STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street
San Francisco, CA 94105

RH05049799 **January 5, 2007**

Title 10, Article 7.1
Proposed Sections 2355.1-2359.7
Title Insurance and Statistical Plan

Summary and Response to Comments Received During 45-Day Comment Period

Pursuant to Gov. Code § 11346.9(a)(3), repetitive comments are aggregated, summarized and responded to as a group. Comments which were not specifically directed at the proposed regulations or procedures followed in proposing the regulations are irrelevant and have been summarized and dismissed as a group.

Additionally, because some comments reflect a more technical analysis of the proposed regulations, the summaries for those comments were not summarized as a group. Comments for pages 454-461, 515-611 and 612-904, which contain a more extensive technical analysis of the proposed regulations have been organized and summarized by comment volume number. The technical comments for Volume 2 are attached to the end of this summary and response.

Bates Numbers of Corresponding Public Comments:

406

Summary of Comments:

Escrow officer for independent escrow company approves of regulation of large escrow companies to reduce unfair practices. Expresses concern that the regulation may hurt smaller independent escrow companies.

Response to Comments:

The Commissioner rejects this comment. The regulations provide escrow companies with the opportunity to recover in charges the reasonable costs of providing their service plus a reasonable profit. If limitation to reasonable costs and reasonable profits cause some firms to withdraw from the market, that is not a reason not to so limit the charges.

Bates Numbers of Corresponding Public Comments:

407-410

Summary of Comments:

Single female escrow agent (EA) disapproves of proposed 27% reduction in escrow fees. Opines as follows:

- EA's serve important role in real estate transactions;
- Escrow fee should be commensurate with liability rather than arbitrarily capped and
- Believes regulation unfairly tarnishes the reputation of all honest escrow officers.

Response to Comments:

The Commissioner rejects this comment. The Commissioner appreciates the value of escrow services and the importance of the services being provided in a fair manner. The regulations provide escrow companies with the opportunity to recover in charges the reasonable costs of providing their service plus a reasonable profit. If limitation to reasonable costs and reasonable profits cause some firms to withdraw from the market, that is not a reason not to so limit the charges.

Bates Numbers of Corresponding Public Comments:

411

Summary of Comments:

Escrow officers work long and hard hours. Believes escrow officers are overworked and views the regulation as an implication that escrow officers are overpaid. The regulation will reduce the number of escrow officers in the industry.

Response to Comments:

The Commissioner rejects this comment. The Commissioner appreciates the value of escrow services and the importance of the services being provided in a fair manner. The regulations provide escrow companies with the opportunity to recover in charges the reasonable costs of providing their service plus a reasonable profit. If limitation to reasonable costs and reasonable profits cause some firms to withdraw from the market, that is not a reason not to so limit the charges.

Bates Numbers of Corresponding Public Comments:

412

Summary of Comments:

Certified Notary Signing Agent (CNSA) states regulation will:

- Restrict her ability to render her service in the convenience of customers home.
- Regulation will reduce the number of notaries.
- States that regulation will negatively impact notary service customers with special needs.

Response to Comments:

The Commissioner rejects this comment. The Proposed Regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code Section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

413

Summary of Comments:

Commenter approves of the regulation.

Response to Comments:

This comment is in support of the Proposed Regulations; therefore, no response is necessary.

Bates Numbers of Corresponding Public Comments:

414

Summary of Comments:

Notice of comments sent by Federal Express.

Response to Comments:

Comments were not specifically directed at the proposed action or the procedures followed by the Commissioner in proposing or adopting the action. Therefore, no response is necessary. (Gov. Code section 11346.9(a)(3))

Bates Numbers of Corresponding Public Comments:

415, 416, 419

Summary of Comments:

Escrow officer and Notary Public (NP) states that regulation will result in lost jobs and reduced income.

Response to Comments:

The Commissioner rejects this comment. The regulations provide escrow companies with the opportunity to recover in charges the reasonable costs of providing their service plus a reasonable profit. If limitation to reasonable costs and reasonable profits cause some firms to withdraw from the market, that is not a reason not to so limit the charges. Moreover, the Proposed Regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code Section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

417-417D

Summary of Comments:

Escrow officer states that the regulation will negatively impact:

- Level of competency among escrow officers;
- Ability of escrow officers to perform the many tasks of their jobs and;
- Reduce escrow officer's ability to protect consumers.

Response to Comments:

The Commissioner rejects this comment. The commenter offers no evidence to support the claim that qualified escrow companies providing good service will not be able to operate successfully under the regulations. To the contrary, the regulations require that charges for escrow be permitted to be high enough to recover reasonable charges plus a reasonable profit. The Commissioner rejects the claim that no qualified businesses will be able to function under these conditions.

Bates Numbers of Corresponding Public Comments:

418

Summary of Comments:

NP states that regulation will negatively impact incentive to become a signing agent.

Response to Comments:

The Commissioner rejects this comment. The Proposed Regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code Section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

420, 420A-420B

Summary of Comments:

Escrow officer and manager of independent escrow company states that regulation will result in:

- Salary reductions and/or layoffs;
- Companies forced out of business and;
- Consumer inconvenience.

Response to Comments:

The Commissioner rejects this comment. The commenter offers no evidence to support the claim that qualified escrow companies providing good service will not be able to operate successfully under the regulations. To the contrary, the regulations require that charges for escrow be permitted to be high enough to recover reasonable charges plus a reasonable profit. The Commissioner rejects the claim that no qualified businesses will be able to function under these conditions.

Bates Numbers of Corresponding Public Comments:

421

Summary of Comments:

- Notary public believes regulation will restrict her ability to render her service in the convenience of customers home;
- Regulation will reduce the number of notaries and;
- Cause financial burden on her business.

Response to Comments:

The Commissioner rejects this comment. The Proposed Regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code Section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

422-423

Summary of Comments:

Escrow officer states escrow industry is highly competitive and that proposed regulations will negatively impact escrow industry which is largely made up of women.

Response to Comments:

The Commissioner rejects this comment. The regulations provide escrow companies with the opportunity to recover in charges the reasonable costs of providing their service plus a reasonable profit. If limitation to reasonable costs and reasonable profit causes some firms to withdraw from the market, that is not a reason not to so limit the charges. The allegation that firms that withdraw from the market, or employees who will not be employed in the industry, include a disproportionate percentage of female employees or single parents is not a reason to allow excessive escrow charges. The Commissioner does not accept the implication that female employees or single parents cannot be productively employed by companies charging reasonable prices.

Bates Numbers of Corresponding Public Comments:

424, 433, 451

Summary of Comments:

These pages are cover sheets containing no comments.

Response to Comments:

Comments were not specifically directed at the proposed action or the procedures followed by the Commissioner in proposing or adopting the action. Therefore, no response is necessary. (Gov. Code section 11346.9(a)(3))

Bates Numbers of Corresponding Public Comments:

425, 425A-425D

Summary of Comments:

Letter in support of the proposed regulation states:

- Title insurance is one of most important insurance products for many Californians;
- There is no competition in the title insurance marketplace; and
- Title insurance is overpriced.

Response to Comments:

This comment is generally in support of the Proposed Regulations; therefore, no response is necessary.

Bates Numbers of Corresponding Public Comments:

426

Summary of Comments:

Certified Notary believes regulation will restrict ability of notaries to render service in the convenience of customer's home.

Response to Comments:

The Commissioner rejects this comment. The Proposed Regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code Section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

427

Summary of Comments:

NP states proposed regulation will:

- Negatively impact real estate industry;
- Reduce number of NPs who perform in-home notary services; and
- Inconvenience customers.

Response to Comments:

The Commissioner rejects this comment. The Proposed Regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code Section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

428

Summary of Comments:

NP states proposed regulation will:

- Reduce income;
- Reduce number of NPs who perform in-home notary services;
- Inconvenience customers; and
- Restrict services to special needs customers.

Response to Comments:

The Commissioner rejects this comment. The Proposed Regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code Section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

429

Summary of Comments:

NP states proposed regulation will:

- Reduce number of NPs who perform notary services.

Response to Comments:

The Commissioner rejects this comment. The Proposed Regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code Section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

430

Summary of Comments:

NP states proposed regulation will:

- Reduce number of NPs who perform notary services;
- Inconvenience customers; and
- Increase fraud.

Response to Comments:

The Commissioner rejects this comment. The Proposed Regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code Section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

431

Summary of Comments:

NP states proposed regulation will:

- Reduce number of NPs who perform notary services;
- Inconvenience customers; and
- Create personal financial burden.

Response to Comments:

The Commissioner rejects this comment. The Proposed Regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code Section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

432

Summary of Comments:

NP states proposed regulation will:

- Inconvenience customers; and
- Create personal financial burden.

Response to Comments:

The Commissioner rejects this comment. The Proposed Regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code Section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

434

Summary of Comments:

NP/Signing agent states proposed regulation will:

- Reduce number of NPs who perform notary services;
- Inconvenience customers; and
- Reduce NP income.

Response to Comments:

The Commissioner rejects this comment. The Proposed Regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code Section 12340.7 expressly excludes notary fees from the definition of “rates” and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

435

Summary of Comments:

NP states proposed regulation will:

- Negatively impact real estate industry;
- Reduce number of NPs who perform notary services;
- Inconvenience customers; and
- Increase fraud.

Response to Comments:

The Commissioner rejects this comment. The Proposed Regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code Section 12340.7 expressly excludes notary fees from the definition of “rates” and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

436

Summary of Comments:

NP states proposed regulation will reduce number of notaries and reduce their pay.

Response to Comments:

The Commissioner rejects this comment. The Proposed Regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code Section 12340.7 expressly excludes notary fees from the definition of “rates” and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

437

Summary of Comments:

Sole proprietor NP states proposed regulation will devastate business and cause personal financial burden.

Response to Comments:

The Commissioner rejects this comment. The Proposed Regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code Section 12340.7 expressly

excludes notary fees from the definition of “rates” and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

438

Summary of Comments:

NP/Loan Signing Agent requests “impact statement” by Legislative Analyst regarding proposed regulation.

Response to Comments:

Comments were not specifically directed at the proposed action or the procedures followed by the Commissioner in proposing or adopting the action. Therefore, no response is necessary. (Gov. Code section 11346.9(a)(3))

Bates Numbers of Corresponding Public Comments:

439-442

Summary of Comments:

Single Female Certified Senior Escrow Officer states proposed regulation will reduce escrow fees by 27% in her very competitive industry in which her company’s fee schedule has not changed in 15 years. State fees should be commensurate with liability and those companies who illegally kickback money should be sanctioned. Believes that regulation not in best interest of public.

Response to Comments:

The Commissioner rejects this comment. The Commissioner appreciates the value of escrow services and the importance of the services being provided in a fair manner. The regulations provide escrow companies with the opportunity to recover in charges the reasonable costs of providing their service plus a reasonable profit. If limitation to reasonable costs and reasonable profits cause some firms to withdraw from the market, that is not a reason not to so limit the charges. Further, the commenter has offered no evidence of price-competition in escrow. Finally, it is true that fees as a percentage of home price have not necessarily changed much. But because title and escrow rates are largely a percentage of home prices, the rise in home prices yields a corresponding increase in title and escrow revenue even when the rate itself (i.e., the numerical percentage) has not changed. The purpose of the interim-maximum regulations is to recognize that because housing prices have increased dramatically, title and escrow revenue has risen far faster than costs would justify.

Bates Numbers of Corresponding Public Comments:

443

Summary of Comments:

Female Escrow Officer states proposed regulation will reduce escrow fees by 27% in escrow industry in which her company’s fee schedule has changed once in 30 years.

States proposed regulation will negatively impact business and lives of seven women who staff instant independent escrow company.

Response to Comments:

The Commissioner rejects this comment. It is true that fees as a percentage of home price have not necessarily changed much. But because title and escrow rates are largely a percentage of home prices, the rise in home prices yields a corresponding increase in title and escrow revenue even when the rate itself (i.e., the numerical percentage) has not changed. The purpose of the interim-maximum regulations is to recognize that because housing prices have increased dramatically, title and escrow revenue has risen far faster than costs would justify. Moreover, the regulations provide escrow companies with the opportunity to recover in charges the reasonable costs of providing their service plus a reasonable profit. If limitation to reasonable costs and reasonable profit causes some firms to withdraw from the market, that is not a reason not to so limit the charges.
The allegation that firms that withdraw from the market, or employees who will not be employed in the industry, include a disproportionate percentage of female employees or single parents is not a reason to allow excessive escrow charges. The Commissioner does not accept the implication that female employees or single parents cannot be productively employed by companies charging reasonable prices.

Bates Numbers of Corresponding Public Comments:

444-445

Summary of Comments:

NP states proposed regulation will:

- Reduce family income;
- Inconvenience customers through fewer choices; and
- Increase fraud.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

446

Summary of Comments:

Real Estate paralegal/NP states proposed regulation will:

- Reduce the number of mobile NPs; and
- Reduce his future income as mobile NP.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

447

Summary of Comments:

Real Estate paralegal/NP states proposed regulation would reduce fees by 27% and will:

- Reduce the number of NPs
- Overburden current NPs; and
- Inconvenience customers through fewer choices.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

448

Summary of Comments:

NP states proposed regulation to reduce fees by 27% is not business friendly and look for other industries to regulate.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

449

Summary of Comments:

NP states proposed regulation will exterminate the notary/signing agent industry.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly

excludes notary fees from the definition of “rates” and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

450

Summary of Comments:

Notary Signing Agent states proposed regulation to regulate escrow and title fees will hurt customers and escrow/title industry workers, including signing agents.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of “rates” and consequently such fees are beyond the scope of the proposed regulations. Relative to escrow, the Commissioner appreciates the value of escrow services and the importance of the services being provided in a fair manner. The regulations provide escrow companies with the opportunity to recover in charges the reasonable costs of providing their service plus a reasonable profit. If limitation to reasonable costs and reasonable profits cause some firms to withdraw from the market, that is not a reason not to so limit the charges. Relative to title, the regulations are intended, in general, to yield sufficient revenue to give the company the opportunity to cover its reasonable costs and to earn a fair profit. Costs are generally recognized on the basis of industry-average costs, which clearly provide that opportunity. Where a company cannot cover its existing payroll or support its current spending on that basis, it suggests that the company may be over-staffed or insufficiently cost-conscious in its expenditures.

The notable departure from industry-average costs is in the area of sales, and it may well be that companies will not be able to support existing costs compensating sales personnel under the current regulation. However, the regulations are premised on the finding of a lack of competition, the presence of reverse-competition, and the effect of reverse-competition of driving up sales and “customer-service” costs. Denying companies the ability to pass such costs through to consumers is purposeful and appropriate.

Bates Numbers of Corresponding Public Comments:

452-453

Summary of Comments:

Disabled NP/Mobile Signing Agent states proposed regulation will:

- Cause personal financial hardship;
- Reduce number of NPs; and
- Inconvenience customers.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

462

Summary of Comments:

Escrow assistant states proposed regulation will cause financial hardship for hardworking escrow industry workers.

Response to Comments:

The Commissioner rejects this comment. The Commissioner appreciates the value of escrow services and the importance of the services being provided in a fair manner. The regulations provide escrow companies with the opportunity to recover in charges the reasonable costs of providing their service plus a reasonable profit. If limitation to reasonable costs and reasonable profits cause some firms to withdraw from the market, that is not a reason not to so limit the charges.

Bates Numbers of Corresponding Public Comments:

463-464

Summary of Comments:

Honest and hardworking escrow officer and manager states proposed regulation will reduce efficiency causing industry layoffs and financial burden.

Response to Comments:

The Commissioner rejects this comment. The Commissioner appreciates the value of escrow services and the importance of the services being provided in a fair manner. The regulations provide escrow companies with the opportunity to recover in charges the reasonable costs of providing their service plus a reasonable profit. If limitation to reasonable costs and reasonable profits cause some firms to withdraw from the market, that is not a reason not to so limit the charges. Moreover, the commenter offers no evidence to support the claim that qualified escrow companies providing good service will not be able to operate successfully under the regulations. To the contrary, the regulations require that charges for escrow be permitted to be high enough to recover reasonable charges plus a reasonable profit. The Commissioner rejects the claim that no qualified businesses will be able to function under these conditions.

Bates Numbers of Corresponding Public Comments:

465

Summary of Comments:

NP/Mobile Signing Agent states proposed regulation will:

- Cause personal financial hardship; and
- Negatively impact underserved, special needs customers.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

466

Summary of Comments:

Escrow coordinator opines that escrow fees should be raised.

Response to Comments:

The Commissioner rejects this comment. The Commissioner has found that the title-insurance market lacks a reasonable degree of competition. He also has observed that prices have risen as home prices have risen, without reflection of reduced costs made possible by automation. He therefore rejects this comment as not substantiated and unpersuasive.

Bates Numbers of Corresponding Public Comments:

467

Summary of Comments:

Hardworking, overworked escrow officer states proposed regulation will hurt industry workers and cause financial harm to their families.

Response to Comments:

The Commissioner rejects this comment. The Commissioner appreciates the value of escrow services and the importance of the services being provided in a fair manner. The regulations provide escrow companies with the opportunity to recover in charges the reasonable costs of providing their service plus a reasonable profit. If limitation to reasonable costs and reasonable profits cause some firms to withdraw from the market, that is not a reason not to so limit the charges.

Bates Numbers of Corresponding Public Comments:

468

Summary of Comments:

NP small real estate/mortgage brokerage owner states proposed regulation will:

- Cause personal financial hardship for industry workers; and

- Inconvenience customers.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

469, 470-471, 472-473, 474

Summary of Comments:

Dedicated escrow industry worker states that proposed regulation to reduce escrow fees 27% is unwarranted.

Response to Comments:

The Commissioner rejects this comment. The Commissioner has found that the title-insurance market lacks a reasonable degree of competition. He also has observed that prices have risen as home prices have risen, without reflection of reduced costs made possible by automation. He therefore rejects this comment as not substantiated and unpersuasive.

Bates Numbers of Corresponding Public Comments:

475

Summary of Comments:

Dedicated NP/Mobile Signing Agent states that proposed regulation to reduce escrow fees 27% is unwarranted, will negatively impact NP industry and as a result will not vote for Insurance Commissioner as Lt. Governor.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

476

Summary of Comments:

NP states that proposed regulation will negatively impact NP industry by causing loss of jobs and thereby reduce security of the country.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

<u>Bates Numbers of Corresponding Public Comments</u>:

477

<u>Summary of Comments:</u>

NP/Mobile Signing Agents supplementing their retirement income state that proposed regulation will negatively impact NP industry and convenience to customer.

<u>Response to Comments:</u>

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

<u>Bates Numbers of Corresponding Public Comments</u>:

478, 478A-478B

<u>Summary of Comments:</u>

California Notaries Public and National Notary association oppose the proposed regulation for the following reasons:

- Would reduce the number of NP/Mobile Signing Agents due to layoffs;
- Would cause reduction in NP income;
- Would negatively impact the real estate industry;
- Would cause inconvenience to customers; and
- Would increase fraud by undermining integrity of property titles.

<u>Response to Comments:</u>

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

<u>Bates Numbers of Corresponding Public Comments</u>:

479

<u>Summary of Comments:</u>

NP opposes the proposed regulation for 27% reduction in fees for the following reasons:

- Would negatively impact the real estate industry;

- Would cause inconvenience to customers; and
- Would increase fraud by undermining integrity of property titles.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

480

Summary of Comments:

Hardworking, honest escrow officer opposes the proposed regulation for 27% reduction in fees for the following reasons:

- Would negatively impact her ability to feed her family if her husband were to lose his job again.

Response to Comments:

The Commissioner rejects this comment. The Commissioner appreciates the value of escrow services and the importance of the services being provided in a fair manner. The regulations provide escrow companies with the opportunity to recover in charges the reasonable costs of providing their service plus a reasonable profit. If limitation to reasonable costs and reasonable profits cause some firms to withdraw from the market, that is not a reason not to so limit the charges.

Bates Numbers of Corresponding Public Comments:

481-483

Summary of Comments:

Single female NP/Notary Signing Agent opposes the proposed regulation for the following reasons:

- Would reduce the number of NP/Mobile Signing Agents due to layoffs;
- Would cause reduction in NP income; and
- Would cause inconvenience and fewer choices for customers.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

484-485

Summary of Comments:

NP/Notary Signing Agent opposes the proposed regulation for the following reasons:

- Would cause inconvenience to customers; and
- Would cause reduction in NP income.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

486-489

Summary of Comments:

Single mother NP/Notary Signing Agent opposes the proposed regulation for the following reasons:

- Would cause reduction in NP/NSA income; and
- Would cause inconvenience to customers.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

490-491

Summary of Comments:

NP/NSA opposes the proposed regulation for the following reasons:

- Would reduce the number of NP/Mobile Signing Agents;
- Would cause reduction in NP income;
- Would cause inconvenience to customers; and
- Would increase fraud and identity theft.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

492

Summary of Comments:

NP and Signing Agent opposes the proposed regulation for the following reasons:

- Would negatively impact the real estate industry; and
- Would harm and inconvenience customers.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

493

Summary of Comments:

Notary Signing Agent opposes the proposed regulation for the following reason:

- Would inconvenience customers.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

494

Summary of Comments:

NP/Notary Signing Agent opposes the proposed regulation for the following reasons:

- Would reduce the number of NP/Mobile Signing Agents;
- Would cause reduction in NP income; and
- Would cause inconvenience to customers.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

495-496

Summary of Comments:

Female small business owner and escrow officer opposes the proposed regulation for the following reasons:

- The Department of Insurance does not understand the differences between a person that performs escrow services and is regulated by the Department of Insurance as opposed to a person that performs escrow services as an independent escrow and is regulated by the Department of Corporations;
- Would reduce the number of escrow officers, many of whom are female;
- Would cause layoffs, hiring of low wage employees and the loss of businesses;
- Would harm real estate industry.

Response to Comments:

The Commissioner rejects this comment. The Insurance Code clearly contemplates the regulation of controlled escrow companies, implicitly recognizing and accepting any incidental effects on independent escrow companies and their regulation by the Department of Corporations. The Commissioner does not claim the authority to regulate the rates of independent escrow companies, and the proposed regulations do not purport to exercise any such regulatory authority. Moreover, the Commissioner appreciates the value of escrow services and the importance of the services being provided in a fair manner. The regulations provide escrow companies with the opportunity to recover in charges the reasonable costs of providing their service plus a reasonable profit. If limitation to reasonable costs and reasonable profits cause some firms to withdraw from the market, that is not a reason not to so limit the charges. Finally, the allegation that firms that withdraw from the market, or employees who will not be employed in the industry, include a disproportionate percentage of female employees or single parents is not a reason to allow excessive escrow charges. The Commissioner does not accept the implication that female employees or single parents cannot be productively employed by companies charging reasonable prices.

Bates Numbers of Corresponding Public Comments:

497-498

Summary of Comments:

Hardworking, self-employed NP opposes the proposed regulation for the following reasons:

- Would decrease NP income;
- Would increase cost of escrow services to consumer
- Would inconvenience consumer; and
- Would harm real estate industry.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

499

Summary of Comments:

California homeowner, taxpayer and voter opposes the proposed regulation for the following reasons:

- Would increase identity theft.

Response to Comments:

The Commissioner rejects this comment. The commenter offers no evidence to support the claim that qualified escrow companies providing good service will not be able to operate successfully under the regulations. To the contrary, the regulations require that charges for escrow be permitted to be high enough to recover reasonable charges plus a reasonable profit. The Commissioner rejects the claim that no qualified businesses will be able to function under these conditions.

Bates Numbers of Corresponding Public Comments:

500

Summary of Comments:

Notary Signing Agent opposes the proposed regulation for the following reasons:

- Would reduce the number of NP/Mobile Signing Agents;
- Would cause reduction in NP income;
- Would negatively impact the real estate industry;
- Would cause inconvenience to customers; and
- Would increase real property fraud.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly

excludes notary fees from the definition of “rates” and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

501-502

Summary of Comments:

Overworked escrow officer opposes the proposed regulation for the following reasons:

- Would cause reduction in escrow officer income;
- Would negatively impact the escrow industry;
- Would result in lost jobs in escrow industry; and
- Makes more sense to regulate fees of lenders agents and brokers.

