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- Note: PowerPoint and audio for the May 20, 2010 “Bankruptcy Update” webinar is now available at www.stewarttexas.com
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June 18, 2010

**Regulatory Update,
Solvency Legislation
Implementation**

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SHORT ANSWER

- Q: Where are we on the implementation of agent solvency legislation by TDI?
- A: Nowhere. TDI has taken no steps to implement the solvency provisions of HB 4338 in the 2009 legislature.

Thank you all for attending this conference.
Goodbye.

No, wait there are some things we can discuss.

**WHY DID WE HAVE SOLVENCY
LEGISLATION?**

- 2009 was a "perfect storm". 1. The legislature was in session; 2. We were involved in the oil and gas bulletin and general exceptions (industry asserting that attorney driven bulletin had solvency implications; 3. Midst of a rate hearing with OPIC seeking a 10+% DECREASE
- 4. United Title failure with \$12 million in escrow and no employees; 5. Land America collapse; 6. Midst of a great economic crisis and the list goes on.

TDI READS AND LISTENS

- Many articles had been published over a period of several months, if not years about the financial plight of the title industry around the USA. TDI apparently read them and expressed concerns about assuring that agents remained solvent enough to handle escrows without stealing from the escrow account.

- Commissioner had appointed a committee of industry folks and his folks to review regulations of title industry and to improve communications between the industry and the department.
- Committee had made some recommendations but neither the commissioner nor staff had made any proposals.

- In a meeting to discuss possible solvency legislation, TDI staff stated that they believed that the minimum unencumbered asset base for agents should be \$500,000 in the country and at least \$1 million in the urban counties.
- Industry attendees were astounded if not aghast at the amount!

- TLTA created a working committee to draft real legislation that would be a compromise and to replace a “placeholder” bill that Stewart had filed so that the industry would have a say in its future.
 - The committee was composed of underwriters and large & small agents and met many times in Austin with TLTA staff.

- ISSUES ADDRESSED BY HB 4338:**
- Minimum capitalization of agents
 - Abstract plants
 - Proof of agent solvency
 - Guaranty fees
 - File access
 - Underwriting premiums held in trust
 - Minimum education for market entry
 - Declaring an agent impaired
 - Proper ways of communicating with agents

- MINIMUM CAPITALIZATION OF AGENTS**
- (1) if the agent maintains its principal office in a county with a population of 10,000 or more but less than 50,000: \$25,000;
 - (2) if the agent maintains its principal office in a county with a population of 50,000 or more but less than 200,000: \$50,000;
 - (3) if the agent maintains its principal office in a county with a population of 200,000 or more but less than one million: \$100,000; and
 - (4) if the agent maintains its principal office in a county with a population of one million or more: \$150,000

MINIMUM CAPITALIZATION

- Once we got over the shock of such a large TDI proposal, we took a look at a practical approach:
 - A much smaller number
 - Based on county size with the smallest counties (<10,000 population partially exempt)
 - Options for reaching the number
 - Phase in

MINIMUM CAPITALIZATION OF AGENTS

- Except as provided by the commissioner by rule, an agent that maintains its principal office in a county with a population of less than 10,000 is exempt from this section.
- (e) An agent that maintains a principal office in more than one county must meet the asset standards for the largest county for which the agent will hold a license

- (f) An agent may elect to:
 - (1) maintain unencumbered assets as required by this section; or
 - (2) place a deposit with the department as authorized by Section 2652.102.

- There is a phase in period for all existing agents to reach the capitalization minimum:
 - New agents must meet before licensing
 - Agents already in business have the number of years in business in which to raise the money up to 10 years.
 - Example: in business 3 yrs= 3 yrs to raise the money
 - In business 7 yrs= 7 yrs to raise the money
 - Although they must put the money up proportionately for each year (1/3rd, 1/7th, 1/10th)

■ (j) Notwithstanding any other provision of this section, this section takes effect only after the commissioner adopts the form, content, and procedures for use of the surety bond authorized under Subsection (a). The commissioner by rule shall establish the procedures for making, filing, using, and paying for the surety bond. Notwithstanding Subsections (g) and (h), the commissioner by rule may extend the dates established under those subsections as necessary to comply with this subsection.

How can the minimum capitalization requirement be satisfied without tying up precious resources and rendering them unproductive?

