



# Bedeviled

## by reinsurance treaties

Periodically the title insurance industry is buffeted by regulatory storms that cause some upheaval but most importantly focus the industry on what it does best and on how to best provide excellent products and services. Such is the case with the current anxiety over the issue of captive reinsurance relationships between title underwriters and others in the industry, including builders and lenders. While the captive reinsurance debate has not received much notice in Illinois, it has been a hot issue in several states, including California, Colorado and Arizona. It also serves as an instructive lesson regarding the wisdom of allowing various segments of the real estate industry to provide services outside their areas of expertise.

Currently, Arizona's five largest title companies are under scrutiny as the State Department of Insurance launches an investigation into their captive reinsurance activities following the example of state agencies in Colorado and California.

Though the issue of captive reinsurance has arisen in the title industry during the past decade, reinsurance is an everyday part of the insurance business and has been used in the title industry for decades. Typically, title insurers have employed what is called "facultative" reinsurance in high liability commercial transactions. Such reinsurance is sought to avoid catastrophic losses from a single policy or transaction and may be obtained because of statutory or regulatory limits on single-risk liability, because of limits established as a matter of prudence by the board of directors of the insurer, or because of concerns expressed by the insured.

In addition to reinsuring specific risks, title insurers may obtain "treaty" reinsurance for their entire portfolio of risk. For example, smaller local and regional title insurance companies whose reserves and financial strength may limit their ability to accept a significant amount of business may obtain "treaty" reinsurance for their entire portfolio as a way to limit their exposure on a single policy or their annual exposure under all policies. Facultative and treaty reinsurance have traditionally been available from several sources including other title insurers and domestic and foreign companies that provide reinsurance to the title industry and other lines of insurance.

Before the mid-1990s, there was no demand from the title insurance industry for reinsurance in connection with most residential title insurance policies. In the late '90s, however,

lenders, builders and others in a position to refer business approached title insurers with proposals for establishing captive reinsurers for the purpose of reinsuring the title insurer's residential title risks on transactions referred to the title insurer by the lenders, builders or similar parties. Since that time, the title industry has been concerned about the propriety of such arrangements and for years has sought input on behalf of its membership from the Federal Department of Housing and Urban Development (HUD) about whether these arrangements are appropriate under the Real Estate Settlement Practices Act (RESPA).

Unfortunately, HUD has been slow to answer, finally responding last August to an American Land Title Association (ALTA) inquiry of five years standing. ALTA's questions to HUD, submitted in 1999, regarded various captive reinsurance arrangements established by builders and lenders with certain title insurers and the legality of such relationships under RESPA Section 8.

In its response, HUD merely referred the industry to a prior opinion on mortgage insurance captive reinsurance arrangements for the appropriate standard. The mortgage insurance pronouncement stated that "... the legality of captive mortgage reinsurance agreements under RESPA depended on whether payments made to the reinsurer are: 1) for reinsurance services actually furnished or for services performed and 2) for bona fide compensation that does not exceed the value of such services."

Effectively, after five years of providing no guidance to the title industry, HUD's August 2004 response on captive reinsurance served mostly to stir the pot without providing any solid recipe for the real estate industry to follow regarding these arrangements.

As president of the Illinois Land Title Association, I can assure you that we in the title industry are committed to working with HUD to ensure that rules are in place that protect the public and those of us in the real estate industry. Those efforts notwithstanding, perhaps the lesson should be drawn that all of us in the real estate industry need to take a closer look at our operations and decide whether it's advisable for us to get involved in segments of the industry that are beyond our professional expertise.

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