Response to Comments:

The Commissioner rejects this comment. The Commissioner appreciates the value of escrow services and the importance of the services being provided in a fair manner. The regulations provide escrow companies with the opportunity to recover in charges the reasonable costs of providing their service plus a reasonable profit. If limitation to reasonable costs and reasonable profits cause some firms to withdraw from the market, that is not a reason not to so limit the charges. Moreover, whether current title premiums are excessive is not determined by comparison to the profitability of other market segments, which may themselves be afflicted with non-competitive markets and reverse competition. The measure of the reasonableness of title charges is measured by comparing those charges to the cost of providing the service. The regulations require that the cost not exceed the reasonable costs of providing the service – largely measured by industry-average costs – plus a reasonable profit.

Bates Numbers of Corresponding Public Comments:

503

Summary of Comments:

Real estate/mortgage broker/NP opposes the proposed regulation for the following reasons:

- Would reduce the number of NP/Mobile Signing Agents and increase unemployment rate;
- Would negatively impact the real estate industry;
- Would cause inconvenience and fewer choices for consumers; and
- Would increase real property fraud.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

504

Summary of Comments:

Self-employed NP/Loan Signing Agent opposes the proposed regulation for the following reasons:

- Would reduce the number of NP/Mobile Signing Agents thereby reducing level of service;
- Would negatively impact the real estate industry; and
- Would cause inconvenience to customers.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

505-506

Summary of Comments:

Notary Signing Agent opposes the proposed regulation for the following reasons:

- Would reduce the number of NP/Mobile Signing Agents thereby reducing level of service;
- Would negatively impact the real estate industry; and
- Would cause inconvenience to customers.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

507

Summary of Comments:

NP/Notary Signing Agent opposes the proposed regulation for the following reasons:

- Would reduce the number of NP/Mobile Signing Agents thereby reducing level of service;
- Would reduce NP income through reduced signing fees; and
- Would cause inconvenience to customers.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

508

Summary of Comments:

Notary Signing Agent opposes the proposed regulation for the following reasons:

- Would devastate business; and
- Inconvenience consumers.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of "rates" and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

509

Summary of Comments:

Certified mobile NP/Loan Signing Agent opposes the proposed regulation for the following reasons:

- Would cause reduction in NP income;
- Would negatively impact the real estate industry;
- Would cause inconvenience to customers; and
- Would increase potential of fraud.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly

excludes notary fees from the definition of “rates” and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

510

Summary of Comments:

NP opposes the proposed regulation for the following reasons:

- Would reduce consumer choices and increase NP/escrow industry workload;
- Would cause reduction in NP income; and
- Would cause inconvenience to customers.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of “rates” and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

511-514

Summary of Comments:

Mother of four and mobile NP opposes the proposed regulation for the following reason:

- Would cause reduction in NP income.

Response to Comments:

The Commissioner rejects this comment. The proposed regulations do not, in any way restrict or regulate notary fees. Indeed, Insurance Code section 12340.7 expressly excludes notary fees from the definition of “rates” and consequently such fees are beyond the scope of the proposed regulations.

Bates Numbers of Corresponding Public Comments:

454-461

Summary of Comments:

This is a duplicate copy of pages 75-82.

Response to Comments:

See the response to pages 75-82.

TITLE 10. INVESTMENTS
CHAPTER 5. INSURANCE COMMISSIONER
Article 7.1
TITLE INSURANCE STATISTICAL PLAN
AND RELATED RULES GOVERNING RATES AND CHARGES

Summary and Response to Technical Comments Received During
45-day Comment Period

Volume 2, Comment No. 515-538:

Commentator: David A. Cheit, for Stevens & O'Connell on behalf of First American Title Company.
Date of Comment: Received 8/30/06
Type of Comment: Written

Summary of Comment (page 1-3):
This passage summarizes the proposed regulation and identifies two exhibits attached to the comment. This passage also represents a summary of the commentator's specific remarks, which are set forth in greater detail within the subsequent pages of the comment.

Response to Comment:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations, or simply summarizes comments which are summarized and responded to in more detail below. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comment (page 3):

The proposed regulations exceed the relevant statutory authority because, rather than develop a comprehensive process that would result in the determination of all relevant standards and findings, the regulations establish unilateral findings on the standard of market competition and a rollback of rates to fixed maximum amounts.

Response to Comment:

The Commissioner disagrees with this comment, insofar as it suggests that the Commissioner's proposed regulations do not take into consideration all of the relevant standards for rate regulation. The Commissioner, in proposing these regulations, has taken into consideration all factors that he deems relevant for rate regulation, as required by the Insurance Code. (See, e.g., Ins. Code section 12401.3(b).)

See response to common comment A.1.

Summary of Comment (page 3-5):

The Birnbaum competition report concedes that the Department of Insurance has insufficient information to determine an insurers' profitability. Additionally, despite the statutory mandate to formulate a comprehensive system as set forth in Insurance Code sections 12401.3 and 12401.5, the Department has never implemented such a system. Thus, the proposed regulations seek to make findings concerning rates and competition before a statistical system is put into place. By making findings without a statistical plan and related regulations in place to aid in the development of such findings, the proposed regulations circumvent the Legislature's mandate.

Response to Comment:

To the extent that this comment suggests that the applicable statutory authority requires the Commissioner to await the results of a statistical plan before making findings regarding market competition, the comment is not correct, as set forth in Response to Common Comment A.1, above.

That the Commissioner has never before implemented a system of rate regulation, and currently lacks California-specific insurer profitability data does not prevent the Commissioner from administering rate regulatory laws going forward. The Commissioner recognizes that title insurers have implemented rates that, to date, have not been limited by an excessive rate standard. While prior administrations have allowed title rates to rise without regulatory standards to prevent an excessive rate, the Commissioner has concluded that such unfettered rate setting has led to rates that substantially outstrip the cost of providing insurance. The need for limits upon such unfettered rates cannot be delayed on the grounds that additional data collection would be useful to confirm the Commissioner's findings. Indeed, the Commissioner may never possess every conceivable data element that would be useful in the determination of non-excessive rates.

Summary of Comment (page 5):

For its findings, the Department relies upon a single, hand-selected consultant's report that lacks the data, methodology and balance to support the Department's findings.

Response to Comment:

The Commissioner rejects this comment. To the extent the comment attempts to impeach the selection of the expert who prepared the report, Birny Birnbaum, his expertise and experience – including service as the Chief Economist for the Texas Department of Insurance – are impeccable, and he is nationally recognized as an expert on title insurance. To the extent the comment asserts that the Commissioner ought to have ordered more reports, the Commissioner rejects this objection. As noted in the report itself, the conclusions reached in the report are consistent with numerous other reports and studies of the title industry in California and elsewhere. To the extent the comment merely incorporates other comments submitted by the commenter, those comments are dealt with in the summaries and responses to them.

Summary of Comment (page 5):

The proposed regulations are similar to the voter-approved directives of Proposition 103. But, unlike Proposition 103, neither the voters nor the Legislature have authorized the application of the Proposition 103 mandates to title insurance.

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment A.2.

Summary of Comment (page 5-6):

The proposed regulations exceed the Department's authority, are not reasonable within the meaning of Insurance Code section 12401.5 and fail to comply with the rulemaking requirements of the Administrative Procedure Act. The reasons for these failures stem from two separate features of the proposed regulations:

1) The proposed regulations contain a "Shoot First and Ask Questions Later" feature which unilaterally lowers rates to a fraction of the rate levels in 2000 and subsequently seeks information from the industry to decide whether these rate levels should have been reduced and whether they were reduced in the correct way.

2) The proposed regulations contain a "Shoot First and Don't Ask Questions" feature, in which the Department unilaterally declares a finding that the title insurance business is not sufficiently competitive but does not set forth any process for gathering information either now or in the future to determine whether this finding was then, or is now, correct.

Response to Comment:

The Commissioner rejects this comment. To the extent the commenter objects to the implementation of interim rate reductions before data have been received under the statistical plan, the Commissioner has amended the proposed regulations to delay the interim rates until there has been sufficient time to receive the initial year's data under the plan. Interim rates may never go into effect if the industry fully and timely complies with the statistical plan. However, whenever interim rates may go into effect, they will be based on a fully adequate basis: the rise in title costs attributable solely to the rise in housing prices, less a reasonable increase attributable to general inflation.

The Commissioner likewise rejects the challenge to his reliance on the Competition Report. The report has been available for over a year and subject to hearings and written comments, to which the Commissioner has responded in this file.

Summary of Comment (page 7-14):

These pages of the comment describe the author's interpretation of the historical context behind the Legislature's adoption of relevant title insurance statutes, as well as the regulations which were developed pursuant to the statutes. The commenter emphasizes three points that he gleans from this history: that the 1973 legislation adopted the excessive-inadequate standard for rate-regulation, that a finding of excessive rates must be preceded by a finding of an absence of a reasonable degree of competition, and that the Commissioner may not fix or determine rates. This portion of the comment also contains the author's recitation of the history behind voter-enacted Proposition 103, the asserted absence of the generic determinations promulgated pursuant to Proposition 103, and the author's interpretation of the methods that the Legislature and voters did, or did not, authorize the Department to perform in order to regulate title insurance rates.

Response to Comment:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. Additionally, this portion of the comment simply summarizes comments which are summarized and responded to in more detail below. Therefore, no response is necessary here. (Gov. Code section 11346.9.)

Summary of Comment (page 14-15):

A procedurally and substantively valid finding on the question of competition is a prerequisite to any determination by the Commissioner that a rate is excessive. The proposed statistical plan component of the regulations, however, fails to provide the Commissioner with any information, at any point in time, that would enable him to determine the degree of competition in the market.

Response to Comment:

The Commissioner rejects this comment. The commenter fails to identify what data would be required to determine the degree of competition. In fact, the data required would permit such analysis by providing the data required to determine market definitions, market concentrations, market trends, profitability, and other market attributes that can inform an assessment of competition.

Summary of Comment (page 15):

The proposed regulations contain a preemptive finding that a reasonable degree of competition does not exist in the title insurance market. This finding is derived entirely from a competition report that was not subject to separate regulatory approval or review. Due to the fact that the regulations contain a "relitigation bar," this regulatory finding is not capable of review or reconsideration now or in the future, to take into account changing circumstances in the title market. Because of the manner in which this finding was made, it fails to retain statistical or analytical validity.

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comments A.1 and C.34.

Summary of Comment (page 16):

The proposed regulations do not await the results of the proposed statistical plan before the imposition of interim maximum rates. Because the regulations fail to evaluate data prior to the imposition of interim rates, the proposed regulations do not provide a valid basis for the establishment of maximum title insurance rates.

Response to Comment:

The Commissioner rejects this comment. The commenter's objection that implementation of the interim rates precedes receipt of data under the statistical plan may have been obviated by the amendment that postpones interim rates until 2009. If, however, the sufficiently complete, timely, and reliable data have been received by that time, the interim rates will go into effect, which is entirely reasonable.

Summary of Comment (page 16-18):

The Legislature envisioned that Insurance Code section 12401.5 would provide the Commissioner with an orderly, comprehensive and valid basis for applying the criteria for the evaluation of rates. Insurance Code section 12401.5 does not authorize the Commissioner to implement immediate rollbacks of rates. The provisions of Proposition 103 are not applicable to title insurance and no other provision of law authorizes the Commissioner to expand the scope of Proposition 103 to title insurance. In this respect, the Commissioner's proposed regulations exceed his authority.

Response to Comment:

The Commissioner rejects this comment. The proposed regulations provide precisely the "orderly, comprehensive and valid basis" for determining whether rates are excessive. The commenter's reference to the rollback provisions of Proposition 103 is inapposite, which commanded both that rates not be excessive and imposed a separate rollback provision. The interim-rates provision of the proposed regulations is based wholly on the prohibition against excessive rates. The Commissioner has concluded that to the extent that charges for title and escrow have risen faster than the cost of providing those services due solely to the rise in housing prices, the rates are excessive under Insurance Code section 12401.3. At least until data are available from the statistical plan, this is a valid basis for the Commissioner to determine whether a rate is excessive.

See also Response to Common Comment A.2.

Summary of Comment (page 18):

The Insurance Code does not permit the Commissioner to set fixed maximum rates, which are similar to those imposed by Proposition 103.

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comments A. 2 and A.3.

Summary of Comment (page 18): While Proposition 103 permits the Commissioner to fix rates for other lines of insurance, the power to "fix or determine rates" was not extended to title insurance and is expressly disallowed by Insurance Code section 12401.3. In this respect, the Commissioner's proposed regulations exceed his authority.

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comments A.2 and A.3.

Summary of Comment (page 18):

By operation of the proposed regulations, the prospective use of any non-complying rate is automatically disapproved prior to its use. This feature of the proposed maximum "interim" rollback rates amounts to a prior approval system of rates, which is contrary to the applicable statutory authority. In this respect, the Commissioner's proposed regulations exceed his authority.

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment A.2.

Summary of Comment (page 18):

Unlike Proposition 103, which disregards considerations of market competitiveness for rate regulation, Insurance Code section 12401.5 requires the Commissioner to make the determination of market competitiveness in accordance with "reasonable rules and regulations" which yield a methodologically and factually valid basis for determining market competitiveness. In this respect, the Commissioner's proposed regulations exceed his authority.

Response to Comment:

The Commissioner rejects this comment. The commenter incorrectly reads Insurance Code section 12401.5 to require that the finding of the absence of a reasonable degree of competition must be based on data submitted pursuant to the statistical plan. The purpose of the data derived from the statistical plan is "to generate statistical information for use in reviewing and evaluating individual rate filings." (Ins. Code, § 12401.5, subd. (d).) In fact, the word "competition" does not even appear in section 12401.5. While that section may be fairly read to permit the Commissioner to use the data in assessing market-wide conditions, it contains no requirement that data from the statistical plan comprise any basis for the assessment whether a reasonable degree of competition exists.

Summary of Comment (page 18):

The Insurance Code does not authorize the Commissioner to address some, but not all, of the standards or rate determinations required by Insurance Code section 12401.3 through a regulatory structure, while reaching separate unilateral findings on other standards or rate determinations. In this respect, the Commissioner's proposed regulations exceed his authority.

Response to Comment:

The Commissioner rejects this comment. The commenter offers no authority for the proposition that the Commissioner may not adopt regulations to assist in determining whether a rate is excessive without also adopting regulations to assist in determining whether the rate satisfies other standards (presumably inadequacy and unfair discrimination). On the contrary, government may address some problems and leave others for another day. The Commissioner has determined that the problem of possibly excessive rates should be given priority in administration of these laws.

Summary of Comment (page 19):

The Commissioner's preemptive findings of a lack of competition and the establishment of interim rate reductions are made outside of the proposed statistical plan and related methodology. In this respect the Commissioner's proposed regulations fail to satisfy the requirement in Insurance Code section 12401.5 that the Commissioner's rules and regulations must be "reasonable."

Response to Comment:

The Commissioner rejects this comment. As stated above, the determination whether there exists a reasonable degree of competition may be made entirely outside the statistical plan. Similarly, the statute does not even require adoption of a statistical plan, so there clearly is no requirement of its use in making a determination that a rate is excessive. The regulations are fully reasonable in both respects.

Summary of Comment (page 19):

The proposed regulations do not contain any method or procedure for determining whether a reasonable degree of competition exists in any aspect of the title insurance business – either now or in the future. Instead, the proposed regulations rely upon the findings in a competition report drafted by a hand-picked consultant. This report does not contain any provision for review or reconsideration of the findings of that report. In this respect the Commissioner's proposed regulations fail to satisfy the requirement in Insurance Code section 12401.5 that the Commissioner's rules and regulations must be "reasonable."

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment C.34.

Summary of Comment (page 19-20):

The competition report, which forms the basis for the Commissioner's finding of a lack of competition, is a failure because it was improperly outsourced by the Commissioner and then imported into the regulations as a finding of a lack of competition. Additionally, the author of the report pursued a predetermined agenda, possesses inadequate qualifications, is obviously biased and bases his report on an incomplete database and skewed methodology. In this respect the Commissioner's proposed regulations fail to satisfy the requirement in Insurance Code section 12401.5 that the Commissioner's rules and regulations must be "reasonable."

Response to Comment:

The Commissioner rejects this comment. The commenter provides no authority for the proposition that the Competition Report was "outsourc[ed]." The Commissioner is authorized to contract for professional services under statutes with which he fully complied. The commenter's ad hominem attack on Mr. Birnbaum is an unwarranted attack on a nationally recognized authority on title insurance regulation. The commenter's assertion of bias on the part of Mr. Birnbaum based on his work for a consumer-advocacy organization is particularly ironic in view of the commenter's own reliance on the comments of experts who regularly contract with the industry for their services. (The Commissioner responds to the comments of those experts elsewhere in this file.)

Summary of Comment (page 20-21):

Insurance Code section 12401.3(b) requires the Commissioner to look at all potentially relevant factors both inside and outside of California, when applying the statutory standards for regulating title insurance rates. Additionally, the Commissioner is required to seek "uniformity" in the application of the statutory standards, including with other states. The National Conference of Insurance Legislators has established a model act by which the Commissioner might determine competitiveness of a given line of insurance. A reasonable regulatory structure would give the Department of Insurance the means to consider and review findings on market competitiveness that have methodological validity. Methodological validity is ensured by promulgating regulations which identify all relevant criteria for assessing the competitiveness of a given market. Factual validity is ensured by promulgating regulations which gather all information necessary for the proper application of the methodological criteria. The proposed regulations contain neither a methodological nor a factual process for ensuring the validity of the Commissioner's findings. In this respect the Commissioner's proposed regulations fail to satisfy the requirement in Insurance Code section 12401.5 that the Commissioner's rules and regulations must be "reasonable."

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment A.12.

Summary of Comment (page 21):

Unlike the typical statutory procedures in other states, the proposed regulations do not include an expiration date for the findings concerning competitiveness and/or a renewal period followed by a new notice and hearing process. In addition, the proposed regulations result in a finding without any mechanism for gathering and evaluating information. In this respect the Commissioner's proposed regulations fail to satisfy the requirement in Insurance Code section 12401.5 that the Commissioner's rules and regulations must be "reasonable."

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment C.34.

Summary of Comment (page 21):

The Commissioner's finding of a lack of market competition, without any mechanism to test or revisit such finding in the future, is inconsistent with the approach taken by the Commissioner with respect to Proposition 103 and the "generic determinations" found within those regulations. While the Commissioner acknowledged that he has not promulgated generic determinations under the Proposition 103 regulatory process because "the world changes," the proposed regulations appear to ignore such changes for title insurance. In this respect the Commissioner's proposed regulations fail to satisfy the requirement in Insurance Code section 12401.5 that the Commissioner's rules and regulations must be "reasonable."

Response to Comment:

The Commissioner rejects this comment. The Commissioner has, in fact, adopted the values called for in the Proposition 103 regulations. (See File No. RH05042749, regulations adopted Nov. 14, 2006.) To the extent there may prove to be a need in the future to modify the findings on competition, that need can be met by further rulemaking, which may be initiated by the Commissioner on his own initiative or in response to a rulemaking petition from a member of the public.

Summary of Comment (page 21-22):

The Commissioner's finding of excessive title insurance profits is based on a two-year data sample from the competition report. The two-year data sample represents the peak of an economic cycle that extended over 15 years, and demonstrates the lack of factual or analytical support for the Commissioner's finding of excessive rates. In this respect the Commissioner's proposed regulations fail to satisfy the requirement in Insurance Code section 12401.5 that the Commissioner's rules and regulations must be "reasonable."

Response to Comment:

See Response to Common Comment C.25.

Summary of Comment (page 22):

The proposed regulations arbitrarily provide for the use of data from the property and casualty business to determine rate levels for title insurance. The unreasonable nature of the use of such data is described in more detail in Attachment B to this comment. In this respect the Commissioner's proposed regulations fail to satisfy the requirement in Insurance Code section 12401.5 that the Commissioner's rules and regulations must be "reasonable."

Response to Comment:

This comment is summarized and responded to below in the summary and response for Attachment B to this comment.

Summary of Comment (page 22):

As explained in more detail in Attachment B to this comment, the proposed regulations fail to establish a formula to determine a reasonable maximum rate for any aspect of the title insurance business.

Response to Comment:

This comment is specifically summarized and responded to below in the summary and response for Attachment B to this comment.

Summary of Comment (page 22):

The proposed regulations do not make an adequate showing of "necessity." While the Commissioner is authorized to promulgate a detailed system to eradicate excessive rates, the proposed regulations will not have that effect. The Commissioner has made no showing of necessity or authority for making pre-emptive findings and setting rate rollbacks with fixed maximum rates that potentially will remain in effect indefinitely and without review.

Response to Comment:

The Commissioner rejects this comment. The absence of a reasonable degree of competition found by the Commissioner, the existence of rates that have much risen faster than reasonable costs, the prevalence of rebating, and the other factors identified in this file are all bases on which the Commissioner has made his finding that adoption of the proposed regulations is necessary and reasonable.

Summary of Comment (page 23):

While the Commissioner's authority to adopt title insurance rate regulations has existed since 1973, the Commissioner has decided to promulgate the regulations during the end of his term of office. The Commissioner has not shown why the regulations are suddenly necessary.

Response to Comment:

The Commissioner rejects this comment. The need for regulation of this industry has been recognized for many years and has become more acute since 2000. The Commissioner has been investigating the industry intensively for several years, confirming the need for the proposed regulations and leading to their adoption in a rulemaking file that itself was opened nearly a year ago.

Summary of Comment (page 23):

In addition to the lack of necessity for the interim-rate reductions, the factors employed to develop the prospective maximum rates are improper for the reasons set forth in Attachment B to this comment.

Response to Comment:

This comment is specifically summarized and responded to below in the summary and response for Attachment B to this comment.

Summary of Comment (page 23):

If the regulations were proposed for the valid purpose of instituting a factually and methodologically defensible procedure for applying statutory standards to title insurance rates, then reasonable alternatives to the proposed regulations abound. The most obvious reasonable alternative would be a regulatory system that addresses all of the statutory standards, rather than just one, and provides for all applicable determinations to be based on the information and criteria developed within the regulatory system itself. By imposing rate reductions before a regulatory system has been developed, the Commissioner ignores reasonable alternatives.

Response to Comment:

The Commissioner rejects this comment. To the extent the commenter is challenging the absence from the regulations of formulas to calculate inadequate or unfairly discriminatory rates, the Commissioner has focused on eradication of excessive rates because he deems that to be the most urgent problem in the market. In fact, data from the statistical plan may well inform any decision he makes as to adequacy and discrimination in rates, but it does not appear that the frequency and harm of those problems is sufficient to justify the investment of regulatory resources in adoption of such regulations at this time. To the extent the commenter is objecting to the use of any information outside the data submitted pursuant to the statistical plan, the commenter has failed to cite any authority in support of this objection, which additional suffers from the infirmity of any proposal that the Commissioner ignore substantial, relevant evidence. Ultimately, the commenter appears to be objecting to the Commissioner adopting regulations that contain any substantive findings, apparently including findings on inherently industry-wide matters such as the competitive condition of markets. The commenter cites no applicable authority or sound policy reason why the Commissioner should not fully employ his rulemaking authority as he has in the proposed regulations.

Summary of Comment (page 24):

The Initial Statement of Reasons fails to recognize the significant adverse impact on business, as explained in Attachment B to this comment.

Response to Comment:

This comment is specifically summarized and responded to below in the summary and response for Attachment B to this comment.

Summary of Comment (page 24):

The Initial Statement of Reasons states that the costs of compliance with the proposed regulations will be “modest in light of the costs already incurred by title entities in complying with current collection and reporting requirements.” On the contrary, compliance with the proposed regulations will be extremely onerous and will require costly and time-consuming development of several data retrieval information systems that do not exist under current reporting systems.

Response to Comment:

The Commissioner rejects this comment. The costs of compliance, which are substantial, are entirely reasonable in light of the serious, well-documented infirmities of the title market and their consequent effect on over $4 billion in annual consumer spending.

Summary of Comment (page 24):

Even if the statistical plan data were provided, the formulas set forth in the proposed regulations will not yield economically valid maximum rates. This point is discussed in detail in Attachment B.

Response to Comment:

This comment is specifically summarized and responded to below in the summary and response for Attachment B to this comment.

Summary of Comment (page 24):
Because the proposed regulations will yield invalid results and because the entire regulatory scheme is invalid, a full evaluation of the burden of compliance is premature and should be deferred until new regulations are promulgated that serve the purposes mandated by the Legislature.

Response to Comment:

The Commissioner rejects this comment. Commenter has identified no invalidity of these regulations and no basis for abiding excessive rates any longer than necessary to bring the companies into legal compliance.

Volume 2, Comment No. 540-583 (Exhibit A to Comments of David A. Cheit):

Commentator: Bruce Stangle and Bruce Strombom, on behalf of First American Title Company.
Date of Comment: Received 8/30/06
Type of Comment: Written

Summary of Comments, Page 2-6: The commenters provide an executive summary of their comments.

