that the process of assigning ALTA Risk Codes is far from perfect. Claims handlers are required to assign a code very early in the claims handling process before they have had a chance to complete their investigation. For example, an adjuster faced with a claim for an unreleased deed of trust may assign Risk Code C thinking that a prior lien had been missed during the title examination. The adjuster may ultimately determine that the lien was reported on the search and shown as a binder requirement, but not paid off due to a closing error. While claims adjusters are supposed to update the ALTA Risk Code as the facts are developed, that is not always done. So, we have to recognize that there is some "noise" in the claims statistics. Nonetheless, I wanted to see if any broad patterns could be discerned.

I contacted our home office and asked if they could break down our 2010 Virginia claims losses by ALTA Risk Codes and was provided with a computer printout. When I graphed the percentage of claims losses attributable to each ALTA Risk Code, I was shocked to see that fully 64% of our 2010 claims losses were due to search errors (ALTA Risk Code C). Another 18% were Closing or Escrow Procedure (ALTA Risk Code F). So, while we were spending hours and hours training our agents in underwriting, 84% of claims were occurring *before* or *after* the binder was underwritten. The 2010 Claims pie chart was as follows:



- Remember that Risk Code "D" is what we would refer to as "underwriting".

One other thing that stood out was that ALTA Risk Code "A" (Basic Risk) constituted only about 7% of claims losses. We were not paying a lot of claims due to risks that could not be discovered "we were paying a lot of claims due to sloppy searches and settlements.

In most forms of insurance, the agent is primarily a sales person and does very little to underwrite or minimize risk and therefore receives a small percentage of premium. Title insurance is quite different. Title agents agree to undertake the expense and effort of searching title and underwriting a binder in order to eliminate any "discoverable risks" and therefore earn and retain the majority of the premium. The underwriter receives a relatively small share of premium in return for taking on "basic risks" such as fraud. The 2010 claims data made it painfully clear that some agents were not earning their lion's share of the premium.

### So, what could be done?

First and foremost, our industry recognized that it needed to weed out the title examiners and agents that had no business being in our business. These included opportunists who jumped on the title bandwagon during the real estate boom without any real background in our industry or respect for the critical role of title insurance. These bad players were often too willing to let standards slide (assuming they understood them) and were staffed by untrained novices. Many have long since left our industry. Some were shown the door by underwriters and regulators. Some simply drifted away as the boom turned to bust.

### Other positive changes have taken place:

Title agents came to realize that they were generally liable for search errors even when they used the services of a third-party examiner and tightened up their procedures for selecting and retaining examiners. Agents now do a better job of explaining search parameters to examiners, confirming examiners have sufficient E&O and recognizing that the cheapest search vendor is not always the best choice.

At the federal level, the CFPB cracked down on lenders and threatened them with liability if they did not monitor the practices and procedures of settlement agents and other settlement service providers. This regulatory pressure led to the development and promulgation of ALTA's "Best Practices", which provided the title industry with its first ever national settlement standards.

In Virginia, the legislature and Bureau of Insurance took a number of steps to tighten title agency standards, including rules addressing the oversight role of "designated licensed producers". The roll out of these State and national standards, together with related training, improved the good agents and helped drive out the weaker, uncommitted players.

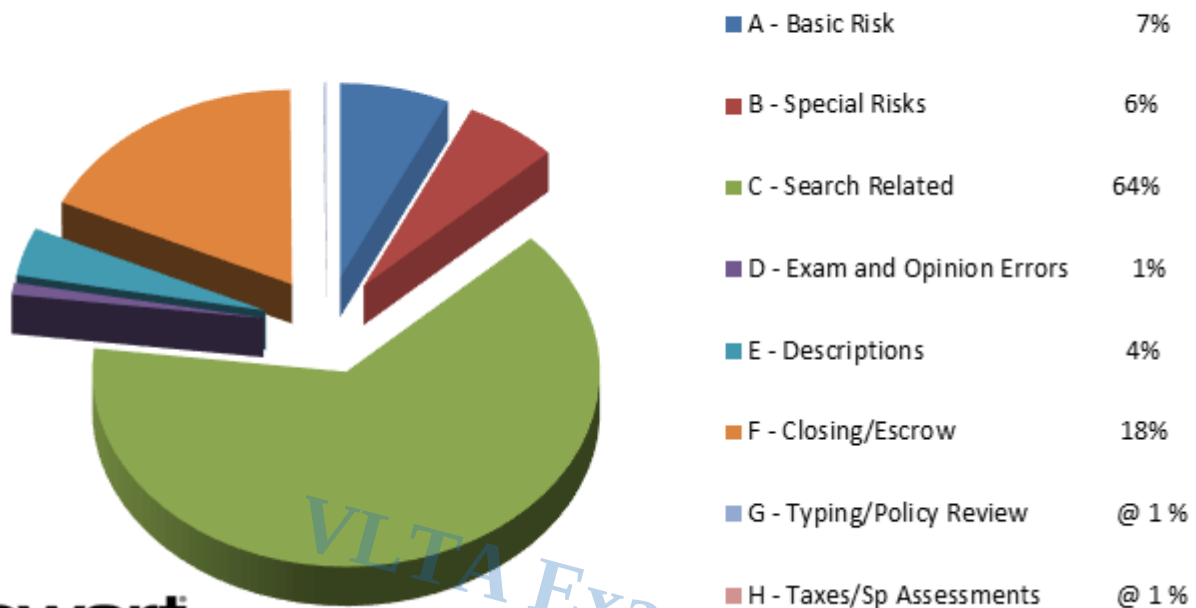
For our part, underwriters tightened our standards for signing agents and made the ALTA Best Practices a central part of agency training. We also focused more educational outreach on ensuring that title agents understood our search standards and the implications of using unreliable title examiners.