- The minimum capitalization requirement can be met one of two ways. Either through the traditional initial bond requirements approach or a demonstration of the required amount of unencumbered assets will satisfy the requirement.
- A title agent's initial bond, pursuant to Sections 2652.101 & 2652.102, is by
 1. Bond
 2. Irrevocable letter of credit
 3. Cash or securities deposited w/ the state
- In other words, if you are an S Corp, a partnership, a proprietorship or other entity which pulls out its capital, you can substitute a Letter of Credit (which you may have to personally guarantee) or a CD (which might be your own) to meet this requirement - and you have up to 10 years to do the total.

The "capital requirement" parts of the requirements appear to be tied to the county in which the "principal office" is located. Can we elect to put our principal office in our smallest county?

- Your principal office is where your chief operating employees are located, where the majority of the financial records are kept, and most likely the location of your servers. For example, if an agent is currently located in a suburban county and adds a metro county to its license but continues to keep its original "main" office in the suburban county, it would presumably be in compliance.

There is absolutely no tie between population density and agency operational costs. If I choose to operate in Harris County with one office, why is that any different than operating in a rural county with one location?

- The TLTA work group considered many different parameters and ultimately concluded that County size was the fairest approach to capitalization. Agents are licensed by county. The size and complexity of the records comprising the title plant are determined by county size. Forty percent of Texas counties have less than 10,000 inhabitants which limits the affect of capitalization requirements.
- Additionally, agents in the same county compete at the same general rent structure, pay roughly the same compensation and benefits, have roughly the same utility costs, insurance costs and suffer the same casualty risks. Premium volume it was concluded, may not level the playing field nearly as much as county size

How will we know when the population threshold is crossed and the reserve requirement goes into effect? What will be the trigger to remove the requirement?

- The county size is only determined after each 10-year US census figures are published. Unless your county size changes dramatically, you are unlikely to have to increase your capital.
- Of course, were your county to lose population, your would have to petition the commissioner to lower your capital requirement.

Why can't we use our plants as part of the "unencumbered asset" list? (The underwriters are able to list title plants as an admitted asset)?

- Plants are not a ready source of capital. An agent whose plant has been sold will be out of business unless the agent leases the plant back. The difficulty of valuing a plant is also a factor. Plants are generally going to have the value that they had when they were created since the up date cost is treated as a cost not an increase in value. The cost from a tax perspective may far exceed the benefit to the agent.

DO WE HAVE TO HAVE OUR ASSETS AUDITED?

- At this time we don't think so although that may be part of the triennial audit process.
- To prove that you are currently solvent, an agent must on a quarterly basis send to the TDI a copy of its Federal Withholding Tax Report 941 and a copy of the check proving payment.

Does Section 2651.158 mean my CPA will determine the method of calculating my assets?

- The agent has the opportunity to choose the form of its capitalization. It can use assets if it has them; it can use a deposit with the TDI; it can use a bond or letter of credit. If using assets there will need to be a way in a rule to confirm the value while confirming those assets are not encumbered, this may include the use of a CPA. The option is with the agent. The smallest agents in the smallest counties do not have to meet this standard at all.

Who at TDI will plan to "take action to close real estate transactions, disburse escrow accounts, pay existing liens, record documents and issue final title insurance policies."?

- The law simply authorizes the Guaranty Association to arrange for these things to be done. The Guaranty Association could hire some of the failed agents former employees, it could hire a third party company approved by the Commissioner to do this type of work; it could make arrangements with the agent's underwriters to have the work done.

GUARANTY FEES

- Heretofore, the maximum guaranty fee was \$5.00.
- The bill removes the maximum and allows the Guaranty Association Board to establish the fee.
- The fee is on a per policy basis and is not chargeable on binders or commitments since they are not policies.

File Access

- TDI and underwriters have recently had great difficulty gaining access to offices, computers and storage facilities when an agent fails. Landlords hold a lien against the stuff in the space and are reluctant to give up the stuff.
 - Many are willing to do so when the privacy and related issues are explained to them
 - The bill

■ Sec. 2651.205. TITLE AGENT RECORDS. (a) A landlord or storage facility, including electronic storage, that accepts possession of an agent's guaranty file or other records takes possession subject to:

- (1) the right of access of the title insurance company involved in the transaction that the file documents, during customary business hours, for the purpose of copying the guaranty file; and
- (2) the obligation to maintain the confidentiality of nonpublic information in the title insurance agent's records according to state and federal laws that govern the title insurance agent.