Response: Responses to the comments summarized in the executive summary are provided below, so no response to the summary of comments is needed.

Summary of Comments, Page 6-7: The commenters describe their engagement by First American and cite key findings from the proposed regulation.

Response: This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comments, Page 7: The commenters argue that the Birnbaum competition report provides no credible evidence that competition, price or otherwise, is absent in California's title insurance and escrow industries.

Response: The Commission rejects this comment. The Commissioner finds the Birnbaum Report provides credible and substantial evidence that a reasonable degree of competition does not exist in California title and escrow markets.

Summary of Comments, Page 7: There is strong evidence to the contrary, showing abundant competition exists. The Birnbaum Report acknowledges that title insurers and escrow companies compete intensively in marketing their services to gain referrals from real estate professionals and for experienced personnel, especially those who have primary contact with those capable of referring home buyers and owners for title insurance and escrow services.

Response: The Commission rejects this comment. The Birnbaum report found an absence of price competition, which is the relevant type of competition at issue. The other types of competition described by commenters reflect the reverse competitive market structure of title and escrow markets and represent a form of competition that does not benefit consumers, drives up prices beyond the reasonable costs of providing title insurance and escrow services and benefits the referrers of business at the expense of the paying consumer.

Summary of Comments, Page 7: Prices for title insurance have dropped as measured by the cost per $1,000 of coverage. The price per $1,000 of coverage has declined by 39% from 1962 to 2000 and by another 24% from 2000 to 2005. Price declines for loan policies for a refinancing have been even greater.

Response: The Commissioner rejects this comment. The measure of price used by commenters – cost per $1,000 of coverage – is not a meaningful measure of the price paid by consumers or the change in prices over time. The commenters use a price per unit of insurance liability – the amount of coverage is insurance exposure faced by the insurance company. This measure is not meaningful because the claim portion of the title insurance premium is only about 5% with expenses accounting for the other 95%. Using the examples provided by commenters, the premium for a median-priced house in 2000 was $1,006.42 and in 2005 grew to $1,617.62 – an increase of 66% in five years for the median-priced transaction. The liability portion of the premium grew from about $50 to about $81, meaning that expenses grew about $570 in five years. This is a major increase in price paid by consumers during a period when title insurers were automating and making the title search and examination process more efficient. The commenter's claim of price decreases is the foundation for many of their subsequent comments and the error in the price decrease argument undermines these subsequent comments.

Summary of Comment, Page 8: The calculations are based on filed base rates. California consumers now typically pay prices substantially below base rates so the changes in prices using base rates understate the actual decline in prices.

Response: The Commissioner rejects this comment. Commenters have provided no evidence to support the claim that consumers typically pay prices substantially below base rates. The Commissioner's review of filed discounts is that most discounts are narrowly defined and limited in applicability. Further, the commenters have not indicated when consumers allegedly started paying prices below base rates. If the alleged discounts were present in 2000, for example, then the comments would be incorrect for the 2000 to 2005 period.

Summary of Comment, Page 8: Total premiums paid for title insurance have increased naturally as price of homes and amount of coverage has increased, but premiums have increased less than the rise in home values, leading to a decline in the insurance prices as a percentage of home values.

Response: The Commissioner rejects this comment. The key measure of price changes is change in price for the median-priced transaction over time as this is the measure of what consumers pay for a comparable product over time. The fact that liability – claim costs – are a small portion of title insurance premium is reflected in the stepped rate schedules employed by title insurers in which the cost per $1,000 of coverage declines as the size of the transaction increases. This declining step rate schedule reflects the fact that the increase in the size of the transaction adds little cost to providing title insurance because the bulk of the costs remain the same, including search, examination, underwriting, sales, marketing, and administration. Again, using the median price values cited by commenters, a consumer purchasing a median priced home would have paid 66% more for the title insurance policy in 2005 than in 2000 with the change in liability accounting for only 3% of the change. During a period in which general inflation was about 13%, the increase in the premium paid was unreasonable and excessive and confirms the Birnbaum Report's conclusion that a reasonable degree of price competition does not exist in California title and escrow markets.

Summary of Comment, Page 9: Product quality has improved with increases in coverage for the basic policy offered. The price comparison understates the decline in prices because the later policies provide more coverage.

Response: The Commissioner rejects this comment. The basis for the commenters' claim of increased coverage is a chart supplied to them by First American. The commenters' do not indicate any independent analysis of changes in coverage. In fact, while there has been some increase in coverage over time, there have also been limitations on coverage.

Summary of Comment, Pages 9-11. Effective rates for title insurance have declined over time even as base rates have remained unchanged because of modified pricing programs and policy forms. First American estimates that in 2005, the majority of owner's policies issued by First American in California were at prices below the base rate. Examples include short term rates, the affordable home ownership program, first time buyers and seniors, new lower-priced policy forms and automated issuance. Significant reductions in rates for refinance loan policies were also introduced in 2005. Other insurers have filed base rate reductions for refinance loan policies, although the percent reductions were not as large as those of First American. In the fact of such clear evidence, it is difficult to understand how the Birnbaum Report could conclude that there is an absence of price competition.

Response: The Commissioner rejects this comment. There is no evidence to support the claim that rates have dropped to any meaningful extent in California. If the various claims made by commenters about the large number of rate cuts, new discounts and low-cost policies were true, the average premium per policy should be declining. Yet, even if the discounts cited by commenters are applied to their 2005 median price example, the premium for the median price transaction would still have increased substantially from 2000 levels without the discount. The Commissioner's review of rate filings made by title insurers, including requests for information to filing companies for impact analyses of various discounts, contradicts the claims of commenters. Filing companies are typically unable to identify the number of consumers receiving a particular discount. More important, filing companies misrepresent the overall rate impact of filings. In one instance, a Fidelity company made a filing in late 2006 claiming the filing represented an overall reduction of over 20%. In fact, the filing resulted in an overall rate increase of about 1% to 2%. The commenters claim that reduced pricing programs, lower-priced products and reductions in rates provide clear evidence of price competition is unsupported and rejected by the Commissioner in the face of clear evidence that home price escalation has dramatically increased the price paid by consumers for title insurance and dramatically increased title insurance premiums collected by title insurance companies.

Summary of Comment, Pages 12-15: Comparing prices for title insurance, escrow and other services across states is complicated by, one, coverage provided may not be comparable across states, two, escrow fees and other closing costs do not include the same set of services, three, closing processes may differ in ways that affect prices, and, four, inputs such as labor, quality of title records, expected loss ratio and degree of regulation may vary. The commenters reviewed a sample of settlement statements provided by First American from California and other states and the results show that title insurance and settlement related charges are lower in California than in most other large states for home sales between $450,000 and $650,000, amounts which bracket the median home sale price in California, and for refinance transactions between $350,000 and $450,000, bracketing the a loan amount equal to the 80% of the median home sales price. The data presented indicate that prices of title insurance, escrow and other related services are not excessive when compared to prices in other states and that prices in California are among the lowest when compared to other states. Unlike the analysis of filed base rates in the Birnbaum report, this comparison uses data from real transactions and reflects amounts consumers actually paid. California consumers pay lower prices than consumers in three other states in which rates are explicitly set by regulators: Texas, Florida and New Mexico. While rates in these highly regulated states reflect the unique histories, cost factors and public policy choices of the legislators and regulators in each state, the comparison provides strong evidence that California consumers do not pay excessive prices and that greater regulation, though it may promote other objectives, is not likely to lower prices in the long-run.

Response: The Commissioner rejects this comment. The survey of settlement statements is not relevant or probative for several reasons. First, the comparison across states is not applicable because of the factors cited by commenters. Second, there is no way to determine if First American actually provided a random sample of settlement statements or a biased sample that skews the results. Third, the comparison across states was for the same size transaction. While the transaction size was median in California, it was much higher than median in other states where housing prices are lower and, in some cases, much lower. The commenter's approach compares the median transaction in California – essentially the typical transaction – with high-value transactions in other states where median home prices are lower. Given that expenses represent the vast majority of title insurance premium and escrow fees and given that title premium and escrow fees decline in steps as the transaction size, we would expect, other things equal, the median-priced home transaction in one state to have a lower title premium than that of a transaction for twice the median home price in another state. Fourth, the comparison to other states is not relevant because the Commissioner is responsible for ensuring that rates in California are not excessive. In fact, there is ample evidence that excessive rates are a problem across the United States and that no state has previously adopted an effective regulatory system to deal with excessive rates. Comparisons to other states provide no information to the Commissioner about the reasonable cost basis for rates in California. The Commissioner also rejects the comment about "greater regulation." First, the commenters made no analysis to indicate whether rate regulation resulted in lower rates in those three states that would have occurred in the absence of rate regulation. Consequently, they are in no position to draw any conclusions about rate regulation lowering prices in the long run. Second, the Commissioner has a statutory responsibility to ensure that rates are not excessive and has found that a reasonable degree of competition does not exist and that a rate which exceeds the maximum permitted rate pursuant to the proposed regulation is unreasonably high for the insurance or other services provided.

Summary of Comment, Page 12: Demand must also be accounted for in determining expected level of prices. If demand increases, prices will be expected to increase. The demand for title insurance has certainly increased in recent years. Without accounting for both cost and demand changes, the Birnbaum Report conclusions about whether price changes are consistent with price competition have no economic basis.

Response: The Commissioner rejects this comment. Demand in title insurance and escrow markets is qualitatively different from demand in other insurance or consumer product markets. In most consumer product markets, there is some price elasticity of demand, meaning that consumers will demand more of a product if the price declines and demand less of a product if the price increases. Demand for title and escrow products and services is price-inelastic, meaning that even if prices were to increase dramatically, there would be little change on the quantity of title insurance demanded. This result occurs because title and escrow demand is derived from real estate transactions and the cost of title and escrow is a relatively small portion of the overall real estate transaction, even if the cost of title and escrow is substantial. In addition, the marginal cost of providing title and escrow declines with greater demand because of, among other things, the fixed cost component of title and escrow costs. With greater volume and declining marginal costs, the average cost per title insurance policy or escrow service declines. In a competitive market, prices would decline to reflect such lower costs. The Birnbaum report discusses title demand in detail. The commenters are incorrect in asserting the Birnbaum Report did not account for demand changes.

Summary of Comment, Pages 15-16 - The Birnbaum Report analyzes filed base prices from 1998 to 2005 of seven title insurance companies for homeowner's, lender's, and lender's refinancing policies. The report finds that base prices for a standard loan were similar across the seven companies and changed little over the period, except for refinancing starting about 2002. As discussed above, filed base rates without proper adjustments do not reflect actual prices. The Birnbaum Report fails to consider inflation, changes in product quality and various discounts off base rates. The Birnbaum Report claims that the absence of larger price diversity across the firms shows an absence of price competition. This is incorrect. It is well established in economics that the closer a market is to perfect competition, the closer are the prices charged by each firm. The more similar the firms' products and services the more similar their prices. The tight band of prices found by the Birnbaum Report is consistent with price competition. In short, the Birnbaum Report fundamentally misunderstands the behavior of prices in a competitive market.

Response: The Commissioner rejects this argument. The commenters mischaracterize the Birnbaum Report conclusion about base rate changes over time. The Birnbaum Report analyzed rate filings and rate changes over time and found not only little diversity among insurers in price, but virtually no change over time. In fact, the changes that did occur were rate increases for companies after a merger to make the acquired company’s prices equal to the acquiring company’s prices. The absence of price competition was evidenced not by a narrow range of prices among insurers at a particular point in time, but by the absence of change over time and the absence of any company to use a price change as a method for gaining more market share. Furthermore, the Commissioner notes that other industry commenters have touted greater price-diversity among non-major companies as evidence of the existence of competition, which this commenter suggests would be evidence of a lack of competition. These conflicting claims are properly resolved by recognizing that the major firms’ pricing is very similar, that other firms may have higher or lower prices, but that any such diversity of pricing has no effect market shares and no impact on larger firms’ pricing – all confirming the absence of a reasonable degree of competition.

Summary of Comment, Page 16: The Birnbaum Report asserts that expenses have fallen over time due to greater automation, other technological improvements and greater volume, but presents no evidence of change in title insurance costs to support the claim. Birnbaum claims filed base rates should have been reduced because of cost declines and the absence of such cost declines indicates an absence of price competition. There is nothing incompatible with cost declines and rising or stable prices if demand rises sufficiently. Birnbaum fails to properly measure price changes. California prices have declined according to our measure of price per $1,000 of coverage.

Response: The Commissioner rejects this comment. The Birnbaum Report cited a study by the American Land Title Association and A.M.Best which identified falling expenses due to automation, technological improvements, greater volume and perfection of title due to frequent turnover of a specific property. In a competitive market with sellers facing declining marginal costs, prices should decline. If sellers are able to maintain higher prices in an environment of declining costs, this is evidence of market power of sellers to raise prices above levels that would obtain in a competitive market and evidence of the absence of a reasonable degree of competition. As discussed in other responses, the commenters have failed properly measure price changes in California for title insurance and escrow products and services.

Summary of Comment, Page 17: Birnbaum errs by stating that one would expect lower rates during a period of high demand. This defies the law of supply and demand, which states that for a given supply, demand increases will raise prices.

Response: The Commissioner rejects this comment. In a competitive market with sellers facing declining marginal costs, prices should decline. If sellers are able to maintain higher prices in an environment of declining costs, this is evidence of market power of sellers to raise prices above levels that would obtain in a competitive market and evidence of the absence of a reasonable degree of competition.

Summary of Comment, Page 17: Birnbaum argues that because the price elasticity of demand for title insurance and escrow is price inelastic, it raises the possibility that sellers, as a group or individually could raise the price of title insurance or escrow services without seeing any decline in quantity demanded. This is incorrect economic analysis. There is nothing in economics that says that inelastic market demand means that individual firms face inelastic demand or that inelastic market demand causes an absence of price competition. If there were no competition, First American prices would not have fallen and escrow companies would not be competing for customers.

Response: The Commissioner rejects this comment. The commenters mischaracterize the Birnbaum report, which does not say that inelastic demand causes an absence of price competition. Birnbaum identifies a number of factors contributing to his conclusion about the absence of reasonable competition, including inelastic demand, high market concentration, high profitability and, most important, a reverse competitive market structure. It is in a reverse competitive market structure, where sellers market their products to entities that refer the paying consumer, where inelastic demand by the paying consumers takes greater prominence. A consumer is not realistically able to exert any influence on title insurers or escrow providers to lower prices because the consumer is not able to withdraw from the title insurance market and still make the real estate transaction. A consumer is not in a position to exert any market power when a lender demands a particular policy form or endorsement and requires the consumer to pay for the endorsement or policy form. Further, the Commissioner disputes the claim that First American prices have fallen or that escrow companies compete for customers, where customers are understood as the paying consumers and not the referrers of business.

Summary of Comment, Page 18: The Birnbaum report claims that higher title insurance prices will price some consumers out of the market, contradicting the claim that consumer demand is inelastic.

Response: The Commissioner rejects this comment. At some point, a price increase in title will affect a consumer's ability to purchase a home or refinance a mortgage. However, that fact does not negate the other fact that for the vast majority of consumers and for a significant range of prices, consumer demand for title and escrow is inelastic. There is no contradiction.

Summary of Comment, Pages 18-19: The commenters criticize statements by the Commissioner in a July 20, 2006 press release.

Response: "This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comment, Pages 19-20: It is well established that high concentration alone does not result in a lack of price competition. A host of other factors must be considered, some of which are detailed in the federal government's *Merger Guidelines*. The number of national title insurance companies has declined over the past 25 years, but the large mergers have been approved by federal antitrust regulators and state insurance commissioners and those mergers would not have been approved if regulators expected adverse effects on competition. There are 10 insurer groups operating in California, more than enough to ensure price competition and the number of underwritten title companies has increased. The entry of new suppliers is an indication of competition.

Response: The Commissioner rejects this comment. The Birnbaum Report considered a number of factors in addition to market concentration and did not base the conclusion about the absence of a reasonable degree of competition on high market concentration alone. The fact remains, however, that title insurance markets are very highly concentrated and that an absence of price competition is much more likely to be found in a highly concentrated market than a market that is not concentrated. The approval of mergers by regulators over the past 25 years is not evidence of a reasonable degree of competition in California title insurance and escrow markets today. Federal antitrust regulators examine a merger to determine if the merger will less competition and do not evaluate whether the pre-merger market is reasonably competitive. State regulators may be subject to statutory requirements to approve mergers if certain conditions are met, regardless of competitive impact. The Commissioner disagrees with the count of underwritten title companies in 2004 and 2005 cited by commenters. In fact, several independent underwritten title companies have been acquired by national title insurers over the past few years and virtually every new "entry" has been an affiliated business arrangement between a title insurance company and an entity able to refer business, including homebuilders and large real estate agencies.

Summary of Comment, Page 20-22: There are basic economic reasons why some markets have few firms. There are many instances of industries with few firms and intense price competition. Attempting to infer the extent of price competition from the number of sellers is misleading because it ignores the buyer's side of the market. Title insurance providers must compete for large lenders who are large scale, have market power and insist on the lowest possible prices. These large lenders demand competitive pricing.

Response: The Commissioner rejects this comment. The commenter mischaracterizes the Birnbaum Report, which did not infer an absence of price competition from the small number of firms operating in the market. The Birnbaum report considered a number of factors, including the buyer's side of the market. The commenters reinforce the analysis of the Birnbaum Report by describing the market power of large lenders who do wield market power because of their ability to deliver a large amount of business to title insurers and escrow providers. The commenters err by claiming that these large lenders are buyers and demand competitive pricing. Lenders do not pay for the title insurance premium or escrow charge and benefit from inflated pricing because the extra revenue collected by title insurers can be used to provide consideration to the lenders – and other referrers of business. The frequent occurrence of illegal rebates as well as affiliated business arrangements which funnel money and other considerations to the referrers of business is evidence that the market power of large lenders does not translate into lower prices for the paying consumer.

Summary of Comment, Page 22: The Birnbaum Report relies on an outdated and incorrect economic model. Birnbaum cites the structure, conduct, performance model that has been examined and found inadequate for over 30 years.

Response: The Commissioner rejects this comment. The Birnbaum Report considered a number of factors based on the Department of Justice Merger Guidelines and accepted approaches for analyzing competition in insurance markets. The National Association of Insurance Commissioners has long examined and analyzed competition in property casualty insurance markets and has codified methods of monitoring competition in model laws. The Birnbaum analysis is consistent with standards established by the Department of Justice and the NAIC.

Summary of Comments, Page 22-23: The Birnbaum Report fails to distinguish between gaining a competitive advantage over a rival and a barrier to entry. Attempting to gain a competitive advantage over a rival is the essence of competition and gaining such advantage is a reflection of competition, not an example of reduced competition.

Response: The Commissioner rejects this comment. The commenters do not indicate how the Birnbaum Report fails to distinguish between gaining a competitive advantage over a rival and a barrier to entry. The commenters subsequently cite and review the barriers to entry cited in the Birnbaum Report.

Summary of Comments, Pages 23: The Birnbaum Report cites four barriers to entry into the title insurance business and none make economic sense as a barrier to entry. The capital requirements in starting a new monoline insurance company are not a barrier because there is no shortage of required capital if profitable opportunities are available. There are well established insurance companies in other liens that the resources to enter if expected profits justified the investment.

Response: The Commissioner rejects this comment. The Commissioner finds the analysis of barriers to entry in the Birnbaum Report persuasive and makes economic sense. The commenters apparently misunderstand what a monoline requirement is because established insurance companies in other lines of insurance may not enter the title insurance market because a separate insurance company devoted solely to title insurance is required. Unlike a property casualty insurance company selling, say, auto insurance can start selling homeowners insurance, this company may not start selling title insurance, but would have to establish a separate insurance company with the necessary capital requirements. The Commissioner finds the claim that there is no shortage of capital if profitable opportunities are available to be a definitional belief in market forces, without any supporting analysis and not probative.

Summary of Comments, Page 23-24: The development of joint plants and easy access to title information for a modest subscription fee has removed any claims that access to title plants is a barrier to entry and the Birnbaum Report acknowledges this. However, the Birnbaum Report incorrectly concludes that in small counties ownership of a title plant may be a barrier to entry if the one or two underwritten title companies do not offer access to the plant. In a small county with a limited number of real estate transactions, it likely would not be economical to enter with a new plant. This is not a barrier to entry, it is a market condition.

Response: The Commissioner rejects this comment. The commenters cite from the Birnbaum Report that access to title plants is not a barrier to entry in larger counties, but fail to note the caution in the Birnbaum Report that ownership of the plant can convey a substantial competitive advantage by creating much different costs for title plant access between owners and subscribers. The commenters' analysis of access to title plants in small counties is incorrect. If it is uneconomical to create a new title plant in a county because of the relatively small number of transactions, then access to the title plant of an incumbent is a barrier to entry. If the incumbent allowed access to the title plant – as with joint plants in large counties – it would be possible for a new firm to enter the market.

Summary of Comments, Page 24: The Birnbaum Report confuses competition for customers with a barrier to entry in citing an entrant's need to overcome established buyer-seller relationships. Encouraging customers to switch from rival firms is a fundamental part of competition.

Response: The Commissioner rejects this comment. The commenters confuse competition for customers, which occurs in a normally competitive market, with competition for the referrers of business, which occurs in the reverse competitive markets of title insurance and escrow. The commenters misrepresent the nature of this competition by describing it as a buyer-seller relationship because the buyer – the consumer paying for the product – is not the target of competition by the seller. The Birnbaum Report shows how access to the referrers of business is a barrier to entry, as evidenced by the facts that virtually all new underwritten title companies are affiliated business arrangements that allow a title insurance company to lock in referrals from a real estate professional and that title insurers are more like to purchase business by acquiring underwritten title companies and paying huge sums to hire senior staff from other companies who will bring business with them.

Summary of Comments, Pages 24-25: The Birnbaum Report concludes that controlled business arrangements are a barrier to entry and a legal form of rebating that raises costs and results in higher prices to consumers. What the Birnbaum Report describes is vertical integration and such action can allow improved efficiency and lower costs. If vertical integration raised costs without providing commensurate benefits, vertically integrated firms would be eliminated by competition from efficient, non-integrated firms. Vertical integration is not a barrier to entry as there is no shortage of potential affiliates.

Response: The Commissioner rejects this comment. The commenters' argument -- that vertical integration – affiliated business arrangements – must lead to greater efficiency and lower costs or else competition would eliminate such business arrangements – is without analytic support, definitional in nature and without probative value. There is a cost to establishing an affiliated business arrangement between a title insurance company and a referrer of title business, such as a real estate broker. The substantial costs of such a business arrangement – which include establishing and operating an underwritten title company – are only justified if the referral partner can provide a substantial amount of business to the title insurance company. Consequently, only the largest real estate agencies, for example, would be candidates for an affiliated business arrangement. In addition, a new title insurer entry without some established relationship with a national bank or mortgage lender would not be able to overcome the established relationships that exist between such banks or lenders and the national title insurance companies, let alone overcome relationships between, for example, national homebuilders and their affiliated title companies. The commenters' argument is incorrect in describing costs and efficiencies of affiliated business arrangements. The creation of a new underwritten title company that is an affiliated business arrangement between a homebuilder or real estate agency and a title insurer involves substantial expense, but adds no substantive capacity or supply to the market. In such arrangements, the new underwritten title company typically relies upon the title insurer to provide most or all of the title and administrative services. The result is added expense whose only goal and outcome is to funnel a portion of the premium dollar to the referring partner. Consumers gain no price benefit as such affiliated business arrangements charge the same rates as the title insurer was already charging. The Birnbaum Report is persuasive that such affiliated business arrangements are a barrier to entry and raise costs without commensurate benefit to consumers who pay for the products and services.

The commenter has provided no evidence that controlled business relationships are not a barrier to entry. To the contrary, numerous studies have concluded that they are. For example, the Department of Justice study found that existing law inadequately dealt with the anti-competitive effects of controlled business arrangements. The evidence indicates that established business relationships with entities in the position to refer title and escrow business are a barrier to entry. Such evidence includes the fact that virtually every underwritten title entry in the past six years has been an affiliated business arrangement with an entity with established business relationships. Other evidence includes the prevalence of expensive "recruitment" of key title and escrow personnel from competitors who bring large blocks of business when they switch companies.