The VLTA reacted by establishing the "Virginia Certified Title Examiner" (VCTE) and "Virginia Certified Title and Settlement Agent" (VCTSA) programs in August 2012, to provide foundational training on core principles of title examination and settlement. In addition to establishing comprehensive educational materials and a certification process, the VCTE and VCTSA programs created a platform for continuing education to ensure that certified title and settlement professionals remain current on industry and regulatory changes in Virginia.

### **Review of claims loss statistics for 2017**

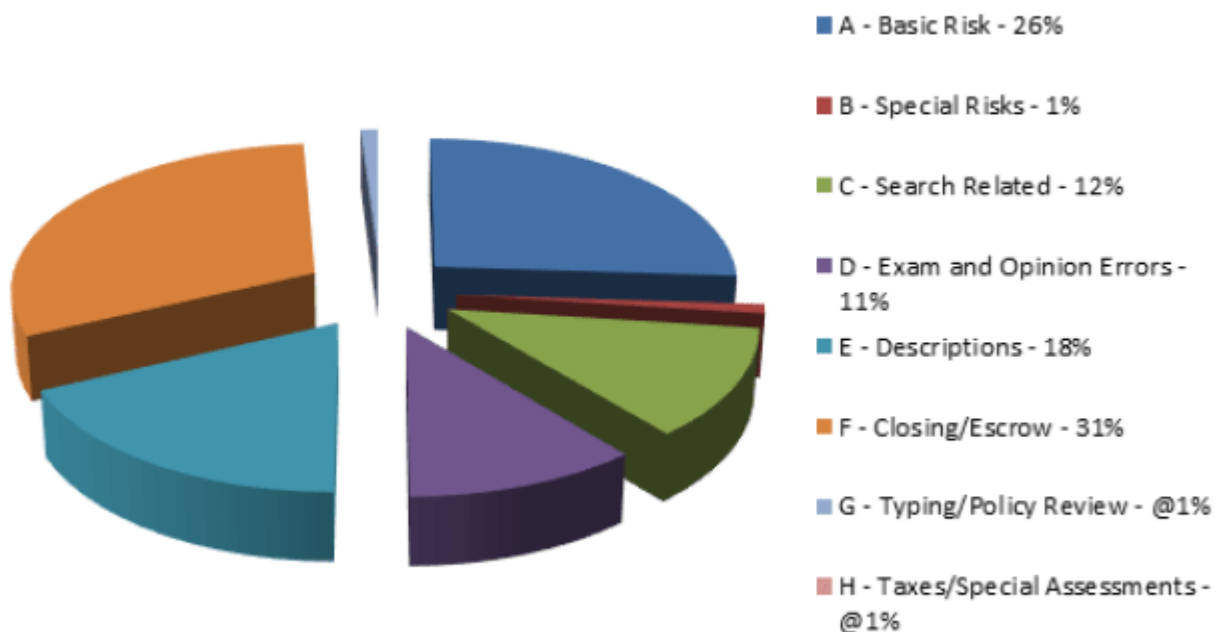
Recently, I decided to review Stewart's year-end claims loss statistics for **2017** to see if these various efforts were bearing fruit. When I compared the most current data with the 2010 figures, the contrasts were dramatic:

## 2010 Title Claims/Losses By ALTA Code



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## 2017 Title Claims/Losses by ALTA Code



As you can see, between 2010 and 2017, ALTA Risk Code A (Basic Risk) went from 7% to 26% a positive sign that fewer discoverable claims were being missed during title examinations. This was supported by the fact that ALTA Risk Code C (Plant, Searching and Abstract



Procedure) dropped from 64% to less than 11%!

Unfortunately, ALTA Risk Code • (Closing or Escrow Procedure) increased from 18% to 31% and underwriting errors reported as ALTA Risk Code • increased from 2% to 18%. However, a substantial portion of these and other percentile increases resulted from the massive decrease in search errors. By cutting out the majority of claims losses formerly attributed to search errors, the remaining categories increased as percentages without necessarily increasing in actual volume. Nonetheless, it appears that more work remains to be done to reduce losses caused by settlement errors.

### **A fairly happy ending:**

The title industry was severely challenged by the •Great Recession•. Fortunately, the subsequent shift in ALTA Risk Code allocations demonstrates that the efforts made by legislators, regulators, underwriters, title agents, examiners and the VLTA in response to the Great Recession are making a big difference.

Comparing ALTA Risk Code data from time to time can be surprising and enlightening. Reviewing prior years• claims losses is a bit like driving by looking through the rear-view mirror. However, an occasional look over our shoulders may help keep us all on the straight and narrow and ensure we are all better prepared the next time the tide goes out.

## **[Learn more about VLTA's certification programs](#)**



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Skip is Virginia state commercial counsel and Southern Virginia Agency Services manager for Stewart Title Guaranty Company. Prior to joining Stewart Title in 1995, Skip was in private practice for 14 years,

where he represented developers, lenders, title underwriters and others in commercial real estate transactions. He also practiced as a litigator handling creditor's rights, lender liability, title defense, mechanic's lien, construction and other commercial litigation.

Skip received his undergraduate degree from the College of William & Mary and his law degree from the University of Virginia School of Law. He is an adjunct professor at Old Dominion University, a Virginia Supreme Court trained mediator and a court appointed arbitrator, and he has qualified as an expert witness in state and federal courts. Skip is a past president of the Hampton Roads Association for Commercial Real Estate. Additionally, he is currently a member of the board of directors of the Virginia Land Title Association.

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