■ (b) If the title insurance agent has been designated impaired, the Texas Title Insurance Guaranty Association has the right to access the guaranty files and other records of the title insurance agent, including electronic records, for 60 days from the date of impairment, during customary business hours, for purposes of copying those records.

■ (c) Except for the right of access granted under Subsections (a) and (b), a lien created in favor of the landlord by contract or otherwise is not impaired.

■ (d) For purposes of this section, "title insurance agent" includes an agent owned wholly or partly by a title insurance company and includes a direct operation.

WHAT EFFECT WILL THIS HAVE ON LEASE NEGOTIATIONS?

- When confronted with state law requirements, landlords will have to make a decision as to whether to lease to a title company. It is believed that most will since banks, liquor stores and other lines of business also have limitations on assets in rental space in case of failure of the lessee.

What if the agent has one or two landlords that will not agree to insert the language? Then the agent would be in default of its agency agreement with its underwriter.

- The law is prospective and applies to rental/lease agreements entered into after that time and only applies to new or amended agency agreements between agents and underwriters.

What about fee attorneys? What control do you have over your fee attorney office leases?

- If an agent is involved in the fee attorney's lease, then the law would apply. Otherwise, if the fee attorney maintains guaranty files, the agreement between the agent and the fee attorney would have to address this. Again, this requirement is prospective and will not effect existing agreements.

Do we now need to create separate trust accounts for splits and premiums?

- No. The money is simply legally classified as being held in trust and does not require you to hold the money in any particular way.
- Please note that this trust requirement applies not just to underwriter premiums but also to P-24 splits.
- Hundreds of thousand of dollars was owed by UTT to its underwriters and to P-24 agents.

What does the plant date have to do with the solvency issue? What was the logic behind 1979?

- A part of the concern in this area is that 1.) Agents who can subscribed to or lease an interest in a joint plant have less assets involved in their agency than before the advent of joint plants. Making the plants cover a longer period of time will add value to the subscription or lease. 2.) The 25-year plant is predicated in part on the application of the 25year statute of limitations which cures many title defects.

What does the plant date have to do with the solvency issue? What was the logic behind 1979?

- The advent of the mineral exception controversy heightened awareness of the need for standard title plants to cover a longer time. Most of the existing joint plants have the origin a short time earlier that 1-1-1979 so this proposal is designed to cover the existing joint plants and gives any agent with a non-qualifying plant 5 years to come into compliance. According to a recent TDI study, the number of title plants with an effective date affected by a 1-1-79 date would be as follows:

Date Range	Plants	% of Plant Population
1961-1980	277	25.67%
1980 and later	31	2.87%

- Of course only a small portion of the plants with an inception date of 1961-1980 are likely to be affected. Thus, there appear to be 31 plants most affected by this change: less than 3% of title plants reported to TDI by title agents and direct operations.

MINIMUM EDUCATION REQUIRED FOR MARKET ENTRY

- **How many hours of training would be required?**
- The commissioner can adopt a requirement for up to 30 hours of training performed by the same providers established in existing P-28.

DECLARING AN AGENT IMPAIRED

- When UTT failed, it was quickly apparent that the guaranty association with its auditors and guaranty fees could only be called upon for help when the agent was actually declared insolvent and placed into receivership. This is a time consuming process and customers had deals that were mid-funding that needed to be finalized.

- Section 2602.107, Insurance Code, is amended by adding Subsection (d) to read as follows:
 - (d) The association shall pay from the guaranty fee account fees and reasonable and necessary expenses that the department incurs in an examination or audit of a title agent or direct operation under this chapter and Chapter 2651.

Sec. 2602.453. AUTHORITY OF ASSOCIATION; COOPERATION OF OFFICERS, OWNERS, AND EMPLOYEES

- (a) On the direction of the commissioner under Section 2602.452, the association may implement any direction made by the commissioner and may access all books, records, accounts, networks, and electronic document storage and management systems as necessary to implement the commissioner's direction.
- (b) Any present or former officer, manager, director, trustee, owner, employee, or agent of the agent, or any other person with authority over or in charge of any segment of the agent's affairs, shall cooperate with the association.