C22: The Commissioner rejects this comment. The competition report found few title insurer entries and, because of mergers and acquisitions, a reduction in the number of title insurance groups over the past ten years. The competition report also found few new underwritten title companies entering the market, that new entries were uniformly affiliated business arrangements that added no new capacity to the system and many acquisitions of independent underwritten title companies by national title insurance groups with the overall result that the number of underwritten title companies has decreased and the market share of the top underwritten title companies affiliated with national title insurance groups has increased over the past ten years.

Moreover, the commenter has failed to provide any evidence that the entries noted in this industry provide any new source of price-competition. The largest number of entries and exists are found among independent escrow companies. However, the Commissioner has found that the largest independent escrow companies -- those with the greatest number of branch offices -- are, in fact, affiliated with title insurance companies or other entities in the position to refer business to underwritten title companies or title insurance companies. Most important, the evidence suggests that most entries are existing firms that offer no price-competition. Despite hundreds of independent escrow companies operating in six Southern California counties, escrow prices in those counties remain essentially the same as escrow prices in other Southern California counties where escrow service is provided by a small number of underwritten title companies and twice the prices in Northern California where escrow services are provided by a fewer than three dozen underwritten title companies even in the most populous county.

Many of the new entries turn out to be controlled business arrangements, such as realtors forming an alliance with title insurers to facilitate the payment of high fees for steering business. The commenter has offered no evidence that the observed market exits reflect increased competition – or even that they do not reflect reduced competition.

Summary of Comments, Page 25-26: The conclusions in the Birnbaum Report about profitability are unsupported and contradicted by other findings in the report. The report states there is insufficient information to determine the profitability of title insurer business in California and only reviews two years of profitability for underwritten title companies. An economically valid measure of profitability must be made over a long period of time to capture both peaks and troughs in the real estate cycle. The Birnbaum Report draws conclusions from experience only in the peak years and is inherently biased. Moreover, the period of high profitability was followed by eight new UTC entries in 2005 which is the response expected in a competitive market. There is no evidence about the profitability of independent escrow companies.

Response: The Commissioner rejects this comment. The Birnbaum Report is persuasive about excessive profitability. The argument that profitability can only reasonably be measured over a lengthy period that covers a real estate cycle is flawed and unreasonable. The premise is that title insurers and investors are willing to accept low profitability in some years because it will even out with high profitability in other years, somehow averaging out over a real estate cycle. This is illogical because title insurers and investors have no idea how long a real estate cycle will take or how high or deep the cycle will go. It is empirically incorrect because title insurance companies do not explain low profitability as a planned event for which they will recover with high profitability a few years down the road. Rather, the national title insurance groups are publicly-traded companies who, like other publicly-traded companies, must deliver profitable results quarter after quarter.

The Birnbaum Report found high profitability for national title insurers over an extended period of time on a national basis and reasonably concluded that profitability in California was as great as or greater than the national average because of the greater growth in transactions and transaction volume than the rest of the country.

In addition, the reported profitability of title insurers and underwritten title companies greatly understates the profitability of the title and escrow industry for several reasons. First, for many owners of underwritten title companies take profit as salary, bonus or commission, which reduces the stated profitability by turning profit into an expense. Second, there are many affiliate transactions among underwritten title companies, title insurance companies and other affiliates, some of which result in double-counting of expenses, some of which reflect profit reported as an expense, such as a management fee, and some of which are inflated expenses for services provided. Third, and most important, profitability, understood as the difference between revenue and the reasonable cost of providing a service is greatly understated because title insurers and underwritten title companies spend the bulk of what would otherwise be profit on expenditures that benefit the referrers of title and escrow business. This "profit" is spent on illegal kickbacks as well as legal expenditures that provide no benefit to the consumer paying for the product, but greatly benefit the real estate agents, mortgage brokers, lenders and homebuilders who are in the position to refer business to title insurance companies and underwritten title companies. The evidence of such expenditures is found in the captive reinsurance schemes under which title insurance companies rebated almost half of the title insurance premium to homebuilders and in the very large percentage of personnel costs devoted to sales, marketing and consumer support, where consumer support is the industry term used to describe free services to those entities considered "customers" by title insurance companies and underwritten title companies -- namely, real estate agents, mortgage brokers, lenders and homebuilders.

The argument about new underwritten title company entries as evidence of reasonable competition is also incorrect. The new entries were affiliated business arrangements which added no meaningful supply to the market, which were vehicles were title insurers to lock up referrals by creating a legal form of rebating to the referrers of business and which did not result in any price reductions for consumers.

Summary of Comments, Page 26-28: When measured against the profitability of benchmark comparators – homebuilders, property and casualty insurers and the S&P 500 for an eleven year period, the operating margins – profits as a percentage of sales – for title insurance companies was below that of the benchmark comparators. Using return on equity as a measure of profitability, title insurers were below homebuilders and the S&P 500 and above property and casualty insurers. The comparison of title insurance holding companies with profits earned in other industries provides no evidence that title insurers realize excess profits.

Response: The Commissioner rejects this comment. The proper standard against which to measure reasonable profitability is the cost of capital required by the title insurance company. The fact that title insurers may have earned a lower profit than other industries does not negate the fact that title insurers earned profits well in excess of the reasonable cost of capital for an extended period of time. The use of profit as a percentage of sales is not a valid measure for comparing profitability across industries because the measure does not consider the capital at risk. As stated in the response to the previous comment, the stated profitability greatly understates the actual profitability of title insurers and underwritten title companies.

Summary of Comments, Page 27: The Birnbaum Report's measures of profitability are meaningless and misleading. The analysis incorrectly assumes that policyholder surplus is identical to stockholders' equity. The analysis only considered the publicly traded parents of the four largest title insurance companies, which introduces survivor bias. There were at least ten title insurance holding companies publicly traded during the period. There is no valid economic reason to expect actual rate of return on equity from accounting records to equal the market-based estimates of the cost of capital to which the Birnbaum Report refers.

Response: The Commissioner rejects this comment. The returns on equity calculations based on policyholder surplus rely upon net income produced under Statutory Accounting Principles. While SAP surplus is generally less than GAAP equity or net worth, SAP income is also generally less than income determined under GAAP. The result is that, over time, SAP returns on equity are about the same as GAAP returns on equity. The reliance on the top four writers was reasonable because the companies control the vast majority of the market in California and countrywide. The use of other companies who do not operate in California or whose title business is only a small part of the holding company results is not appropriate. It is reasonable to expect that, over time, actual rates of return will equal market-based estimates of the cost of capital. If actual rates of return are routinely below market-based estimates of the cost of capital, investors will logically conclude that the business is unable to achieve the necessary return on capital on a going-forward basis.

Summary of Comments, Page 28-9: The Birnbaum Report provides no evidence to support the assertions that escrow markets suffer from the same problems and create the same problems for consumers as those ascribed to title insurance markets. The presence of over 700 independent escrow companies disproves the notion that most escrow markets are highly concentrated. The data show that escrow companies enter and exit the market with business cycle demonstrating no barriers to exit. With scores of independent escrow companies and no barriers to entry or exits, there is no factual support for the claim of no price competition.

Response: The Commissioner rejects this comment. The commenters' analysis of independent escrow companies is superficial and incorrect. The commenters' overstate the number of independent escrow companies because the Department of Corporations issues a license to each branch location of an escrow company. Consequently, an escrow company with sixty branch offices is listed as 60 licensees, but in reality represents one decision center and one company. The vast majority of independent escrow companies operate in only six Southern California counties. In the remaining 52 counties, escrow is provided by title insurers and underwritten title companies and, consequently, the market concentration for escrow is similar to that for title insurance. The largest so-called independent escrow companies – those with the greatest number of branch offices – are, in fact, not independent, but are affiliates title insurers or underwritten title companies. Consequently, the independent escrow companies are not additional market participants but effectively branch offices of underwritten title companies or title insurers. Finally, the commenters' claim that scores of independent escrow companies and no barriers to entry provides no factual support for the finding of no price competition is a non sequitor. Despite hundreds more escrow companies operating in six Southern California counties, the prices for escrow in those counties are twice that found in even the largest Northern California counties with only dozens of escrow providers or fewer. Clearly, a large number of escrow providers do not lead to competitive pricing.

Summary of Comment, Page 29: The Birnbaum Report observes that escrow fees are higher in Southern California than in Northern California and incorrectly concludes that independent escrow companies simply add another layer of cost which is passed onto consumers. This argument ignores the facts and makes no economic sense. The difference in escrow rates results from the Department of Insurance failing to allow prices in Northern California to rise to levels it has approved in Southern California. Northern California rates are below competitive levels as evidenced by a filing from First American showing unprofitable operations in Northern California. The lack of independent escrow companies in Northern California is evidence that rates in the north are below competitive levels.

Response: The Commissioner rejects this comment. The commenters' arguments are factually incorrect. The Department of Insurance does not have and has not had authority to disapprove title or escrow rates. That authority will begin with the implementation of the proposed regulations. Consequently, the commenters' claim that the Department has denied rate requests or forced title insurers or underwritten title companies to use any specific set of rates is incorrect. The commenters' claim that Northern California escrow rates are below competitive levels – where presumably "competitive" means a rate sufficient to produce a reasonable profit – is implausible. It is unreasonable to believe that all competitors in dozens of counties – some of which operate only in Northern California – would continue to offer escrow services at a loss for a period of at least 25 years. The Peat Marwick study, cited in the Birnbaum Report, found the same escrow price discrepancy in 1980 as exists today. As with other arguments by the commenters, the claim that the absence of independent escrow companies demonstrates that rates are below competitive levels is definitional or tautological in nature – the argument assumes the answer to the question of whether price competition exists and then claims the assumption is correct. In this case, the commenters claim independent escrow companies do not operate in Northern California because rates are not competitive assumes price competition exists as opposed to other reasons why independent escrow companies operate almost exclusively in only six counties. It is unreasonable to expect that if independent escrow companies offered a valuable service that some consumers in Northern California would not want to obtain that service. Finally, it is indisputable that independent escrow companies add a layer of expense because lenders refuse to allow independent escrow companies to perform full escrow and require underwritten title companies or title insurers to perform subescrow when independent escrow companies perform escrow. This is an additional cost and activity not faced by consumers in Northern California.

Summary of Comment, Page 30-32: Reverse competition is a term of art unique to the title industry and not a formal concept in economics. Marketing to third parties takes place in other industries. There is no evidence for the Birnbaum Report claim that the cost of marketing and title insurance prices would be lower if title insurers, underwritten title companies and escrow companies marketed directly to consumers. All marketing is costly. If marketing directly to homeowners were more efficient, it would have been adopted a long time ago and such direct marketing does not exist. Using recommendations from a real estate agent saves a consumer the cost and expense of investigating a product the consumer typically has little knowledge to make an informed choice. Just as consumers rely on doctors for medical advice and financial advisers for financial advice, it is reasonable for consumers to rely upon real estate agents for title and escrow advice.

Response: Reverse competition" is a well-established concept in insurance economics and has been used to describe the market structure of title insurance and credit insurance markets for at least 30 years. The term has been used, in reference to title insurance, for nearly 30 years, apparently first having been coined by the 1977 Department of Justice study. Since then, it was repeated in several other studies, including the Peat Marwick report for HUD and the California Insurance Commissioner's Bulletin 80-12. The term has been codified in regulations, including the New York State credit insurance regulation and has been used and defined in work products of the National Association of Insurance Commissioners. In addition, the comment mischaracterizes reverse competition. Reverse competition does not refer to consumers seeking advice of third parties; it refers to a market structure in which the seller markets the product to a third party who refers the paying customer to the seller, the consequence of which is that the referrer of the business has the market power and is able to extract considerations from the seller who passes the cost of the considerations onto the paying consumer who has no market power to discipline the pricing of the seller.

Summary of Comments, Page 33: The commenters offer a conclusion briefly summarizing their earlier comments.

Response:

Response: Responses to the comments summarized in the executive summary are provided below, so no response to the summary of comments is needed.

Summary of Comments, Page 34: The commenters describe their company and their qualifications and experience.

Response: This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Gov. Code section 11346.9.)

<u>Volume 2, Comment No. 584-611 (Exhibit B to Comments of David A. Cheit):</u>

Commentator: Bruce Stangle and Bruce Strombom, on behalf of First American Title Company.
Date of Comment: Received 8/30/06
Type of Comment: Written

Summary of Comments, Page 2: The commenters provide an introduction to their comments including a description of their engagement by First American Title Insurance Company.

Response: Responses to the comments summarized in the introduction are provided below in response to the detailed comments which are summarized in the introduction, so no response to the summary of comments in the introduction is needed.

Summary of Comments, Pages 2 -6 : The commenters provide their general belief that rate regulation, which the commenters describe as price caps, for title insurance runs counter to a general trend of deregulation and is likely to adversely affect consumers and taxpayers in California. The commenters argue that rate regulation will distort incentives that have benefited consumers, that increased regulation will cause costs to increase and will cause inadequate rates.

Response: The Commissioner rejects this comment. The Commissioner disagrees with the commenter's description of deregulation as universally benefiting consumers and points to the problems with electricity and workers' compensation deregulation in California in recent years as examples of deregulation gone bad. The ills projected by the commenters are predicated on an assumption that the regulations will not operate as intended, which is to ensure that title rates and escrow fees are cost-based and reasonable in relation to underlying costs. Their assumption is unreasonable and, consequently, so are their conclusions. The comment is also based on the erroneous assumption that regulation would be replacing a competitive market, which is contrary to the Commissioner's findings. The commenters arguments are also based on the assumption that the Commissioner has discretion about rate regulation. The Commissioner has a statutory responsibility to ensure that rates are not excessive and has found that a reasonable degree of competition does not exist and that a rate which exceeds the maximum permitted rate pursuant to the proposed regulation is unreasonably high for the insurance or other services provided. Finally, while there is a cost to any new regulatory initiative, the proposed regulations are necessary and the costs are reasonable in relation to the benefits to consumers.

Summary of Comments, Pages 6-7. The commenters summarize their comments on the interim rates.

Response: The specific comments summarized here are responded to below, so no response to the summary is needed.

Summary of Comments, Page 7-8: The proposed interim rate reductions are so large they will wipe out operating profits and cause operating losses.

Response: The Commissioner rejects this comment. The commenters' analysis is flawed because they assume that companies will do nothing to reduce expenses in response to lower rates. This is clearly incorrect. Some expenses, which are paid as a percentage of premium, will decline as premium declines. Other expenses will be reduced by companies in response to lower revenues, particularly the excessive sales and marketing expenses spurred by reverse competition that provide no benefit to the consumer paying for the products.

Summary of Comments: Page 8: Targeted price reductions and discount programs will be eliminated because greater-than-specified reductions on a policy cannot be used to offset less than specified reductions to other policies.

Response: The Commissioner rejects this comment. The market response suggested by commenters is illogical. Discounts are typically calculated as a percentage of the base premium. If the base premium is reduced, the discount is reduced by the same percentage, even though the discount program itself has remained unchanged. There is no reason to believe discounts, which purportedly have some basis in reduced costs, would disappear with an overall reduction in rates because the cost basis for the discount remains. Furthermore, to the extent the commenters argue (without proffering evidentiary support) that companies currently are using high rates to subsidize other rates, the commenters are asserting that the proposed regulations will terminate unfair discrimination in existing practices, which would be an additional reason in favor of adoption of the proposed regulations.

Summary of Comments, Page 9. The interim rates will exacerbate the current downtown in the real estate market and lead to a devastating reduction in revenue.

Response: The Commissioner rejects this comment. The revised regulations have postponed the interim rate reductions until 2009 and fully eliminated them if data reported pursuant to the statistical plan and annual financial reporting requirements are available for implementing the maximum charge formulae. In addition, the interim rate reduction now contains a provision to reduce or eliminate the interim rate reduction if transaction sizes – generally the sales price of properties – flattens or declines. Finally, the revenue reductions associated with the interim rate reduction are simply a rollback of excessive rates caused by insurers failure to lower rates in a period of rapidly escalating home prices, as discussed further in the November 27, 2006 Staff Report on the Interim Rate Reduction.

Summary of Comment, Page 9 The calculation of the interim rate reduction is flawed. There is no basis for assuming that 2000 is an appropriate base year.

Response: The Commissioner rejects this comment. The year 2000 was, indeed, carefully selected – not because of any asserted poor performance by the companies but because that year marked the beginning of the sharp increase in housing prices. Since the sole purpose of the proposed regulations is to offset the increase in title premiums and other charges due solely to housing inflation that exceeded the cost of providing the insurance or other services, the selection of 2000 is entirely appropriate. If the rates in 2000 were anything other than satisfactory to companies, they could have filed for and obtained rate increases. The fact that they did not is a clear basis for finding that the 2000 rate were not inadequate.

Summary of Comment, Page 10: Adequacy conclusions are not supported.

Response: The Commissioner rejects this comment. The November 27, 2006, Staff Report on the Interim Rate Reduction explains why rates and revenues resulting from the interim rate reduction are reasonable and adequate.

Summary of Comment, Page 11: The interim rates ignore factors considered important by the Department.

Response: The Commissioner rejects this comment. The commenters incorrectly conflate the interim rate reduction provisions with the maximum charge formulae. The two are mutually exclusive. The interim rate reductions are exactly as described – interim – and are not an effort to replicate the maximum rate formulae. Were they to do so, there would be no need or basis for an interim rate reduction. The Commissioner has determined that, if certain conditions occur, an interim rate reduction is necessary and appropriate until the maximum charge formulae can be implemented.

Summary of Comment, Page 11: The estimate of premium increases from 2000 to 2005 is biased and unreliable. By failing to account for discounts, the calculations overstate the growth in premiums and cause the proposed rate reductions to be overstated. Only five companies' rates were used.

Response: The Commissioner rejects this comment. The commenter's analysis is incorrect. The use of base rates to calculate average premiums in 2000 and 2005 is an accurate method for evaluating how changes in transaction size affected premium growth during the period and it is that relationship and it is that relationship that is the basis for the interim rate reduction, as explained in detail in the November 27, 2006 Staff Report on the Interim Rate Reduction. Further, the percentage growth in average premium would likely be higher – resulting in a bigger interim rate reduction – under the commenters' scenario because the dollar change from 2005 would be compared to a smaller 2000 base average premium. The companies whose rates were used to calculate average premiums represent the largest writers and a substantial share of the market. There is no indication that rates for other insurers varied from the largest writers to a significant degree and companies with small market shares would have little or no effect on the calculations.

Summary of Comment, Page 12: There are significant errors in the inflation factor. The rate of inflation calculations appear to be incorrect.

Response: The Commissioner rejects this comment. The inflation calculations are correct as explained in the November 27, 2006 Staff Report on the Interim Rate Reduction. The commenters reference is to an error in the July 3, 2006 Staff Report on the Interim Rate Reduction, which has been superseded.

Summary of Comment, Page 12-13: The rate of inflation in California should be used, not the rate of inflation in the United States.

Response: The Commissioner rejects this comment. The November 27, 2006 Staff Report on the Interim Rate Reduction explains why the local or regional consumer prices indices are not as reliable or relevant as the selected national consumer price index.

Summary of Comment, Page 13: The argument advanced in the Interim Rate Report that productivity gains should offset increases in the rate of inflation is incorrect as change in productivity is one of the factors that determine the rate of inflation. The interim rate calculation fails to consider inflation after May 2005.

Response: The Commissioner rejects this comment. There is no productivity adjustment in the interim rate calculation so the comment is inapplicable. In addition the July 3, 2006 Staff Report on the Interim Rate Reduction has been superseded by the November 27, 2006 Staff Report on the Interim Rate Reduction which also renders the argument inapplicable. The revised regulation provides for consideration of inflation after May 2005 and into the period the interim rates will be in effect, if, in fact, the interim rates go into effect.

Summary of Comment, Page 14: The interim rate calculation fails to consider the effect of fixed costs as that term is typically used.

Response: The Commissioner rejects this comment. The interim rate reductions are designed as a stop gap measure and focus solely on the dramatic increase in transaction volume since 2000. Transaction volume is not relevant to the interim rate reductions, but will be considered by the statistical plan and permanent rate regulations. The term fixed costs as used in the interim rate calculation is limited to defining that portion of the premium subject to inflation and has no other purpose in the regulations.

Summary of Comment, Page 14-15: Transaction data appear to be unreliable.

Response: The Commissioner rejects this comment. DataQuick is an industry standard source of information on real estate transactions and used by analysts and title insurance market participants, including the California Association of Realtors. No data set is perfect, but the Commissioner finds the DataQuick data reliable for the purposes used in the interim rate calculations. The fact that the November 27, 2006 Staff Report on the Interim Rate Reduction and the superseded July 3, 2006 Staff Report on the Interim Rate Reduction discuss issues with the use of the data does not undermine the reliability of the data, but serves to explain the Commissioner's use of the data.

Summary of Comment, Page 15-16: Arbitrary and unsupported cost assumptions are used.

Response: The Commissioner rejects this comment. The only cost assumptions in the interim rate reduction calculations are the percentages of premium that vary with premium level (variable costs), the percentage of premium that varies with change in exposure (losses) and the percentage of premium subject to cost inflation (fixed costs). The basis for the amounts are explained in the November 27, 2006 Staff Report on the Interim Rate Reduction. Moreover, the interim rate reductions are designed as a stop gap measure and focus solely on the dramatic increase in average transaction size since 2000 and not to replicate the detailed cost analyses of the maximum charge formulae. Finally, small changes in the percentages associated with the three cost categories do not result in large changes to the interim rate calculation.

Summary of Comment, Page 16: No actuarial analysis was performed to support the loss ratio assumption.

Response: The Commissioner rejects this comment. The loss provisions for the title interim rate reduction are based on the long-term average claim costs for title insurance and, consequently, are reasonable. The loss provision for escrow is based on a review of two years of recent data from underwritten title companies and, consequently, is reasonable. In addition, the interim rate reductions are designed as a stop gap measure and focus solely on the dramatic increase in transaction volume since 2000 and not to replicate the detailed cost analyses of the maximum charge formulae.

Summary of Comment, Page 17: No justification or calculations are provided for the title refinance interim rate reduction or escrow rate reductions.

Response: The Commissioner rejects this comment. The November 27, 2006 Staff Report on the Interim Rate Reduction provides the justification for and calculations of the title refinance and escrow interim rate reduction

Summary of Comment, Page 17-18: Escrow rate reductions will be too large in some counties and too small in other counties because price appreciation varied by county from 2000 to 2005.

Response: The Commissioner rejects this comment. The revised proposed regulations provide for regional rate reductions for escrow. The regional reductions are based on groupings of counties with, among other things, similar price appreciation over the 2000 to 2006 period.

Summary of Comments, Page 18: Countercyclical pricing will lead to a misallocation of resources because the regulation will interrupt the role of price in providing market signals about resource allocation.

Response: The Commissioner rejects this comment. The commenters assume incorrectly that current prices are the result of a competitive market and reflect resource allocation that would occur in a competitive market. The Commissioner has determined a reasonable degree of competition does not exist and, consequently, the assumption relied upon by commenters and the argument predicated on that assumption are not valid. It is the current lack of a reasonable degree of competition that has lead to a misallocation of resources, with excessive amounts being spent on illegal kickbacks and sales and marketing to referrers of business.

Summary of Comments, Page 19: The quality of products and services available to consumers will decline. Firms offering higher-quality, higher-cost service will be unable to charge sufficient prices.

Response: The Commissioner rejects this comment. The argument is predicated on the assumption that there is significant variation in service quality and that such variation is associated with significant cost and price differentials. No evidence exists to support this contention. In fact, the absence of price variance among providers indicates no difference in price associated with differences in quality, if such quality differences exist, or no significant difference in quality. Furthermore, the comment assumes that any variability in "quality" affects ultimate consumers, an assumption for which there is no evidence. The Commissioner has found that, just as title and escrow companies call the referrers of business to them their "customers," allusions to better service are generally to advantages for the referrers of business, not ultimate consumers who pay for the service.

Summary of Comments, Page 20: The formulaic ratemaking approach is backward looking and will delay reactions to changing market conditions.

Response: The Commissioner rejects this comment. The comment is essentially a criticism of rate regulation generally, and, is not relevant since the Commissioner is statutorily required to ensure, among other things, that rates are not excessive in the absence of a competitive market. The commenters are also incorrect in stating that the formula is backward looking. The formula specifically accounts for the most important future market changes impacting title insurance costs – the number and size of transactions – through reference to standard forecasts. The use of certain historical data as a starting point for cost analysis is standard ratemaking procedure in insurance. Finally, the maximum rate formula only produces maximum permissible charges and does not dictate the prices charged by insurers and escrow provides. These companies can use any additional information they wish to develop their filed rates, subject to the maximum, and can revise rates as the companies see fit, subject to the maximum charges, which change regularly as new data and forecasts are available.

Summary of Comments, Page 21: The determination of the maximum rate of return is flawed and results in an inadequate amount. The rate of return used should represent the amount required to attract and retain capital to the industry. Market-based estimates of the cost of capital should be used instead of being based on historic accounting returns. The expected returns for title and property casualty will be different and property casualty returns therefore are not valid for assessing reasonable title returns. The risk premium proposed does not recognize that privately held companies require a greater return than publicly held companies.

Response: The Commissioner rejects this comment. Use of market-capital to determine profit is circular, since the higher the recognized capital the higher the return and the greater the market value of the investment. Furthermore, in the long run book value and market value tend to converge. And, in fact, the courts have consistently rejected the claim that a regulated entity is entitled to market-based returns. (E.g., *Permian Basin Area Rate Cases* (1968) 390 U.S. 747, 769; *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, 320-321; cf. *id.* at 301-302 [authorizing use of statutory capital rather than GAAP capital].)

Summary of Comments, Page 22: The rates will be too low to attract capital and new entrants because the rate of return is based on accounting returns that reflect the depreciated historical cost of assets, which are generally lower than the replacement cost of those assets.

Response: The Commissioner rejects this comment for the reasons stated above.

Summary of Comments, Page 22-3: Inflation and productivity changes are not accounted for properly. California inflation should be used instead of national inflation. Inflation should not be offset by productivity as productivity is considered in inflation.

Response: The Commissioner rejects this comment. For the reasons set out in the November 27, 2006 Staff Report on the Interim Rate Reduction, the selected national Consumer Price Index is more reliable than local or regional price indices. It is reasonable to have a productivity adjustment given the much faster productivity gains in title insurance and escrow than in all industries combined. Automation and the move to electronic documents have and will continue to greatly increase worker productivity in title insurance and escrow. The use of a national productivity measure is a very conservative method of accounting for some of that productivity improvement.

Summary of Comments, Page 23-4: Various factors are arbitrary and without reasonable justification, including the 15% sales cost factor and relativities for policy forms, endorsements and counties.

Response: The Commissioner rejects this comment. The Staff Report on the Sales Factor sets out the rationale and justification for the sales cost factor. The relativities were derived from a review of relativity values used in company filings with the Department. It should be noted that companies are not required to employ the relativities contained in the proposed regulations; they can use any relativities they wish so long as the resulting premium on the policy does not exceed the maximum calculated under the regulations.

Summary of Comments, Page 25: The commenters describe their company, education and experience.

Response: This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comments, Page 26-28: The comments present charts which are references in earlier comments.

Response: The comments to which the charts are addressed have been responded to above. No additional response is required.

<u>Comment Bates Pages 612-904:</u>

Commentator: Fidelity National Title Company (James Woods, Neal Wolf, Kathryn Baxter, Todd Padnos).
Date of Comment: Received 8/30/06
Type of Comment: Written

<u>Summary of Comment (page 1)</u>:

This passage summarizes the proposed regulation and identifies the attached appendix to the comment.

<u>Response to Comment</u>:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations, or simply summarizes comments which are summarized and responded to in more detail below. No response is, therefore, necessary. (Gov. Code section 11346.9.)

<u>Summary of Comment (pages 2-4)</u>:

This portion of the comment presents a summary of the commentator's specific remarks which are set forth in greater detail within the subsequent pages of the comment.

<u>Response to Comment</u>:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations, or simply summarizes comments which are summarized and responded to in more detail below. No response is, therefore, necessary. (Gov. Code section 11346.9.)

<u>Summary of Comment (page 4)</u>:

The Proposed Regulations exceed the relevant statutory authority because Insurance Code Section 12401 expressly prohibits the Commissioner from fixing or determining rates and Section 12401.5 provides that no statistical plan (or rules or regulations pertaining thereto) shall fix or determine or in any way impair competitive rating in the free market.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The proposed regulations do not "fix" or "determine" rate levels. They define the level above which the rate is excessive. Companies are free to compete by charging any rate they wish so long as the rate is not "excessive." (Ins. Code § 12401.3.) It has long been understood that the code authorizes the Commissioner to prohibit excessive rates and that doing so does not constitute the proscribed fixing or determination of rates.

<u>Summary of Comment (page 5)</u>:

The Insurance Code does not authorize the Commissioner to issue rules and regulations relating to rate-making for title insurers. Section 12401.5 which is cited as authority for the proposed regulations to prescribe by reasonable rules and regulations, *inter alia*, the form and content of certain data to be provided to the Commissioner by licensed title insurers. Neither Section 12401.5 not any other statute provides the Commissioner with the authority to promulgate rules and regulations: 1) further refining the two-part test articulated in Section 12401.3(a) for determining what constitutes an excessive rate; 2) expanding, interpreting or otherwise affecting the definition of "excessiveness" contained in the statute; or 3) establishing rates or maximum rates for title insurance products.

Response to Comment:

The Commissioner rejects this comment. On the contrary, the statutory purpose of the regulations is "[a]s a further aid to uniform administration of rate regulatory laws of this state," and the "[d]ata gathered under the statistical plan may be used in conjunction with analytical input from an industry advisory organization to generate statistical information for use in reviewing and evaluating individual rate filings by title insurers pursuant to the standards set forth in Section 12401.3." Those are precisely the functions of the proposed regulations. In so doing, the proposed regulations properly "implement, interpret, make specific [and] carry out" (Gov. Code section 11342.2) the provisions of Insurance Code sections 12401.3, 12401.5.

Summary of Comment (pages 5-6) :

The Insurance Code in Section 12401.5(d) expressly provides that "no statistical plan or modification thereto, or rules or regulations pertaining thereto, shall do any of the following . . . fix or determine, or in any way impair competitive rating or the free market."

Response to Comment:

The Commissioner rejects this comment. The proposed regulations specify a maximum and permit companies to charge any rate that does not exceed the maximum. That preserves both "competitive rating" and, to the extent it otherwise exists, a "free market." The regulations merely limit competition within the range of rates that are not excessive. The proposed regulations expressly permit and encourage price competition ("competitive rating") by permitting companies to charge any rate they wish so long as the rate is not excessive. The Commissioner does not accept the view implied in this comment that the ability to charge an excessive rate is essential to, or part of, a properly functioning competitive market. If the Legislature was of the view that competitive rating, competition, or the free market requires that companies be allowed to charge excessive rates, it would not have prohibited rates that are excessive (§ 12401.3(a)) and would not have authorized the Commissioner to terminate the use of excessive rates.

Summary of Comment (page 6) :

The Commissioner, through the Proposed Regulations, is wrongfully seeking to bestow upon himself the right to right to exercise a legislatively-proscribed power (the power to fix rate) through a legislatively proscribed mechanism (rulemaking). As explained by the California Supreme Court, "where a statute impairs an administrative agency to adopt regulations, such regulations must be consistent, not in conflict with the statute and reasonably necessary to effectuate its purpose." *Ontario Cmty Found., Inc. v. State Bd. of Equalization*, 35 Cal.3d 811, 816 (1984)(citing to Gov't Code Section 11342.2). Thus, the Commissioner has no power to vary or enlarge the terms of an enabling statute or to issue regulations which conflict with [the enabling statute] or any other statute." *Credit Ins. Gen. Agents Ass'n v. Payne*, 16 Cal.3d 651, 656 (1976). Administrative regulations that violate acts of the Legislature are void. *Ontario Cmty. Found.,* 35 Cal.3d at 816. The Proposed Regulations must, therefore, be withdrawn.

Response to Comment:

The Commissioner rejects this comment. For the reasons stated above, the proposed regulations exercise authority expressly conferred upon the Commissioner by statute.

Summary of Comment (page 6):

The Legislature, through Insurance Code Sections 12414.13 through 12414.19, established a mandatory and exclusive procedure by which the Department may challenge a rate charged by a title insurer on the grounds of excessiveness. That procedure affords due process rights, including notice, the opportunity to respond, present evidence and call and cross-examine witnesses, and the right to appeal an adverse decision and places the burden of pleading and proof on the Department on the issue of excessiveness.

Response to Comment:

The Commissioner rejects this comment. Each of the rights enumerated in this comment – due process, notice, opportunity to respond, right to present evidence and to examine and cross-examine witnesses, right of appeal, and allocation of burden of proof – are provided within the meaning of the Insurance Code. The commenter appears incorrectly to assume there will be no hearing on a rate that exceeds the interim maximum. A company that fails to bring its rate down to the required level would receive a notice of noncompliance and, if it requested a hearing, would receive one. To the extent that the commenter contends that due process requires that companies be given an opportunity to relitigate the Commissioner's formulaic regulatory definition of "excessive," the Commissioner rejects this comment. Regulation by formula based on industry-average costs has long been practiced by regulatory agencies and approved by the courts. That includes applying numerical values adopted in regulations to individual companies' hearings without giving those companies the opportunity to adjudicate the values. (See, e.g., *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216.) This provision is appropriate and does not deprive companies of due process.

Summary of Comment (page 7):

The Legislature, through Insurance Code Section 12414.29, stated that the enforcement of the rate-related provisions must be accomplished in accordance with the procedures set forth in Sections 12414.13 through 12414.19. (Commenter's quotation of section 12414.29 omits the language "notwithstanding any local regulation or ordinance.")

Response to Comment:

The Commissioner rejects this comment for the reasons stated above.

Summary of Comment (page 7):

The Proposed Regulations would deprive companies of due process. Among other things, the Proposed Regulations would: 1) the Commissioner's finding (that a reasonable degree of competition does not exist in certain segments of the industry) deprives the individual title company of the right to be heard and present evidence on the competition component; 2) immediately "roll back" rates for an interim period, and result in a setting of maximum rates for an indefinite period based upon this unilateral finding, without the requisite showing of an emergency that would justify such immediate price controls and without affording due process rights to affected companies; and 3) deem any rate in excess of the maximum rate that is determined in accordance with the Commissioner's formulae as excessive, without providing the affected title insurer with the right to hearing or judicial review of the excessiveness finding.

Response to Comment:

The Commissioner rejects this comment. The commenter has failed to identify any right it has that the proposed regulations abridge. While the commenter has (and has exercised) the right to comment on the finding of the absence of a reasonable degree of competition, nothing in the Constitution or the Insurance Code precludes this inherently industry-wide finding from being made by rulemaking. The setting by regulation of maximum rates, below which companies are free to set adequate rates as they see fit, is wholly lawful and constitutes neither the setting of rates nor price-controls. And, as noted above, regulation by formula based on industry-average costs has long been practiced by regulatory agencies and approved by the courts. That includes applying numerical values adopted in regulations to individual companies' hearings without giving those companies the opportunity to adjudicate the values. See, e.g., *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216.

Summary of Comment (page 8):

Insurance Code Section 12401.3(a) provides a test for determining the excessiveness of a particular rate. This section provides that "[n]o rate shall be held excessive unless: (1) the rate is unreasonably high for the insurance or other services provided, and (2) a reasonable degree of competition does not exist in the particular phase of the business of title insurance to which the rate is applicable."

<u>Response to Comment</u>:

The Commissioner rejects this comment. The effect of the proposed regulations is simply to facilitate the finding of whether a rate is unreasonably high for the insurance or other service provided and to make the appropriate finding with regard to the absence of a reasonable degree of competition. The commenter has proffered no legal reason why the proposed regulations may not do so in the manner they have.

<u>Summary of Comment (pages 8-9)</u>:

The Insurance Code establishes an exclusive procedure for determining a rate to be excessive as set forth in Section 12414.13. Under this procedure, a "person aggrieved" by a rate charged or a rating system established or employed by a title insurer may request that the title insurer review the subject rate or rating system. Insurance Code Section 12414.13. If the title insurer denies the request or fails to respond to the request within 30 days, the aggrieved party may file a written complaint and hearing request with the Commissioner. Insurance Code Section 12414.13. If the Commissioner finds that the complaint alleges an actual violation and the complainant would be aggrieved if the violation were proven, he is required to conduct a limited examination of the facts underlying the complaint. Insurance Code Section 12414.13. The Commissioner may also call an examination on his own initiative. Insurance Code Section 12414.21.

If, after completion of the examination, the Commissioner has good cause to believe the title insurer is not in compliance with the rating laws, but that failure to comply is not willful, the Commissioner must issue a Notice of Noncompliance. Insurance Code Section 12414.14. The Notice of Noncompliance must give the title insurer not less than 10 days or more to correct the noncompliance. Insurance Code Section 12414.14. If, after the completion of the examination, the Commissioner has good cause to believe the title insurer is not in compliance with the rating laws and that the failure to comply is willful, or the title insurer fails to correct the alleged noncompliance within the time specified, the Commissioner may conduct a public hearing. Insurance Code Section 12414.15.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The procedural provisions described by the commenter are the procedures to be used under the proposed regulations. The comment offers no reason not to adopt the proposed regulations.

<u>Summary of Comment (page 9)</u>:

One of the two elements of excessiveness (the competition element) has already been found to exist under the Proposed Regulations (without providing the companies due process) and any rate in excess of the formulaic maximum is conclusively presumed to be excessive. Section 2357.1(a).

Response to Comment:

The Commissioner rejects this comment. The comment is premised on the unsupported assumption that the regulations may not make the specified finding or prescribe the methods of determining whether a rate is excessive. Neither assumption is correct.

Summary of Comment (page 9):

Insurance Code Section 12414.18 provides that a hearing held in connection with the "denial, suspension, or revocation of a license or certificate of authority . . . [or as a result of the failure of an insurer to correct an alleged noncompliance] under these provisions shall be conducted in accordance with the provisions of Chapter 5 (commencing with Section 11500) of the Government Code." These sections of the Government Code provide the respondent title insurer procedural rights and safeguards, including notice of proceedings, opportunity to review and respond to an accusation, discovery (including depositions, the right to compel discovery), the right to appear, call and cross-examine witnesses at hearing before an administrative law judge. Gov't Code Sections 11500-11528. The Commissioner has the burden of both pleading and proof with respect to any claim that a title insurer's rates are excessive. Insurance Code Section 12414.18.

Response to Comment:

The Commissioner rejects this comment. The same provisions of the Government Code apply to hearings under Proposition 103 (see Ins. Code section 1861.08), and the same provisions of the Proposed regulations to which the commenter objects are found in the regulations adopted under Proposition 103 and approved by the Supreme Court in *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216.

Summary of Comment (page 9):

The company is afforded a right of appeal and judicial review. Insurance Code Section 12414.19.

Response to Comment:

The Commissioner rejects this comment. Nothing in the proposed regulations abridges the commenter's right to judicial review.

Summary of Comment (page 10):

The Proposed Regulations ignore these procedural mandates. Excessiveness is determined, an interim rate is immediately imposed, and new maximum rates are fixed without any public hearing or procedure. Under Insurance Code Section 12401.3(a), a finding that the title insurance market is non-competitive is necessary to a determination that a particular company's rate is excessive. The finding in this case has been made on a unilateral basis without any notice to affected companies, any opportunity to conduct discovery, any opportunity to present evidence, and opportunity to call and cross-examine witnesses. The Commissioner states that he "agrees with" the findings of the Birnbaum report, a report he commissioned, and which is fundamentally flawed.

The Commissioner has made a finding of one of two critical components of a determination of excessiveness by fiat. He may not do that. He must comply with the exclusive, legislatively-mandated procedure for challenging rates in the insurance industry.

The Commissioner has failed to resort to (or exhaust) the statutorily prescribed administrative remedy for attacking a title insurance rate on grounds of excessiveness.

Response to Comment:

The Commissioner rejects this comment. No company's rates will be found to be excessive without the statutorily prescribed hearing. The commenter has failed to proffer any basis for the claim that notice-and-comment regulations may not make findings that are binding in the subsequent hearing, and the law is to the contrary.

Summary of Comment (page 10):

The Commissioner seeks to amend the Insurance Code by attempting (not merely to fix rates in the title insurance industry) but by taking away the statutorily prescribed rights of insurers who are subject to a "Notice to Correct Noncompliance" (NCN Proceeding).

Response to Comment:

The Commissioner rejects this comment. The commenter has failed to identify basis for claiming any hearing right not provided by the proposed regulations, including the right to a noncompliance hearing.

Summary of Comment (page 11):

The Proposed Regulations prevent a company from litigating the issue of excessiveness and any issue other than whether or not its rates exceeded the maximum rates established by the regulations. Section 2359.6. The Proposed Regulations expressly proscribe "relitigation" of both the statutory elements of excessiveness, whether 1) the rate in question is unreasonably high and 2) a reasonable level of competition exists in the title insurance industry notwithstanding the fact that neither of these elements have been the subject of litigation.

Response to Comment:

The Commissioner rejects this comment. To the extent that the commenter contends that due process requires that companies be given an opportunity to relitigate the

Commissioner's formulaic regulatory definition of 'excessive,' the Commissioner rejects this comment. The effect of the 'relitigation bar' is simply to assure that, in determining whether an individual insurer's rates are excessive, the administrative law judge does not entertain the question whether the premises underlying the rate regulations are sound. (See *20th Century v. Garamendi* (1994) 8 Cal.4th 216, 312.) This provision is appropriate and does not deprive companies of due process.

Summary of Comment (page 12):

The findings and determinations of the Commissioner regarding the non-existence of a "reasonable degree of competition" in certain phases of the business of title insurance, and the report upon which such findings and determinations were predicated, are erroneous. Rather than establish the lack of competition in a rate hearing subject to judicial review, the Commissioner concludes in the Proposed Regulations that a 'reasonable degree of competition" does not exist. This predicate is erroneous, thus the rate-setting scheme built upon this predicate must be rejected or withdrawn.

Response to Comment:

The Commissioner rejects this comment. The commenter has proffered no support in this comment for its contention that the Commissioner's finding is erroneous. The commenter apparently relies on comments of others that have been submitted, to which the Commissioner responds directly elsewhere in this file.

Summary of Comment (page 12):

There was significant criticism of the Birnbaum Report at the January 5, 2006 public workshop with respect to methodology and conclusions. These criticisms demonstrated that the Birnbaum Report is fundamentally flawed and provides no justification for the hypothesis that "a reasonable degree of competition" is lacking in the industry.

The Birnbaum Report fails to follow a methodology that a professional competition economist would employ to determine the state of competition in a particular industry, i.e., the methodology and critical factors used by the Antitrust Division of the United States Department of Justice and the United States Federal Trade Commission.

Response to Comment:

The Commissioner rejects this comment. The criticisms to which the commenter alludes have been found by the Commissioner to be insubstantial. Specifically with respect to methodology, the commenter is relying on enforcement standards for review of mergers under the Clayton Act and under the Federal Trade Commission Act, which is not the purpose of the proposed regulations. Nevertheless, the Commissioner notes that the analytical methods employed in the Competition Report are the same methods employed by both enforcement agencies. What the Competition Report does not examine is whether efficiency-enhancing economies will be created by the merger – an appropriate omission since no merger and no efficiency-enhancing economies are implicated by the proposed regulations.

Summary of Comment (page 13):

The Birnbaum Report fails to consider a number of critically important determinants of competition, including:

1) The existence of significant rate reductions made during the past few years by a large number of title insurers;
2) The fact that these rate reductions were driven by competition or pressure to match rivals' rate reductions;
3) The existence of websites maintained by title insurers and third parties that allow consumers to compare rates and potential discounts;
4) The existence of price competition for the business of commercial and banking customers who are sophisticated and high volume purchasers of title insurance and thereby exert pricing pressure on title insurers;
5) The practice by which real estate service providers refer their clients to title insurers offering the best rates and/or best quality of services;
6) The existence and benefit to consumers of non-price competition;
7) Expansion possibilities for existing competitors in the market;
8) Entry conditions for new market participants;
9) Product differentiation;
10) Competitive responses; and
11) Cost considerations.

All of these items are discussed in Vistnes' analysis.

Response to Comment:

The Commissioner rejects this comment for reasons stated in his responses to the Vistnes comments elsewhere in this file.

Summary of Comment (page 14):

Birnbaum made no effort to reconcile his findings with the results of the competition analyses performed by the FTC in connection with the two recent mergers of large title companies doing business in California: the 1999 merger of Fidelity National Financial and Chicago Title Corporation, and the 2005 merger of First American and United General Title Company. The FTC did not oppose either merger. After its investigation, the FTC concluded that entry and expansion into the title insurance market is reasonably easy provided insurers have access to local title plants, and that the market is reasonably competitive. This contradicts the Birnbaum conclusion and no effort is made to resolve this contradiction or explain why the Birnbaum analyses should be accepted instead of those of the FTC.

<u>Response to Comment</u>:

The Commissioner rejects this comment. Whether a given merger will harm competition requires an assessment of existing competitive conditions and a prediction of the merger's effect on those conditions. There is no evidence there was a reasonable degree of competition in 1999 or 2005 that was susceptible to injury from the proposed mergers. The Competition Report does, however, note that immediately after the Fidelity acquisition of Chicago, Fidelity raised its rates to Chicago's level. The Competition Report also notes that the FTC was sufficiently concerned about the acquisition that it imposed conditions intended to ameliorate the injury to competition. The commenter proffers no evidence the conditions succeeded in that endeavor.

<u>Summary of Comment (pages 14-15)</u>:

Dr. Vistnes conducted an analysis and came to the conclusion that there is a "reasonable degree of competition" in the industry. Dr. Vistnes's qualifications to conduct this competition analysis are set forth on pages 14-15.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The Commissioner has responded to the Vistnes comments separately in this file.

<u>Summary of Comment (pages 15-16)</u>:

The Vistnes analysis is comprehensive and employs the methodology generally accepted by competition economists for examining industries.

Dr. Vistnes examined: 1) the nature of the relevant markets, including the title insurance and title search services markets; 2) the structure of the industry; 3) opportunities for existing market participants to increase market share; 4) evidence of meaningful price competition; 5) evidence of meaningful non-price competition; and 5) evidence of competition for real estate professional's referrals and the benefit thereof to consumers.

Dr. Vistnes concluded that: 1) there is competition in California's title insurance market; 2) there is no economic evidence to conclude that there is not a reasonable degree of competition in California's title insurance industry; 3) California's title insurance markets are fundamentally competitive despite the presence of limited market imperfections endemic to virtually all competitive markets.

Accordingly, the factual predicate for the Commissioner's action is erroneous.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The Commissioner has responded to the Vistnes comments separately in this file.

<u>Summary of Comment (page 16)</u>:

The Proposed Regulations would place a ceiling on profits without taking into account an individual title insurer's need to generate a reasonable rate of return on invested capital; accordingly, the Commissioner has effected a "taking of property" in violation of the United States and California constitutions.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The proposed regulations do not place a ceiling on profit. The only quantity regulated under the Insurance Code and the proposed regulations is the rate charged, not any component of that rate, including profit. The adoption of regulations limiting the rate that may be charged and basing that limit on an industry-average profit level does not constitute a taking, as numerous cases have held. (See, e.g., *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, 292-298 and cases cited.)

<u>Summary of Comment (page 16)</u>:

The Commissioner has failed to take into account criteria that must be considered when determining whether an insurer is receiving a reasonable rate of return, including: 1) the capital structure of the specific insurer; 2) the cost structure of the specific insurer; 3) risk factors applicable to the specific insurer; and 4) current market conditions that are not reflected in the Commissioner's treasury bill formula. As a result, the Proposed Regulations create a real possibility that an insurer will not achieve a reasonable rate of return. Under these circumstances, the rates established pursuant to the Proposed Regulations are unconstitutionally confiscatory.

<u>Response to Comment</u>:

The Commissioner rejects this comment for the reasons stated in his response to the preceding comment.

<u>Summary of Comment (pages 17-19)</u>:

The Proposed Regulations do not provide a mechanism by which an insurer can seek relief from the imposed rates in order to achieve a reasonable rate of return. The Proposed Regulations preclude insurers from seeking relief from the mandatory rate caps. The Proposed Regulations provide that "[a]ny charge greater than the maximum title insurance charge is *conclusively* deemed excessive within the meaning of Insurance Code Section 12401.3(a) (emphasis added in comment.) Title insurers are being compelled to make their capital available for use by consumers without any means of obtaining a reasonable rate of return for the use of this capital. Such a result is unconstitutional.

The Supreme Court of the United States and California have held that a regulated entity is entitled to charge rates that allow it to achieve a reasonable rate of return, and that the adoption of any statute or regulation that deprives the entity from achieving that result constitutes an unconstitutional taking. *See, e.g., Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Bluefield Water Works & Improvement Co. v. Public Service Commission*, 262 U.S. 679 (1923); *Calfarm v. Deukmejian*, 48 Cal.3d 805 (1989).