DECLARING AN AGENT IMPAIRED

- The agent is insolvent; and
- [(B)] designated by the commissioner as an impaired agent and is:
- (A) placed by a court in this state or another state under an order of supervision, conservatorship, rehabilitation, or liquidation;
- (B) placed under an order of supervision or conservatorship under Chapter 441;
- (C) placed under an order of rehabilitation or liquidation under Chapter 443; or
- (D) otherwise found by a court of competent jurisdiction to be insolvent or otherwise unable to pay obligations as they come due.

IMPAIRMENT

- This change allows a more nimble response by the department, allows assistance by the guaranty association and allows the agent's underwriters to participate in resolving title and escrow problems.

MANNERS

- Some agents had been complaining about the approach that some TDI staffers had taken when seeking information and meetings with agents.
 - Faxes with no cover sheet
 - Be here tomorrow letters
 - And similar heavy handed approaches

Sec. 2651.206. EXAMINATION REPORTS.

- (a) An audit, review, or examination conducted under this chapter or Chapter 2602 must be conducted in accordance with rules adopted by the commissioner. The rules must provide:
 - (1) that before a report from an examination, review, or audit becomes final, the department will furnish to the title agent or direct operation a copy of the report and any evidence on which the report relies;
 - (2) a reasonable period of not less than 10 days after the title agent or direct operation receives the report and evidence from the department for the title agent or direct operation to respond;

- (3) an opportunity for an appeal under a process similar to the process under Title 28, Part 1, Chapter 7, Subchapter A, Texas Administrative Code; and
- (4) procedures to ensure that the report and any evidence regarding the report remain confidential and are transmitted only to designated representatives of the title agent or direct operation.

- (b) The commissioner shall furnish the title agent or direct operation with a draft of the report and a copy of any evidence not later than the 10th day before the scheduled date of a meeting requested by the department regarding a report.

Section 2703.202, Insurance Code

- (e) Information received or requested by the commissioner as part of an individual audit or examination under Chapters 2602 and 2651 may not be used for rate setting under Subchapter D, Chapter 2703. Nothing in this section prohibits a party from conducting discovery in a ratemaking or other proceeding or producing other information requested by the department, or verifying the data reported under a statistical plan or report promulgated by the commissioner.

WIND-DOWN PLAN

- April 29, 2010
- RE: NOTICE OF NEW WIND-DOWN PLAN REQUIREMENT
- TO ALL TITLE AGENTS IN TEXAS:
- Changes to Administrative Rule D-1(II)(C) were adopted as part of the 2008 Biennial Rules Hearing and these changes became effective on February 1, 2010. The rule now states: "Each title insurance agent operating in Texas shall prepare a plan for winding down the title agent's operations by the Company should the title insurance agent fail to wind down its own operations, including the title insurance agent's immediate cessation of business due to title insurance agent or Company action." The rule also states: "The title insurance agent's plan and authorization must be furnished to each Company and the Department." Additional information about this new requirement can be found on the TDI website.
- TDI's copy of the wind-down plan should be mailed to:
 - Texas Department of Insurance
 - Title Examinations **Mail Code 106-2T**
 - P.O. Box 149104
 - Austin, Texas 78714-9104
- Violations of this rule may result in the referral of the matter to the Enforcement Division of the Texas Department of Insurance for the initiation of disciplinary action and the imposition of sanctions pursuant to *Texas Insurance Code Annotated* sections 82.051–82.055, 84.021, and 84.022.

WHEN DO WE EXPECT SOMETHING FROM THE COMMISSIONER?

From TDI website:

- HB 4338 adds several new requirements for agents. Although HB 4338 becomes effective September 1, 2009, some of its requirements will not be operative as a practical matter until relevant rules and forms are in place.
- Effective September 1, 2009, HB 4338 requires that new abstract plants comply with HB 4338 requirements as to abstract plant age. Existing plants have until 1/1/2014 to meet the new requirements. New HB 4338 requirements as to quarterly withholding reports, management training, and minimum capitalization will be further defined through rules and forms before those requirements become operative.

THANK YOU!

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- Attorneys email bar card number to Ken Wrider for CLE credit
- Next Texas TIPS Online July 15, 2010, "Foreclosure Update, Service Members Acts, Texas and Federal" by Fred Schraub
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