Response to Comment:

The Commissioner rejects this comment. Nothing in the proposed regulations deprive companies subject to the proposed regulations of the opportunity to earn a reasonable profit. (See *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216.) The citation to *Calfarm* is unavailing to commenter. The vice of the statute found wanting in that case was a flat reduction in rates with no basis for the percentage chosen and no reference to the companies' costs. In that case, the Court found that the "risk that the rate set by the statute is confiscatory as to some insurers from its inception is high enough to require an adequate method for obtaining individualized relief." (48 Cal.3d at p. 820.) That condition does not obtain here, where the permanent rates are based explicitly on costs and the interim rates prescribe a temporary percentage reduction that is based on the company's own chosen rates plus careful calculation of the amount by which those rates have risen due to housing inflation in excess of the cost of providing the product or service. Thus, there is nothing in *Calfarm* that would imply any infirmity in the proposed regulations.

Summary of Comment (page 19):

The maximum rate of return set forth in the Proposed Regulations is confiscatory on its face. The Proposed Regulations define the maximum rate of return for inclusion within a rate calculation as the sum of the "average return in short, medium and long-term U.S. Treasury bonds for the most recent three months plus 3 ¾ percent, which the Commissioner finds represents the long-term risk-premium for investments presenting risks to investors comparable to the risks of investing in the title insurance business. In effect, the Commissioner has selected the capital asset pricing model, otherwise known as CAPM, as the method for determining cost of capital. Under this approach, a risk premium is added to current risk free yield to obtain a current cost of capital. As of the date of this comment, when the average Treasury yield over the past three months has been approximately 5 percent, this formula yields a maximum allowed rate of return of 8 ¾ percent.

David Appel, a leading cost of capital economist, has determined the Commissioner's risk premium is erroneous. Accordingly, the maximum rate of return derived is confiscatory on its face.

Response to Comment:

The Commissioner rejects this comment. The risk premium has been modified in the November 27 amendment to the proposed regulation. To the extent Dr. Appel may have continuing objections to the profit term, the Commissioner responds to those objections in his responses to the Appel comments elsewhere in this file.

Summary of Comment (page 19):

The Proposed Regulation contains no explanation as to how the Commissioner arrived at the figure of 3 ¾ percent. There is nothing in the Proposed Regulations that suggests the Commissioner relied upon competent expertise to select this risk premium.

Response to Comment:

The Commissioner rejects this comment. The risk premium has been adjusted, and the adjusted figure is fully explained in the Staff Report on the Profit Factor.

Summary of Comment (page 19-20):

According to Dr. Appel, the appropriate risk premium for the average risk security in the U.S. capital markets is approximately 7.7 percent. However, because title insurers present a slightly lower than average risk as measured under CPAM, the appropriate risk premium for purposes of CAPM is between 6.0 and 6.5 percent. Assuming a risk premium of 6 ¼ percent, the current CAPM cost of capital would be approximately 11 ¼ percent, rather than the 8 ¾ percent resulting from the application of the Proposed Regulations.

The analysis requires consideration of the discounted cash flow (DCF) in order to determine the appropriate rate of return for a regulated entity. Applying the DCF model to currently available data for title insurers indicates a fair return of approximately 16 percent. Because it is typical to average DCF and CAPM results to determine the allowed return for a regulated firm, applying that procedure would indicate a fair return of approximately 13 5/8 percent, almost 5 percentage points higher than the value resulting from the Proposed Regulations. The maximum rate of return established under the Proposed Regulations is, therefore, confiscatory on its face.

Response to Comment:

The Commissioner rejects this comment. The relevant regulation has been amended. To the extent the commenter continues to object to the regulation as amended, the Commissioner addresses those objections in his response to the commenter's 15-day comments.

Summary of Comment (pages 20-21):

The Commissioner's selected risk premium and resulting maximum rate of return is confiscatory in comparison to alternative investment opportunities presently available in capital markets. Appel Report at p. 5. For example, investors can currently earn yield of approximately 7 percent on investment grade corporate bonds, while the prime rate across the top U.S. commercial banks is 8.25 percent. *Id.* Both of these investments involve a risk level much lower than title insurance; accordingly, it is unreasonable to expect investors to devote capital to the title insurance industry when faced with the Commissioner's limitation on the rate of return.

A comparison to other regulated industries results in a similar conclusion. The California Public Utilities Commissioner has recently allowed equity returns for water utilities averaging near 10 percent and returns for electric utilities averaging in excess of 11 percent. Appel Report at p. 5. Water and electric utilities are widely believed to constitute lower risk investments than insurance; consequently, it is unlikely that investors would commit equity capital to bear the risk of title insurance exposures for a return of 8 ¾ percent. *Id.* Based on the above, Appel's opinion is that the maximum allowed return contemplated under the Proposed Regulations would cause title insurers to consider withdrawal or significant restriction of their activities in California. Appel Report at p. 5.

Response to Comment:

The Commissioner rejects this comment. The relevant regulation has been amended. To the extent the commenter relies on the comments of Dr. Appel to object to the regulation as amended, the Commissioner addresses those objections in his response to Dr. Appel's comments.

Summary of Comment (pages 21-22):

The Commissioner has arbitrarily and without authority set a 15% limit on the sales costs that can be recouped as a component of the title insurance premium. The Proposed Regulations state that 15% is the amount "the Commissioner finds to be a reasonable cost for salaries and commissions for sales and other acquisition expenses, and customer service expenses." Section 2357.12. No explanation or justification is provided for this conclusion and there is no basis for it. Moreover, if the Commissioner has the authority to set the "reasonable" expenditures of sales costs, presumably he may establish the appropriate costs for any aspect of the business, e.g., executive compensation, etc.

It appears the Commissioner has chosen this figure without any analysis or consideration of market factors. Limits on commission rates can be found in the Insurance Code (commissions for credit life insurance are capped at 35% and commissions for credit disability at 30%), but such caps are set by statute, not regulation, and no statutory authority exists for the Commissioner to set caps on title insurance commission rates.

As discussed by Mark Folk in his attached report, a 15% cap on sales costs does not reflect the realities of the insurance market because the Commissioner routinely approves rates for other lines of insurance that include the payment of a sales commission in excess of 15%.

The limitation of sales costs to 15% of premiums is even more restrictive than it appears because it includes non-commission items. Thus, other costs that are associated with sales, including salaries and general expenses such as postage are also included in the 15% limitation.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The basis for the 15% sales factor is laid out in the Staff Report on Sales Factor. The Commissioner agrees that he has the duty to recognize all reasonable costs and has the authority, in connection with that determination, to specify what constitutes an excessive level of compensation for executives, although he has not found it necessary to do so at this time in these proposed regulations. References by the commenter to statutes that cap commissioner are inapposite. The 15% sales factor is not a cap and, like any other component of the proposed regulations, a company is free to pay whatever commissions it wishes so long as it does not charge an excessive rate overall. Likewise, rates in other lines in which higher commissions are approved are irrelevant in the absence of any showing that those rates are afflicted with reverse competition driving up sales costs. While the commenter is correct that the 15% includes non-commission items (e.g., other acquisition), it is also true that it excludes certain costs sometimes counted in commissions, such as field underwriting and field claims adjustment.

<u>Summary of Comment (page 22)</u>:

The Proposed Statistical Plan exceeds the Commissioner's authority. The Insurance Code authorizes the Commissioner to promulgate reasonable regulations establishing financial data reporting requirements and a statistical plan. However, the Proposed Regulations require the submission of vast quantities of information that go beyond the limits of this statutory authorization. Insurance Code Section 12401.5 is the only statute that provides the Commissioner the authority to issue a statistical plan and that statute allows the Commissioner to collect only financial information related to aggregate financial performance and loss experience. This section does not permit the Commissioner to require submission of information detailing every title transaction in the State as is done by the Statistical Plan established by the Proposed Regulations.

The Proposed Regulations impose an unprecedented level of data reporting obligations upon title insurers. Clark statement at p. 10.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The commenter has failed to specify what data elements collected in the statistical plan is unwarranted, other than the objection to transaction-specific data and incorporation of the Clark comments. The Commissioner has explained that the collection of transaction-specific data is necessary both to report summary data and to perform the title and escrow functions, so reporting this data should not be a significant burden, and it provides information that companies have proven unable to provide in prior submissions. The Commissioner responds to the Clark comments separately in this file.

<u>Summary of Comment (page 23)</u>:

Preparing the data submissions required by the Proposed Regulations would be prohibitively expensive and difficult or impossible to accomplish. The Proposed Regulations would require a complete overhaul of FNTG's information technology systems. The existing systems do not support the collection of much of the data required and cannot run the majority of calculations specified. Modification of the system would be so extensive that it would be more efficient and economic to create and deploy a new title production system. To accomplish the changes within the timeframe set would require FNTG to hire new information technology staff and obtain the assistance of technology consultants. The cost for creating the system would be approximately $192 million, and training of employees would cost $63 million and the increase in data collection would increase operating expenses in the amount equal to approximately $156 million. Revamping HR and payroll systems would cost approximately $22 million.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The Commissioner notes that each of the title companies, including Fidelity, are essentially information-technology companies with significant data processing and analysis arms. Given the companies' technological sophistication, the Commissioner does not credit the claims of impossibility or great burden. The statement that existing systems lack the capacity to maintain the data or perform the calculations is not credited by the Commissioner, who is aware of numerous corporate and governmental databases that are vastly more extensive than anything required to respond to the proposed regulations. The Commissioner also doubts that individual companies will invest hundreds of millions of dollars in system development; if the proffered numbers are even remotely realistic, it can be expected that industry-wide services and products will be developed. While the Commissioner does not credit the specific numerical claims, which are patently unrealistic, he acknowledges that there will be significant costs incurred for compliance. However, those costs are not unreasonable for an industry that collects over $4 billion in revenue and appears to be charging excessive rates in the hundreds of millions of dollars.

<u>Summary of Comment (pages 23-24)</u>:

Much of the information required to be submitted is already collected pursuant to other statutory and regulatory requirements. Title insurers and UTCs are required to submit: loss or expense experience and the data, statistics or information collected or used by it as the basis for and in support of its rates, rating plans and charges filed (10 CCR Section 2556.1), audited financial reports and annual or quarterly statements (Insurance Code Sections 900.2, 931(a), (b), 1591, 12389.4), and information on closed orders from controlled and noncontrolled business sources (Insurance Code Section 12397.5(c). The

Proposed Regulations require the same information to be provided in a new and different format which is a waste of resources for both the entities and the CDI.

Response to Comment:

The Commissioner rejects this comment. To the extent the information is already being collected, the requirement that it be reported in a uniform format is not unreasonable.

Summary of Comment (page 24):

The Proposed Regulations require the submission of data that is not needed to evaluate the financial condition of title insurers or to regulate title insurance rates. As Mike Miller points out in his attached report, title insurers are currently required to submit their rates, with extensive information regarding loss experience and past expenses. Insurance Code Sections 900, 931 and 934. In combination, this data should be more than sufficient to determine if a rate is excessive under the test provided by the Insurance Code. Mike Miller notes that regulators across the country regulate rates with the same information. There is nothing unique about title insurance or about California that would require the creation of such an unnecessary, extensive, over-detailed and expensive database.

Response to Comment:

The Commissioner rejects this comment. He has responded separately to the comments of Mr. Miller. The Commissioner rejects the unsupported assertion that the statistical plan is unnecessary or over-detailed.

Summary of Comment (pages 24-25):

The database required by the Proposed Regulations will include sensitive information that constitutes "personal information" as defined in California Civil Code 1798.3 (personal information is "any information that identifies or describes an individual, including but not limited to, his or her name, social security number, physical description, home address, home telephone number, education, financial matters and medical or employment history.")

California law requires all businesses to "implement and maintain reasonable security procedures and practices appropriate to the nature of the information, to protect the personal information from unauthorized access, destruction, use, modification, or disclosure." Cal. Civ. Code Section 1798.81.5. Insurers are further required to implement a comprehensive security program that includes "administrative, technical and physical safeguards for the protection of consumer information." These safeguards must be "appropriate to the size and complexity of the licensee and the nature and scope of its activities." Title 10, Section 2689.14. The entities subject to the Proposed Regulations will be required to implement expensive and complex system changes to ensure this data is held securely.

Since the data sought is beyond the scope allowed under the Insurance Code, the Proposed Regulations will create new risks of data disclosure with no associated regulatory benefit.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The proposed regulation do not require the reporting of any of the categories of sensitive information enumerated in this comment. It is true, however, that the companies already collect most or all of these categories of information, so nothing in the proposed regulations will increase the risk that company data will be compromised to the detriment of personal privacy. The Commissioner reiterates the obligation of businesses to implement and maintain the necessary procedures and practices to protect private information.

<u>Summary of Comment (pages 25-26)</u>:

Is it impossible for the entities subject to the Proposed Regulations to comply with the certification requirement established. Each submission must be accompanied by a certification, under penalty of perjury, of an officer that the information in the submission is complete, accurate and in compliance with relevant California laws and regulations.

Many of the submissions required by the Proposed Regulations contain information that the submitting entity received from a nonaffiliated third party. As a result, the submitting entity will not be able to verify the accuracy of the information. The Proposed Regulations do not permit an officer to certify the information in the report is true to the best of his/her knowledge. In essence, reporting entities would be compelled to choose between a false certification or failing to make a complete disclosure. Either way, the reporting entity would be violating the law.

This certification requirement is without precedent. Sarbanes-Oxley, for example, requires officers to certify only that the reports fairly represent the financial condition of a company, a subject about which officers are expected to have personal knowledge. So far as FNTG is aware, there is no other law in the country that requires an officer or director to certify facts that are beyond the knowledge or control of the entity providing the information. Such a requirement is not only unfair to the reporting entity, it is unfair to the officer required to certify the information.

<u>Response to Comment</u>:

The Commissioner rejects this comment. All of this information, in aggregate form, is already reported by the companies and certified by their appropriate officers. If they can execute that certification today, they can execute the certification prescribed in the proposed regulations.

<u>Summary of Comment (pages 26-27)</u>:

The Proposed Regulations require disclosure of sensitive business information to the CDI which then becomes subject to disclosure under the California Public Records Act. For example, Report T101 requires title insurers to disclose the source of the order, the complete name of any real estate agent, real estate agency, lender, homebuilder or other business source as well as its business name. It also includes information regarding transaction size, street address and zip code. The assembly of the information required by the Proposed Regulations in a single public database will enable competitors to access information about their competitors' legitimate marketing efforts that would otherwise be unavailable through a California Public Records Act request.

The Proposed Regulations would also require title insurers to disclose trade secrets without adequate safeguards. Requiring submission of information puts it at risk of inadvertent disclosure notwithstanding the section of the Proposed Regulations which states that "[i]nformation claimed as a trade secret . . . shall not be made public by the Commissioner . . . without first giving the company at least 30 days' written notice and an opportunity to object to the release and seek a court order preventing release. Section 2355.8(c). If a company should inadvertently fail to object to disclosure, the implication is that the Commissioner would disclose the information notwithstanding its designation as a trade secret. Given the lack of legitimate regulatory purpose for the data to be disclosed, risk of disclosure unnecessary and unreasonable.

Response to Comment:

The Commissioner rejects this comment. The statement concerning report T101 ignores the fact that this report is expressly omitted from information subject to disclosure. (See § 2355.8.) The commenter has failed to substantiate the claim that safeguards under the proposed regulations are inadequate to protect trade secrets. If a company erroneously fails to object to disclosure, the fault is with the company, not with the proposed regulations.

Summary of Comment (page 27):

The Proposed Regulations are invalid under the California Administrative Procedures Act. The Proposed Regulations do not meet any of the six APA standards that the Office of Administrative Law uses to review regulations: 1) necessity; 2) authority; 3) clarity; 4) consistency; 5) reference; and 6) non-duplication.

Response to Comment:

The Commissioner rejects this comment, which is a summary of points made by the commenter and responded to by the Commissioner below.

Summary of Comment (page 28):

The Commissioner does not have the authority to set title insurance rates. The Insurance Code expressly prohibits the Commissioner from setting title insurance rates. Insurance

Code Section 12401. No provision of the Insurance Code or other California law gives the Commissioner the power to set title insurance rates.

Response to Comment:

The Commissioner rejects this comment, which merely repeats the comments made at pages 4-6 of the comments and are responded to above.

Summary of Comment (page 28):

The Proposed Regulations contain formulae for setting maximum rates for "maximum title insurance charge for a policy," "maximum policy charge," "preliminary report charge," and "maximum charge for an escrow transaction" using the data submitted under the Proposed Statistical Plan. In light of the restrictions on rate of return and recoupable expenses and the annual readjustment of maximum rates, it is likely the industry participants will adopt these maximum rates as their existing rates. Thus, in reality, the formula for calculating maximum rates actually set rates in violation of the Insurance Code.

Response to Comment:

The Commissioner rejects this comment, which merely restates erroneous comments made at pages 16-21 above and to which the Commissioner has responded above.

Summary of Comment (pages 28-29):

The proposed regulations require title insurers to implement an interim rate rollback to 77% of the rates charges for sales transactions and 84% for refinancings in the year 2000. This sets a rate. The Commissioner has also failed to allege or substantiate the existence of an emergency that would justify the rate rollback.

The California Supreme Court has held that price control of insurance rates is invalid except in an emergency situation. *See CalFarm Ins. Co. v. Deukmejian*, 48 Cal.3d 805, 821-22 (1989)(finding no emergency existed to justify price controls that deprive insurers of a fair rate of return after a rate rollback.)

Response to Comment:

The Commissioner rejects this comment. The percentage reductions have been modified in the November 27 amendment to the proposed regulations. The commenter errs in claiming that *Calfarm* prohibits any form of rate regulation in the absence of an emergency; rates have been regulated across the economy, including insurance rates in California under Proposition 103, without any finding of emergency.

Summary of Comment (page 29):

The Proposed Regulations also set rates by specifying discounts applicable to certain types of policies (e.g., a refinance policy is given a relativity of 0.65 (ALTA policy) or 0.55 (CLTA policy). By specifying this relativity, the Proposed Regulations set the discounts applicable to a refinance policy (a discount of 35% or 45% off the base rate). In practical terms, this amounts to the setting of a rate in contravention of Insurance Code Section 12401.5.

Response to Comment:

The Commissioner rejects this comment. Again, the company is free to employ whatever discounts and relativities it wishes, so long as the final rate does not exceed the maximum, and without any regulatory prohibition on the charging of any lower rate.

Summary of Comment (page 30):

The Proposed Regulations set a specific rate for concurrent policies. The Proposed Regulations state that "the charge for a concurrent policy shall not exceed $25 plus $0.10 per page, exclusive of reasonable charges for any inspection required in the ordinary course of business solely for the concurrent policy. Establishing a dollar amount that may not be exceeded is setting a rate.

Further, the rate set is significantly less than FNTG's current charge for a concurrent policy; accordingly, the Commissioner is setting a rate that is likely to be inadequate.

Response to Comment:

The Commissioner rejects this comment. The specified amount is not the prescribed charge but a maximum. Since the concurrent policy is issued practically with no cost other than producing the document, it is reasonable to expect some companies to charge less than the maximum specified in the proposed regulations.

Summary of Comment (page 30):

The Proposed Regulations give the Commissioner the authority to "correct" the sum of the reported data "in his discretion for missing and erroneous data." The Proposed Regulations provide no guidelines with respect to exercise of this discretion; therefore, there is no assurance the Commissioner will not act arbitrarily to manipulate the submitted data to assure the calculated maximum rates are at a level he arbitrarily deems to be appropriate.

Response to Comment:

The Commissioner rejects this comment. The ability of a statistical agent acting under the direction of an Insurance Commissioner to correct erroneous data is well established. The words "correct," "missing," and "error" have accepted, well-understood meanings.

The Commissioner is entitled to the presumption that he will duly carry out his official duties.

<u>Summary of Comment (page 30)</u>:

The Proposed Regulations require submission of vast quantities of information that go beyond that which is permitted under the Insurance Code. Section 12401.5 permits the Commissioner to issue a statistical plan for the industry. The statute allows the Commissioner to collect financial information related only to "aggregate economic performance" and "loss experience." The statute does not permit him to require the submission of information detailing every title transaction in the State. As a result, the information sought by the Proposed Regulations exceeds the Commissioner's authority under the Insurance Code.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The commenter has failed to specify what data elements are claimed to lie beyond the Commissioner's authority under Insurance Code section 12401.5. Each data element is either a measure of overall financial results, economic performance, or less experience or a quantity that goes into the calculation of those measures. The Commissioner has responded above to the commenter's objection to collection of transaction-specific data and found the objection to be without basis.

<u>Summary of Comment (page 31)</u>:

Insurance Code Section 12401.5 provides that the Commissioner may issue "reasonable rules and regulations" for the annual reporting of financial data with respect to "aggregate economic performance of title insurance entities" and to create a statistical plan for title insurance entities. This statute provides that the collection of information for the statistical plan shall be limited to the reporting of "experience information" by title insurers. Any statistical plan promulgated by the Commissioner must be "reasonably adapted to each of the rating systems in use within the state." Insurance Code Section 12401.5(b). In other words, a permissible statistical plan must reflect the various rating systems actually in use by title insurers and prohibits the Commissioner from setting title insurance rates or otherwise impairing competitive rating or the free market in California.

<u>Response to Comment</u>:

The Commissioner rejects this comment. As noted above, each data element collected pursuant to the statistical plan is either a measure of overall financial results, economic performance, or less experience or a quantity that goes into the calculation of those measures. Section 12401.5 says the Commissioner "may give due consideration to the rating systems in use and, in order that the plan may be as uniform as is practicable among the several states." The reference to uniformity with other states is wholly discretionary with the Commissioner, as denoted by the word "may" and the reference to "due consideration." The Commissioner has examined data maintained by members of this industry, including data filed with the Department and data obtained in two data calls, and has concluded that uniformity with other states is not practicable and would be deleterious to the administration of California laws.

The Commissioner has determined that the statistical plan is reasonable and does not conflict with the intent of Insurance Code section 12401.5. The reporting of details regarding each company's operations is required because the Commissioner has determined that existing reporting is inadequate. The Commissioner has considered the rating systems employed in other states and found them to be inadequate to California's needs. In part, those needs are identified in the calculations prescribed in the proposed regulations. The needs are further informed by the inadequacies of current reporting and the inadequacies of companies' responses to two data calls promulgated in part to assess the reasonableness of rates. In addition, the other states' rating systems do not provide sufficient information to facilitate examination and auditing of companies' data.

Summary of Comment (pages 31-32):

The annual financial data reporting requirements seek non-financial data which has no bearing on "aggregate economic performance" of the disclosing company that the Commissioner is not entitled to obtain. Insurance Code Section 12401.5 limits the information that may be collected as part of the annual financial data reporting requirements to "financial data" that is required to determine "aggregate economic performance" for the year. Accordingly, the Proposed Regulations violate the Insurance Code.

For example, the Proposed Regulations require UTCs to submit thirteen separate reports as part of the Annual Financial Reporting Requirements. The first of these reports is the Title and Escrow Transaction Report (UTC01). That report requires UTCs to provide detailed transactional information about the type of real estate transaction, the street address of the property, the zip code of the property, the source of the order, the date the order was opened, and other non-financial information. This information has no bearing on "aggregate economic performance" of the UTC, and cannot be characterized as financial information.

Response to Comment:

The Commissioner rejects this comment. The objection to report UTC01 is simply a re-hashing of the commenter's objection to the collection of transaction-specific information. The information is required to verify more aggregated data on sales and to determine the components of cost of writing the insurance – information the companies have been conspicuously unable to provide in past filings and responses to data calls by the Commmissioner.

Summary of Comment (pages 32-33):

The Proposed Statistical Plan seeks transactional data the Commissioner is not entitled to obtain. Insurance Code Section 12401.5 limits the information that may be collected as part of a statistical plan to “loss experience data.” The statutory purpose of creating such a plan is to ensure that “the experience of all title insurers is available to the commissioner on an annual basis.” The information requested by the Proposed Regulations includes detailed transactional data on every title transaction most of which has no bearing on loss experience.

The Proposed Regulations require title insurers to submit 17 reports as part of the Statistical Plan. The first is the Title and Escrow Transaction Report (T1010). This report requires insurers to provide detailed transactional information on each title, escrow or other service transaction that was opened in the previous year and that was closed or cancelled during the reporting period. The information required includes the type of real estate transaction, street address of the property, zip code of the property, source of the order, the date the order was opened, other non-financial information, the name and location of the facility where the title search and examination was conducted, the location of the facility at which the title policy was issued, the names of the buyers and the sellers’ real estate agents, information not relevant to the an insurer’s loss experience during the preceding year.

Response to Comment:

The Commissioner rejects this comment. All of the collected data elements bear on the company’s aggregate economic performance and are required to verify the aggregated data being reported.

Summary of Comment (page 28):

The Proposed Statistical Plan is not reasonably adapted to existing rating systems. The Proposed Statistical Plan requires the collection and reporting of data that compels insurers to adopt the rating system favored by the Commissioner; this is contrary to Insurance Code Section 12401.5 which requires the statistical plan be “reasonably adapted to each of the rating systems in use within the state.” The Proposed Regulations seek to impose a new rating system unlike any in existence.

Insurance Code Section 12401.5(b) states that the Commissioner should “give due consideration to the rating systems in use and, in order that the plan may be as uniform as is practicable among the several states, to the rules and to the form of the plan used for these rating systems in other states.” Nothing in the Proposed Regulations gives any indication that the Commissioner considered whether the statistical plan would be uniform or looked at other states’ rating systems.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has determined that the statistical plan is reasonable and does not conflict with the intent of Insurance Code section 12401.5. The reporting of details regarding each company's operations is required because the Commissioner has determined that existing reporting is inadequate. The Commissioner has found inadequacies of current reporting and the inadequacies of companies' responses to two data calls promulgated in part to assess the reasonableness of rates.

Summary of Comment (pages 33-34):

The Proposed Statistical Plan would impair competitive rating and the free market in violation of Insurance Code Section 12401.5 (which states that no statistical plan or regulations pertaining thereto shall impair competitive rating or the free Market). The Proposed Regulations provide competitors access to proprietary information. Detailed information (currently unavailable) about competitors' experience, expenses, and premium splits will be made available through the database created for collection of information under the Statistical Plan. This will permit title insurers and UTCs to more easily able to monitor each other's pricing and experience, facilitating price convergence. The ability to more closely monitor competitors' pricing will serve as a disincentive, not an incentive, to price competition. Companies may choose to compete by reducing their costs to below industry average while charging the maximum rate to achieve a higher rate of return. Such action is likely to result in a diminished level of service to California consumers. Accordingly, it is possible consumers will suffer losses (e.g., loss of rate lock on mortgage loan due to increase time for issuing a title policy) that far exceed any savings on title insurance.

The reporting categories utilized in the Proposed Statistical Plan and the administrative difficulty in adopting products or classifications that differ from those in the Proposed Statistical Plan will likely result in companies deciding to offer only such product classifications. The Proposed Statistical Plan will have the effect of reducing competition in the form of product and service innovation.

Response to Comment:

The Commissioner rejects this comment. The argument about convergence of rates ignores the Commissioner's finding that there is not a reasonable degree of price competition in the market today, so the hypothetical obtaining pricing information does not reasonably risk any injury to competition. Furthermore, the comment ignores the fact that not just pricing information but actual rates charged are already filed by companies pursuant to Insurance Code section 12401.1. Nothing in the proposed regulations will make the monitoring of hypothetical competitors' rates any easier than it already is. Nor is there any evidence that this ability to monitor pricing has had any of the effects the commenter conjures, such as under-pricing or loss of rate-locks. The Commissioner rejects the unsupported assertion that there may be a loss of product or service innovation; the proposed regulations expressly provide for the filing for new products and services. (See § 2359.3.)

Summary of Comment (page 34):

The Commissioner claims to have authority to issue the Proposed Statistical Plan and Annual Financial Data Reporting Requirement under Insurance Code Section 12389, 12397.5, 12401.3, 12401.21 and *20th Century Ins. Co. v. Garamendi*, 8 Cal.4th 216 (1994). The Insurance Code does not provide authority for the Proposed Regulations' annual financial reporting requirements for a Proposed Statistical Plan. Certain Insurance Code Sections authorize the Commissioner to gather information from title insurers and UTC, but none serve as authorization for a statistical plan or for information gathering such as contemplated in the Proposed Regulations. Moreover, none of the cited sources of authority expands or modifies the limits on the Commissioner's authority under Section 12401.5.

Response to Comment:

[Each contention is separately summarized below.]

Summary of Comment (pages 34-35):

Insurance Code Section 12389 governs licensing of UTCs and requires UTCs provide confidential audits to the Commissioner and be subject to examinations. It does not authorize the Commissioner to gather information for a statistical plan or gather vast quantities of financial information as required by the Proposed Regulations, nor does it expand the obligation of UTCs under Section 12501.5 to provide annual financial data relating to "aggregate economic performance."

Response to Comment:

The Commissioner rejects this comment. Every data element required of UTCs under the proposed regulations pertains to the UTCs' aggregate economic performance.

Summary of Comment (page 35):

Section 12397.5 requires licensees to "make submissions as are required by the Department of Insurance to enable the department to determine the nature and extent of the licensee's efforts to actively compete in each county in which it transacts its business." Section 12397.5 gives the Commissioner limited authority to obtain information regarding a licensee's "efforts to actively compete" as that term is used in the statute. Section 12397.5 does not provide the Commissioner with the power to gather information regarding competition, or the power to do so through a Proposed Statistical Plan. It states that, for the purposes of the statute, "[c]ompetitive behavior shall be measured by the source of closed title orders in each county in which the licensee engages in the title business and by the entity's progress toward obtaining over 50% of its business from a non-controlled source." Accordingly, the Commissioner is required to make his determination of competition based solely on an annual verified report that is required by statute.

Response to Comment:

The Commissioner rejects this comment. The data required under the statistical plan is all relevant to the purposes of Insurance Code section 12401.5. The Commissioner does not rely on section 12397.5 as authority for the proposed regulations, although it is true that a salutary by-product of the data collected may be additional insights into the extent, if any, of competition in the relevant markets. The fact that the data may be useful for that purpose does not render its collection for other authorized purposes improper.

Summary of Comment (page 35):

Section 12401.3 provides that no title insurance rates may be excessive, inadequate or unfairly discriminatory. The section states that with respect to making those determinations, "consideration shall be given, to the extent applicable, to past and prospective loss experience within and outside this state, to a reasonable margin for profit and contingencies, to past and prospective expenses both countrywide and those specifically applicable to this state, and to all other factors, including judgment factors, deemed relevant within and outside this state." However, it does not provide authority for issuance of a statistical plan, nor does it modify or alter the limitations on such a plan in Section 12401.5.

Response to Comment:

The Commissioner rejects this comment. The data collected pursuant to the proposed regulations includes data on past and prospective loss experience, to the company's ability to achieve a reasonable profit, to the company's expenses, and to "other factors, including judgment factors, deemed relevant within and outside this state." (Ins. Code section 12401.3(b).)

Summary of Comment (page 36):

The Proposed Regulations cite to Section 12401.21 as authority for issuance of the Proposed Statistical Plan. There is no such section, therefore, this must be a typographical error.

Response to Comment:

The Commenter is correct. The correct reference is to section 12414.21. After this regulation is filed with the Secretary of State, the Commissioner will submit this change without regulatory effect to the Office of Administrative Law pursuant to California Code of Regulation, title 1, section 100(a)(5).

Summary of Comment (page 36):

Citation of *20th Century Ins. Co. v. Garamendi*, 8 Cal.4th 216 (1994) in support of the Proposed Statistical Plan is inappropriate as the Commissioner's authority to issue regulations must stem from a statute, not a decision of the Supreme Court.

Moreover, *20th Century Ins.* cannot serve as authority for the Proposed Regulations because it did not consider title insurance or the Commissioner's authority to implement regulations such as these. In *20th Century Ins.*, various insurers challenged the Commissioner's actual implement the rate rollback provisions of Proposition 103 as well as the validity of the regulations adopted. The Court examined the Commissioner's implementing regulations in depth, and concluded that they were valid in all their particulars under Proposition 103. Thus, *20th Century Ins.* was a case fundamentally about the scope of the Commissioner's power under Proposition 103. Proposition 103 does not apply to title insurers; therefore, the Proposed Regulations which deal exclusively with title insurance, are not supported by *20th Century Ins.*

Response to Comment:

The Commissioner rejects this comment. While *20th Century* arose under a different statute, it applied the same constitutional principles that would apply to the proposed regulations here and refutes the constitutional challenges asserted by this commenter and other members of the industry. Furthermore, the prohibition on "excessive" rates is identical in Proposition 103 and Insurance Code section 12401.3.

Summary of Comment (page 36):

The Proposed Regulations are not necessary. They do not "effectuate the purpose" of any statute and, as discussed above, conflict with applicable law. Nor are they required to achieve the purpose for which they are purportedly intended, namely, to prevent excessive title insurance rates. That purpose (as discussed above) is fully and adequately dealt with under the Insurance Code.

Response to Comment:

The Commissioner rejects this comment. The comment merely incorporates the commenter's prior comments. The Commissioner incorporates his prior responses.

Summary of Comment (pages 36-37):

The Proposed Regulations are not necessary under the APA. To prove necessity under the APA, the Commissioner is required to promulgate a detailed statement of reasons setting forth why the regulations are necessary to effectuate the purpose of a valid statute. The Commissioner has prepared a Proposed Statement of Reasons following the basic form required by the APA, however, it fails to satisfy the substance of the law. The Statement of Reasons fails to consider any reasonable alternatives to the Proposed Regulations, relies upon a discredited report and fails to adequately assess the impact that the Proposed Regulations will have.

Response to Comment:

The Commissioner rejects this comment. The APA requires an initial and a final statement of reasons. The Commissioner has prepared both. The Commissioner has considered all of the alternatives of which he is aware, including all of the alternatives proposed in comments in this file, and has found none to offer a reasonable prospect of preventing the continued charging of excessive rates. The commenter has failed to proffer any alternative that the Commissioner finds to have any reasonable likelihood of achieving that statutory purpose.

Summary of Comment (page 37):

The Government Code requires that the Statement of Reasons include: 1) a description of reasonable alternatives to the regulation and the agency's reasons for rejecting those alternatives; 2) a "description of reasonable alternatives to the regulation that would lessen any adverse impact on small business and the agency's reasons for rejecting those alternatives" and 3) a determination by the Commissioner that no reasonable alternative considered by the CDI would be more effective or would be as effective and less burdensome to affected private persons than the Proposed Regulations. Gov't Code Section 11346.2.

The Statement of Reasons concludes that there are no reasonable alternatives. No reasonable alternatives are considered and discussed. Although an agency "is not required to artificially construct alternatives, describe unreasonable alternatives, or justify why it has not described [such] alternatives, the failure to describe any reasonable alternatives is inappropriate.

Existing law gives the Commissioner the power to challenge rates on the grounds of excessiveness on an individualized basis without setting a maximum rate. Accordingly, reasonable alternatives do exist and should have been considered by the Commissioner.

Response to Comment:

The Commissioner rejects this comment. The Commissioner specifically finds the commenter's proposed alternative not to be a reasonable alternative to the proposed regulations. The commenter recommends that the Commissioner simply rely on ad hoc enforcement actions with no regulatory standards prescribed on the basis of data collected in the statistical plan. The Commissioner has found that this is not a feasible, practicable, or manageable alternative. If the reasonableness of rates must be litigated from the ground up in each case, the Commissioner has concluded that it would be impossible to effectively enforce the prohibition on excessive rates.

Summary of Comment (page 38):

A statement of reasons must include "an identification of each technical, theoretical, and empirical study, report, or similar document, if any, upon which the agency relies in proposing the adoption, amendment or repeal of a regulation." Gov't Code Section 11346.2(b)(2). In reaching the conclusion that there is a lack of competition in the industry, the Commissioner relies on a single report he commissioned and ignored numerous other studies that reach opposite conclusions. Moreover, the Birnbaum Report was subject to significant criticism with respect to its methodology and conclusions at the January 5, 2006 Public Workshop. For example, Dr. Vistnes testified that the Birnbaum Report ignores standard professional economic methodology to analyze competition, including the methodology used by DOJ and FTC in their joint *Merger Guidelines* by placing heavy emphasis on concentration ratios without considering other market factors. Moreover, Dr. Vistnes found the industry is, in fact, competitive.

The Notice states that "[i]nput from workshop participants was taken into account in the formulation of the Proposed Regulations, however criticism of the Birnbaum Report submitted at the Workshop is not addressed, suggesting that this criticism was ignored.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The commenter has failed to distinguish between comments that were ignored and comments that were considered and found incorrect or insubstantial. The comments cited by commenter fall into the latter category, for reasons stated in response to the comments of Dr. Vistnes.

<u>Summary of Comment (pages 38-39)</u>:

A statement of reasons must include a statement of all facts, evidence, documents, testimony or other evidence on which the agency relies to support an initial determination that the action will not have significant adverse economic impact on business and a description of the potential for adverse economic impact. The Commissioner admits that the Proposed Regulations "may have a significant statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states."

However, the Commissioner then claims that the additional cost of compliance to title insurers, UTCs and CECs will be modest because they are "already required to report financial data to the Commissioner." This is wrong. The Proposed Regulations do not take account of the existing rating or recordkeeping systems; therefore, every title insurer, UTC and CEC will be required to invest in new data collection and storage systems in order to comply with the Proposed Regulations. This expenditure, combined with the decrease in revenues resulting from the interim rate reduction and future limit on maximum rates, will put significant economic strain on title insurers, UTCs and CECs and may result in some companies ceasing to do business.

<u>Response to Comment</u>:

The Commissioner rejects this comment. While the Commissioner has found that the proposed regulations may have an adverse impact on some businesses – mainly those businesses that have heretofore been able to charge excessive rates – the Commissioner has also found that the net effect on California businesses and consumers in the aggregate is positive. While the costs to regulatees of compliance with the statistical plan will be significant, they will be far less than the benefits to the public of the effective prohibition of excessive rates, which the evidence indicates amounts to hundreds of millions of dollars annually in the over-$4-billion industry.

<u>Summary of Comment (page 39)</u>:

The Commissioner improperly concludes the Proposed Regulations will result in no cost to any state agency. A vast amount of data will be reported to CDI. That information must be reviewed and annual hearings must be held in connection with that data. It does not seem possible that the CDI would not incur additional costs in performing this collection and review.

Moreover, the Notice does not consider the likely impact on the revenues available to the State of California. The Proposed Regulations would significantly reduce the amount of title insurance premium collected, premium taxes collected would be reduced. Similarly, the income of UTC and CECs subject to state income tax would be reduced, reducing the tax base. These effects could be amplified if companies choose to stop doping business in the State of California as a result of the Proposed Regulations.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The bulk of the data-processing costs will be borne by the companies through their support of the statistical agent. While there will be some regulatory costs for the Department of Insurance, the Commissioner has concluded that those costs will be offset by savings in examination and other costs currently being incurred that can be avoided once the superior data from the statistical plan is being received.

The Commissioner rejects the unsupported comments regarding lost revenues to the state. In general, the impact on premium taxes will be small because the portion of premium subject to premium taxes is only 10% due to the small portion of premium retained by title insurers. (Thus, for example, a 20% reduction in premium will result in only a 2% decline in premium taxes from the affected companies.) While there may be some decline in income tax payments by companies that will receive less revenue, the extent to which that decline translates into lower income taxes will depend on how successful the companies are at reducing their expenses to protect their bottom-line. And any decline in revenue represents money that will remain with California consumers, who are likely to spend it elsewhere, increasing revenues and income to myriad other businesses, many of which pay higher marginal taxes than title companies.

Summary of Comment (page 39):

The Proposed Regulations lack clarity; they are poorly drafted with so many ambiguities that they are largely incomprehensible. See Norris Clark Statement concluding that the Proposed Regulations are "beyond comprehension" and none of the regulations he had personal experience with during his 31-year career at CDI approached the level of incomprehensibility of the Proposed Regulations.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has responded to the specific comments of Mr. Clark elsewhere in this file.

Summary of Comment (page 40):

California law requires that regulations be drafted in plain, straightforward language, avoiding technical terms and, where possible, using coherent and easily readable language so the meaning of the regulations will be readily understood by those directly affected. The Proposed Regulations fail to meet this standard because the regulations: 1) define and use terms in a manner that is ambiguous and inconsistent with industry usage; 2) require submission of data that does not reflect industry practice and is not clearly defined; 3) include contradictory and confusing provisions; 4) are inconsistent with the description of the Proposed Regulations in the Statement of Reasons; and 5) include numerous incorrect cross-references and internal citations. See Gov't Code Section 11349(a) re: clarity.

Response to Comment:

[Each of these contentions is addressed individually below.]

Summary of Comment (pages 40-42):

Although the Proposed Regulations start with a "definitions" section, the terms used in the Proposed Regulations are ambiguous and inconsistent with industry usage. Moreover, many defined terms are not consistently used in the text of the Proposed Regulations, resulting in conflicts in meaning. The Proposed Regulations also contain terms that are treated as defined terms but are not included within the "definitions" section. Further, because defined terms are not capitalized or otherwise set apart, it is often not clear what meanings are intended.

Ambiguity:
A number of terms are defined ambiguously.

1) Date of Application: This term is defined by reference to "the date on which the rate filing is stamped "Received" by the Department of Insurance Rate Filing Bureau, an action that would occur with a paper filing. It is not clear

how this term should be applied to electronic filings made through the "SERF" system.

2) Base Policy: Although the calculation of the "average title policy class relativity," which is used in the calculation of the maximum charge for a policy, no definition of a "base policy" is provided. This term flows through the equations used to calculate the maximum charge for a title insurance policy; therefore, the absence of a definition introduces ambiguity that makes it difficult to perform the calculations.
3) Full Escrow: There are two definitions of full escrow. In both instances, full escrow is defined with reference to the "typical residential transaction." See Section 2355.3(a) and 2356.8. However, neither "residential transaction" nor "typical residential transaction" is defined. Because there is no precise definition of a "typical residential transaction," and the understanding of such a transaction may vary greatly among industry participants, this term cannot be used without definition.

   The definition of "full escrow" is also ambiguous because it is inconsistent with definitions contained in the Insurance Code. See Sections 2358.7(1) and 2356.8(a)(2). For example, it includes as one of the activities comprising full escrow: "requesting a preliminary title search or title commitment to determine the present condition of title to the property." This definition is inconsistent with the definition of "preliminary report," "commitment," or "binder" set forth in Insurance Code Section 12340.11. That definition is drafted to make clear that a preliminary report is not an abstract of title and is not subject to "the rights, duties or responsibilities applicable to the preparation and issuance of an abstract of title." Because the definition of "full escrow" in the Proposed Regulations refers to "preliminary title search or title commitment" in a manner that deviates from this established definition, it creates an ambiguity regarding whether abstractor duties and liabilities are applicable to the "requesting [of] a preliminary title search or title commitment to determine the present condition of title to the property" as part of a full escrow. Section 2355.3(1).

4) Title Insurance Transaction: The term "title insurance transaction" is defined by the sale of real property, not the issuance of a title insurance policy. See Section 2355.3(x). Moreover, various types of real estate transactions that involve the issuance of a title insurance policy (e.g., home equity loan) are excluded from the definition, as are various activities that are considered "transactions" in common Industry usage (e.g., the issuance of a preliminary report, issuance of trustee's sale, litigation and other filed guaranty forms, issuance of endorsement, etc.)

Response to Comment:

The Commissioner rejects this comment. Each of the four terms is readily understood to persons in the industry. The need for clarity of the date of filing of an electronic filing is not a product of the proposed regulations but of the statutory framework; the date for purposes of these proposed regulations is the same date on which the clock begins to run on the 30-day period of Insurance Code section 12401.1. The term "base policy" has the same meaning applied by the companies in the ordinary course of their business when, for example, applying discounts that are calculated as a percentage of the rate for the base policy. There is no inconsistency in the references to "full escrow"; the definition is provided in section 2355.3, which includes a non-exhaustive list of activities, which is consistent with the instructions for data element TI01.D in section 2356.8. The definition of "title insurance transaction" is properly defined to exclude the issuance of a preliminary report not associated with a sale or refinancing.

Summary of Comment (pages 42-43):

A number of the terms found in the Proposed Regulations are defined in a manner that is inconsistent with industry usage.

1) Concurrent Policy: In practice, a concurrent policy is a lender's policy issued simultaneously with an owner's policy covering the buyer. The Proposed Regulations define "Concurrent policy" as "a second (or subsequent) policy issued by a title insurer or its affiliate at or around the same time that title insurer issues the first title insurance policy in the transaction." See Section 2355.3(e). Moreover, the words "around the same time" are ambiguous and make it difficult to determine when policies covering the same property would not be "concurrent policies" as defined in the Proposed Regulations.
2) Full Escrow: The informal definition provides that it is "the complete set of escrow activities associated with a typical residential transaction, including at a minimum . . ." See Section 2356.8. This suggests that any escrow transaction that does not include even one of the enumerated activities is not "full escrow," particularly as the explanation at T101.D notes that these are the "minimum activities comprising "full escrow." See 2356.8. For example, although "preparing escrow instructions" is one of the enumerated activities, lenders often prepare escrow instructions and provide them to the escrow provider. As the definition is written, any transaction in which the lender did so would not constitute "full escrow" in contrast to the industry's understanding that "full escrow" could still occur.

   Taken together, the definitions of "full escrow" and "subescrow" (which is defined as "funds transfer for lenders in those situations where another entity, typically an independent escrow company, is performing other escrow activities") contained in the Proposed Regulations leave no room for the provision of escrow services that fall between the two definitions. This is especially problematic as the Proposed Regulations set maximum rates for full escrow and escrow, but do not allow for the setting of rates for other escrow functions. This issue flows throughout the Proposed

Regulations as, for example, Reports T101.U and T101.V require the reporting of charges for "full escrow" and "subescrow" but make no provision for the reporting of escrow services that fall between the two categories.
A more comprehensive list of examples of inconsistent use of defined terms in the Proposed Regulations is set forth in Tab 2 of the Appendix.

Response to Comment:

The Commissioner rejects this comment. The definition of "concurrent policy" is purposeful. The Commissioner has found that when two policies are issued together, the cost of issuing one is very low, such that the industry practice of charging for the second an amount close to the charge for the first is clearly excessive. Given the need to prohibit such excessive charges, it was necessary to identify the policy that is properly viewed as imposing the lesser cost. That need led to the terminology adopted in the proposed regulations. The phrase "around the same time" has a commonplace understanding and is used to prevent companies from defeating the purpose of the proposed regulation by claiming no concurrency if the policies are issued even seconds apart.

The Commissioner also rejects comment regarding "full escrow." To the extent the comment merely restates prior comments of the commenter, the Commissioner incorporates his responses to those comments here. The commenter materially misquotes section 2355.3. The full sentence reads: "*'Full escrow' means the complete set of escrow activities associated with a typical residential transaction, including, at a minimum: serving as the liaison to all parties in the transaction; preparing escrow instructions; requesting a preliminary title search or title commitment to determine the present condition of title to the property; complying with the lender's requirements as specified in the escrow agreement; receiving purchase funds from the buyer; preparing or securing the deed or other documents related to escrow; prorating taxes, interest, insurance and rents according to instructions; securing releases of all contingencies or other conditions required; recording deeds and any other documents as instructed; closing escrow when all instructions from buyer and seller have been carried out; disbursing authorized funds; and preparing final statement.*" By selective quotation, the commenter suggests that any transaction that includes a request for a preliminary title or commitment has been defined as a full escrow. As the foregoing full quotation makes clear, that is not the case – a "full escrow" must include "the complete set of escrow activities associated with a typical residential transaction."

Summary of Comment (pages 43-45):

The Proposed Statistical Plan, which is intended to collect the information needed to calculate the reasonable maximum rate from industry participants, fails to take industry practices into account in its requests for data and descriptions of those requests. As a result, many of the instructions for creating the reports are illogical or nonsensical in light of actual industry practice. Examples are set forth below.

1) Error Rate: The description of the acceptable error rate for the Proposed Statistical Plan is unclear and does not take into account the difficulty of maintaining accuracy in light of the enormity and detail of the data requested. The Proposed Regulations establish a data acceptance standard of 1%. However, the Proposed Regulations do not define what constitutes an error. It is not possible to determine from the Proposed Regulations whether fields are left blank because they are inapplicable or because there is no data available that would be considered incorrect for determining the error rate. In addition, it is unclear whether the 1% rate refers to 1% of all data fields in every transaction or errors found in 1% of all transactions reported. This ambiguity makes it difficult to determine what data control standards are needed in order to comply.

Response to Comment: The Commissioner rejects this comment. The 1% data error threshold and its application are clearly described in the proposed regulation. The proposed regulations state that the 1% error tolerance applies to the basic edit checks of invalid formats, invalid codes and illogical entries. The 1% tolerance is an error rate for the threshold review of the data to ensure the most obvious errors are addressed by reporting companies prior to submission of reports to the Commissioner. Similarly, the proposed regulations state clearly that the standard is 1% of the records, not fields. It is clear from the description in the proposed regulations that, if a blank entry is a permissible data entry for a particular field, then a blank entry will not be counted as a basic edit check error and, if a blank entry is not a permissible data entry, then a blank entry will be counted as a basic edit check error.

2) Discrepancies in reports from title insurers and UTCs: There are discrepancies in the reports to be submitted by the title insurers and UTCs that are illogical in light of the practices of both types of entities. For example, title insurers are required to submit a "Report of Title Policy Forms, Endorsements, Discounts, and Surcharges," but no corresponding report is required for UTCs or CECs, even though UTCs and CECs may independently offer escrow discounts. No reason is given for this discrepancy.

Response to Comment: The Commissioner rejects this comment. The absence of a Report of Title Policy Forms, Endorsements, Discounts, and Surcharges for underwritten title companies is not a discrepancy. All the information sought in this Report can be obtained from title insurers and there is no need to require underwritten title companies to provide the same information.

3) T103: Report T103.4 requests "fees only for transactions in which the reporting company was the initial recipient of funds from the ultimate consumer." It is not clear how escrow fees should be reported when the lender pays the fees, for example, in a "no closing cost" refinancing or when funds are not received from the ultimate consumer.

Response to Comment: The Commissioner rejects this comment. As the quoted language clearly states, the Report asks the reporting company to report escrow fees only for transactions in which the reporting company was the initial recipient of funds from the ultimate consumer. As clearly stated, the reporting is contingent on whether the reporting company is initial recipient of the funds, not on who pays the fees. It is similarly clear that if no funds are received from the ultimate consumer, then there should be no reporting.

4) T111: T111 (Report of Escrow Discounts and Surcharges) purportedly concerns escrow discounts and surcharges, however, the description of the report indicates that each row is "a different policy form endorsement," terminology that is applicable title insurance policies, not escrow transactions. In addition, the description of that report refers to "discounts and surcharges of the base escrow rate," while no definition of "base escrow rate" is provided. The text of this provision is, therefore, unintelligible.

Response to Comment: The Commissioner rejects this comment. The instructions clearly state, "report a unique code for each escrow discount and surcharge." The commenter's claim that the instructions are unintelligible is incorrect on its face. The term "base escrow rate" is well understood as that is the term used to describe escrow rates before application of discounts or surcharges. Given the context of the description – in a report on escrow discounts and surcharges – the commenter's claim that base escrow rate requires a specific definition is not credible.

5) T114: Reports T114.U through T114.X provide for the reporting of up to 4 surcharges or discounts, while T114.Y through T114.AC provide for the reporting of up to 5 endorsements. However, there is no instruction provided regarding how to report a policy or transaction that has more than 5 endorsements or 4 surcharges or discounts. Although a typical title insurance transaction would have 2 or 3 endorsements, it is not uncommon for a transaction to involve 5 endorsements or 4 surcharges.

Response: The Commissioner rejects this comment. The reporting instructions clearly state how to report multiple endorsements or surcharges. Since the report only provides for reporting of up to four surcharges or discounts and up to five endorsements, it is obvious that for a policy with six endorsements, only five will be reported

Summary of Comment (page 45):

The Proposed Regulations contain contradictory language regarding the scope and applicability of various portions of the Proposed Regulations. The Proposed Regulations contain three provisions relating to their "scope" which are unclear and contradict each other; accordingly, it is difficult or impossible to determine which provisions of the Proposed Regulations apply to which entities and transactions.

The Proposed Regulations create a new Article 7.1 of the California Code of Regulations. The first reference to the scope of the regulations is in Subarticle 1 which reads that "[t]his article [Article 7.1] applies to every title insurer, underwritten title company, and controlled escrow company doing business in this state." See Section 2355.2. However, Subarticle 3 appears to narrow this scope, stating "[t]he provisions of this article [Article 7.1] apply to every policy of title insurance issued for any residential property. See Section 2357.1.

Subarticle 4 also has a scope section which states "the provisions of this article apply to the provision of and charges for full escrow and subescrow services by a title insurer, an underwritten title company, or a controlled escrow company for residential property transactions." See Section 2358.1.

Other scope provisions under Subarticles 3 and 4 refer only to residential property transactions, while other sections of the Proposed Regulations contemplate applicability to commercial transactions. For example, title insurers are required to include commercial sales when submitting Detailed Claim Reports and Detailed Policy Reports. See Sections 2356.8(a) and 2356.8(n). Title insurers are also required to include commercial sales when filing Title and Escrow Transaction Reports. See Section 2356.8(a).

Response to Comment:

The Commissioner rejects this comment. Section 2355.2 identifies the companies subject to the article. Sections 2357.1 and 2358.1 are explicit that they identify which of the companies to which article 7.1 applies are subject to subarticles 3 and 4.

Summary of Comment (page 46):

The description of the interim rate roll back in the Statement of Reasons conflicts with the text of the Proposed Regulations. The Statement of Reasons states that the Proposed Regulations will provide for an interim rate reduction to 74% of what was charged for the same policy in 2000. However, the actual text of the Proposed Regulation provides for a roll back to "77% of the rate the company was charging for the same policy on November 1, 2000" for purchase transaction policies and "84% of the rate the company was charging for the same policy on November 1, 2000" for refinance policies. See Sections 2357.19(a), (b).

Response to Comment:

The Commissioner rejects this comment. The percentage reductions have been amended. The final statement of reasons is consistent with the final text.

Summary of Comment (page 46):

Over 150 of the references to data fields and sections in the Proposed Regulations do not exist or do not match the data cited. Accordingly, it is impossible to use the data collected under the Proposed Statistical Plan in the calculations of maximum rates.

For example, Section 2357.2 of the Proposed Regulations states that: "[n]o charge for a policy of title insurance may exceed the maximum title insurance charge for that policy, as specified in section 2357.6. Section 2357.6, however, is the formula for calculating the "maximum average title insurance charge," not the charge for the policy.

A chart showing additional incorrect references is attached at Tab 3 of the Appendix.

Response to Comment:

The Commissioner has responded to these comments separately.

Summary of Comment (pages 46-47):

The Proposed Regulations contain numerous cross-references which, while not incorrect, are so imprecise as to render them unusable. For example, even though Section 2357.3, entitled "Determination of Title Insurance Totals, and which is frequently referenced by other sections, includes nearly 40 subsections ((a) -)a1)) covering 17 pages of the Proposed Regulations, the subsection references are omitted, requiring a reader to review the entire section to search an electronic version in order to locate the relevant subsection. This makes it extremely difficult for a reader to locate the cross-referenced provisions of the Proposed Regulations, rendering them nearly unusable.

Response to Comment:

The Commissioner rejects this comment. The comment appears to concede that the proposed regulations are unambiguous in this regard, merely difficult to work with. That is not a valid ground for objecting to their adoption. In any event, the Commissioner has reviewed the text and amended it since this comment where appropriate.

Summary of Comment (page 47):

The Proposed Regulations conflict with existing provisions of State and Federal law; accordingly, they fail to meet the consistency standard. First, as discussed above, the Proposed Regulations conflict with the Insurance Code in many respects. Next, the Proposed Regulations conflict with the Real Estate Settlement Procedures Act (RESPA) which prohibits inducements for the referral of business settlement services, including title insurance. The Proposed Regulations provide a discount for a "transaction [that is] party of a firm commitment to provide at least 100 orders per year." See Section 2358.7(a). To the extent this constitutes a discount for steering business to the title insurer or UTC, use of such a discount would violate the anti-inducement provisions of RESPA.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has responded above to the comments above alleging inconsistencies with the Insurance Code, finding none of the comments to have merit. The alleged conflict with RESPA is based on provisions in current rates. The Commissioner has not found the cited discount to be a prohibited inducement. The Commissioner is confident the commenter would not argue that the Commissioner should prohibit this discount. If a court of competent jurisdiction finds the provision to be illegal, the regulation can be amended as necessary, but that condition does not exist today.

Summary of Comment (page 47):

The Proposed Regulations duplicate existing state statutes by requiring companies to submit data that is already required under statute. "Non-duplication" is defined as "not serv[ing] the same purpose as a state or federal statute or another regulation." Gov't Code Section 11349(f). If there is duplication, the Commissioner must identify and explain why such duplication is necessary. *Id.*

Response to Comment:

The Commissioner rejects this comment. The commenter has failed to specify the state or federal statute or regulation the commenter claims is duplicated. On the contrary, the commenter has gone to great lengths to emphasize that the proposed regulations impose vast new obligations not currently found in the law. While the Commissioner does not credit the exaggerated claims of burden, he agrees with the commenter that the proposed regulations call for the collection of data not currently required by any other regulation.

Summary of Comment (page 48):

The Proposed Regulations must cite as a reference the statute, court decision or other provision of law that is being implemented, interpreted or being made specific by the promulgation of the Proposed Regulations. See Gov't Code Section 11349(e). The Proposed Regulations cite specific statutes; however, none of the cited statutes are being implemented, interpreted or being made specific. For example, Insurance Code Section 12401.1 governs the filing of schedules of rates and requires every title insurer, UTC and CEC to file with the Commissioner its schedule of rates, all regularly issued forms of title policies which the rates apply, and every modification thereof which it proposes to use in the state. The Proposed Regulations, in establishing a Proposed Statistical Plan and formulaically establishing maximum rates, do not implement or interpret this provision.

Response to Comment:

The Commissioner rejects this comment. Insurance Code sections 12401.3 and 12401.5 authorize the entirety of the proposed regulations, and other cited sections provide additional support.

<u>Summary of Comment (pages 48-49)</u>:

The Proposed Regulations do not work. The Proposed Regulations rely on the cooperation of a "statistical agent" that does not exist. There is currently no advisory organization that fits the definition of a statistical agent contained in the Proposed Regulations. There is currently no organization that meets all the requirements (statistical agent must have at least five years of experience in data collection, data maintenance, data quality control, accounting, and related matters and shall have among its members title insurers and underwritten title companies). California Land Title Association and American Land Title Association have title insurers and UTCs as members, but do not qualify because they lack experience in data collection, data maintenance, data quality control, accounting, and related matters.

Moreover, the Proposed Regulations state that "[t]he statistical agent shall be funded by its members in accordance with the rules of that organization, and in an amount determined by that organization." See Section 2355.5(a)(1). Neither the Proposed Regulations nor the Insurance Code provides for the creation of such organization or provides any method of requiring insurers to join and fund such an organization. Absent a requirement, it is illogical to conclude that such an organization will form and title insurers and UTC will join.

Without a statistical agent, the CDI would need to use its own resources and personnel to collect and analyze the data submitted under the Proposed Statistical Plan. This would place an insurmountable resource burden on CDI. Once the Proposed Regulations become effective, 18 title insurers and 134 UTCs will file information requested at approximately the same time.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The Commissioner does not agree that neither ALTA nor CLTA has experience in data collection. Other organizations also have such experience. The payment of statistical agents by member companies is a commonly encountered mechanism to pay for the collection of insurance data. The Commissioner is confident that qualified industry organizations will have the means and incentive to participate in implementation of the proposed regulations. Were they not to, the Commissioner is confident the Department could meet the need. But the Commissioner emphasizes his confidence that it will not be required to do so.

<u>Summary of Comment (page 49)</u>:

The data used to calculate maximum rates is so unreliable, inaccurate and stale as to yield resulting maximum rates that are unrelated to present conditions. In addition, the formulae to which that data is applied contains significant mathematical errors that render their outputs meaningless, regardless of the quality of data inputs.

Response to Comment:

[This is the conclusion for the next few sections.]

Summary of Comment (page 49):

The Proposed Regulations use historical data collected from title insurers and UTCs as adjusted by an inflation/productivity factor intended to estimate future changes in expenses to calculate the maximum rate for title insurance and escrow charges. See Section 2357.3. The Proposed Regulations also use data from third parties to estimate projected transaction counts for use in the calculation of maximum rates. *Id.* The resulting data is unreliable because: 1) the data is stale and not representative of market conditions; 2) historical data is not an accurate prediction of future volumes; 3) the projection factors used do not reflect the California title insurance market; and 4) data provided by third parties is of questionable reliability and availability (each point of which is addressed below).

Response to Comment:

The Commissioner rejects this comment. Where the projections employ historical trends, they reflect the Commissioner's determination that those sources are the most reliable available. Elsewhere, the proposed regulations resort to forecasts from acknowledged authorities, such as the California Association of Realtors and the California Department of Finance. The propriety of reliance on such forecasts is substantiated by the widespread reliance on them by others in government and business. The Commissioner emphasizes that forecasts are employed because they are used by businesses themselves, would be relied upon by rational title companies in setting prospective rates, and accordingly cannot be avoided. Reliance on industry-standard sources is appropriate for the proposed regulations.

Summary of Comment (pages 49-50):

The Proposed Regulations rely on data collected and reported (whether as part of the Proposed Statistical Plan and from third parties or commercial sources) in prior years in order to calculate a current and future maximum rate. See Section 2357.3. Because there is a delay in reporting data, the numbers available for use in the maximum rate formula will generally be at least 6-18 months old. As a result, the maximum rates calculated under the Proposed Regulations cannot be viewed as accurately reflecting the true costs of doing a title or escrow business in California.

Response to Comment:

The Commissioner rejects this comment. Historical data is absolutely essential for the most reliable possible basis for rating, but that data is not inappropriately relied upon. Rather, such figures are appropriately projected forward from the historical period to the rating period.

<u>Summary of Comment (page 50)</u>:

The projection factors used to calculate expected transaction counts include existing and forecasted home sales and median values reported by the California Association of Realtors and the California Department of Finance, and historical and forecasted refinancings and median values reported by the Mortgage Bankers Association. There is no reason to assume these forecasts will be accurate. If any of these forecasts are inaccurate, that would affect the calculation of maximum rates, possibly resulting in a maximum rate that is too low (if forecasts are overly optimistic). Corrections to rates set as a result of incorrect forecasts would not occur until after the submission of next year's report under the Proposed Statistical Plan and subsequent calculation of new maximum rates. It is, therefore, inappropriate for the Commissioner to utilize this information in estimating expected transaction counts.

Moreover, it is unclear CDI is entitled to use these proprietary data sources. Even if these data sources may be used, there is no guaranty that these organizations will continue to publish them in the future. In most instances, the Proposed Regulations do not provide for an alternate source or calculation method in the event the named source is unavailable.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The commenter itself asserts that one cannot rely exclusively on historical data, and the proposed regulations do not do so. There is inevitably forecasting error, which is a problem that besets every business that must set prospective prices. Rational businesses do not pretend that published forecasts are guaranteed to be accurate, but they are relied upon for business decisions nonetheless. The commenter has not suggested more reliable sources of such forecasts and has affirmatively rejected sole reliance on historical data. It is apparent the commenter has nothing constructive to recommend on this point.

<u>Summary of Comment (page 50)</u>:

The Commissioner has failed to demonstrate that the use of recent historical statistics projected into the future generates a reasonable projection of future results. Past performance is no guaranty of future results.

<u>Response to Comment</u>:

The Commissioner rejects this comment for the reasons stated above.

<u>Summary of Comment (pages 50-51)</u>:

The two projection factors, "expense inflation factor" and "productivity growth factor" are based on national data and neither is adjusted to reflect California-specific differences. These factors are, therefore, inaccurate and unreliable in calculating expected costs for the California title insurance market. It is unreasonable to assume that the effects of inflation and improved productivity on the industry in California will mirror those of the national economy as a whole.

<u>Response to Comment</u>:

The Commissioner rejects this comment. Where the Commissioner has selected national rather than local data, it is because local data are less stable or otherwise less appropriate, as reflected in the Staff Report on Interim Rates.

<u>Summary of Comment (page 51)</u>:

The Proposed Regulations set forth highly complex formulae pursuant to which a determination of maximum rates is made. See Sections 2357.1-2357.19. However, the maximum rates generated through these calculations are an unreliable measure of the excessiveness of a given rate because, in addition to their problematic use of historical data (discussed above): 1) certain of the data and calculations are so ambiguously defined as to leave the intended user unable to determine the proper way to collect data or perform the calculation; 2) the formulae require the aggregation of information that cannot be aggregated; and 3) the use of the CDI's "relativities" within the formulae are nonsensical and result in mathematical errors that render the outputs meaningless. (These arguments are addressed below.)

<u>Response to Comment</u>:

The Commissioner rejects this comment for the reasons stated below.

<u>Summary of Comment (pages 51-52)</u>:

The Proposed Regulations define terms and describe reports or calculations so ambiguously that is not possible for a title insurer to complete the report or calculation.

For example, two key factors necessary to compute the maximum policy charges rely on historical transaction counts, "multiplied by the transactions growth rate." See Section 2357.4(a), (b). However, the term "transactions growth rate" is not defined. Another key factor in the maximum policy charge formula is the "market value growth rate." See Section 2357.(e) – (i). This term is also undefined. Without these definitions, it is impossible to determine what figures to input and the formula becomes unworkable.

These definitional issues make it likely different title insurers will interpret the required reports differently, rendering the data collected incompatible for comparison or making industry-wide calculations such as those contemplated by the Proposed Regulations.

<u>Response to Comment</u>:

The Commissioner rejects this comment. The November 27 amendment corrected the typographical error to use the correct defined term, "transactions growth factor."

Summary of Comment (page 52):

The Proposed Regulations require title insurers and UTCs to report data that has been aggregated in such a way as to render the data useless.

For example, Report T101.S requires that when multiple owner's policies are issued in a single transaction, the premium for all such policies will be reported as an aggregate. See Section 2356.8(a)(2). However, these policies will often have different liability amounts, and correspond to different premium amounts. Similarly, one policyholder may qualify for discounts that the other does not. Particularly in situations such as a tenancy in common purchase, there is no reason to treat all buyers who are issued a title insurance policy as one economic unit for the purposes of measuring the cost of title insurance. Aggregating these unrelated premiums will render the report meaningless as a measure of the cost of title insurance to a purchaser.

Similarly, Report T101.T requires aggregation of premiums for all lender's policies issued in a single transaction. See Section 2356.8(a)(2). If the policies have different liability amounts, the charges would be different because of available discounts. In addition, the transaction may involve both a home equity loan and a traditional mortgage, and the policies issued may vary greatly both in coverage and price. Aggregating the premium for all lender's policies in a transaction would, therefore, render the data meaningless.

Response to Comment:

The Commissioner rejects this comment. The data reporting requirements have been structured so that the data reported are relevant, useful and necessary for the purposes of the proposed regulations. Specifically with respect to Report TI01, the purpose of Tables TI01 and UTC01 is not to measure the cost of title insurance to an individual purchaser, but to gather information about transactions that can be aggregated in different ways for different analyses and then be used to calculate various totals employed in the proposed regulations and to provide detail for data quality review. Even if one purpose were to measure the cost of insurance to a purchaser, the Reports would do that for the overwhelming majority of purchasers, who are not reflected in the exotic example cited by commenter. In addition, some of the questions raised by the commenter could be answered by review of data submitted in Report TI12.

Summary of Comment (page 52):

The formulae established for calculating maximum rates for the title insurance and escrow fees use "relativities" (the ratio of actual title insurance premium or escrow fees to a base level of title insurance premiums or escrow fees) established by CDI. However, the calculations of transaction or policy specific charges use relativities in such a way as to render them meaningless. For example, after the maximum average title insurance charge for a given amount of insurance is calculated, it is multiplied by the relativity applicable to the particular policy and divided by the "average title class relativity" for the industry as a whole. Ostensibly, this results in a maximum title premium applicable to a particular policy type after correction for overall industry practice. However, the calculation of the "average title class relativity" is so flawed that the resulting factor is meaningless. As a result, applying it to the average title insurance charge renders the resulting "maximum title insurance charge for a policy" meaningless.

With respect to the equations setting maximum escrow rates, the use of relativities is similarly flawed. There, the relativity particular to the transaction is applied twice in calculating the "maximum escrow charge for a transaction." (Both the calculation of "maximum charge for an escrow transaction" in Section 2358.4 and the calculation of the maximum average full escrow charge in Section 2358.5 – which is used in the calculation of the maximum charge for an escrow transaction – have the transaction escrow relativity as a multiplier.) The maximum escrow charge, therefore, includes the square of the transaction relativity, a meaningless number, as a factor, rendering the resulting maximum charge meaningless.

Response to Comment:

The Commissioner rejects this comment. The commenter does not specify any basis for the claim that the calculation of the average title class relativity is flawed.

Summary of Comment (page 53):

In Section 2357.3(a), the Proposed Regulations purport to calculate the average title policy class relativity. However, in making this calculation, each company's total base premium is squared, divided by the company's total premium, and multiplied by the relativity (specified in the Proposed Regulations) applicable to the policy used to determine that company's base premium for all companies. In essence, this calculation results in an "average title policy class relativity" that is the ratio of an adjusted basic premium amount to total basic premium. This is inconsistent with the use of the term "relativity" elsewhere in the Proposed Regulations where the numerator of a relativity if the total (actual) premium charge. Moreover, the calculations which are apparently meant to normalize each company's reported basic premium so that the industry total basic premium is a meaningful number do not do so. The calculation is so convoluted that the resulting "premium" number is devoid of meaning. It would be more appropriate to calculate an industry average relativity as the ratio of total premiums for all companies divided by the sum of each company's base premium divided by the relativity of that company's base policy.

Response to Comment:

The Commissioner rejects this comment. The claim that the calculation is so convoluted as to be devoid of meaning is clearly incorrect. The other instances of the term "relativity" in the proposed regulations are for factors that serve a different purpose than the average title policy class relativity. The use of the term is not inconsistent as the entire term "average title policy class relativity" has a specific meaning and is used only in the maximum rate formula calculation. The commenter is correct that purpose of the average title policy class relativity is to normalize each company's reported basic premium so compilation of industrywide basic premium is an aggregation of comparable items, but is incorrect that the calculation does not accomplish this. The calculation does accomplish that purpose and the commenter has not indicated otherwise.

Summary of Comment (pages 53-54):

The Proposed Regulations set interim maximum title insurance rates in a manner that is confusing and illogical. For example, the interim rate reductions consist of different percentages for different transactions, e.g., a rollback to 77% of the year 2000 rates charged for sale transactions, 84% of the year 2000 rates for refinance transaction, and 73% of rates charged for escrow transactions in 2000. No justification is provided for these differing rollback percentages or for the use of 2000 as a base year, particularly as many rates have decreased since 2000.

It is also unclear from the rollback provision how it is to be applied when new discounts are applicable that were not in effect in 2000. Application of the rollbacks to refinancings is similarly unclear. Thus, although Section 2357.19(a) provides for interim reductions of the charge for policies and endorsements involving non-refinancing transactions and Section 2357.19(b) provides for interim reductions on policies and endorsements involving refinancing transactions, no mention is made concerning rate reductions for transactions for refinancings not specified in subsection (a) or (b), e.g., home equity policies, trustee's sale or other guarantees and other products not mentioned therefore appear to be unaffected by the interim rate reductions.

Response to Comment:

The Commissioner rejects this comment. The revised percentages are fully explained in the Staff Report on Interim Rates.

Summary of Comment (page 54):

The Commissioner has made a finding in the Notice that there is a lack of reasonable competition in the title insurance market and that a "comprehensive, uniform system for preventing excessive rates is necessary to ensure appropriate rates in this non-competitive environment." However, the Statement of Reasons includes statements that imply or accept as a given that current rates are excessive. The Notice and Statement of Reasons are also silent regarding grounds for concluding that current rates are so excessive that immediate reductions are necessary.

Response to Comment:

The Commissioner rejects this comment. The absence of a reasonable degree of competition gives rise to the reasonable inference that prices are excessive. The structure of Insurance Code section 12401.3 supports this inference, in the authorization of rejection of excessive rates conditioned on the absence of a reasonable degree of competition. This inference is substantiated by the Staff Report on Interim Rates, which has shown how in the absence of price competition rates have risen much faster than costs.

Summary of Comment (page 54):

There appears to be a gap between the effective dates of the interim rates and the prescribed rate filings. The interim rates expire upon publication by the CDI of the factors that would establish new maximum rates. See Section 2357.19(d). However, Section 2359.1 provides that a regulated entity has up to 60 days to make a rate filing in conformity with the annual publication by the Commissioner. Section 2359.1(d). No guidance is provided as to what happens upon the "expiration" of the interim rates and the effective date of a new rate filing subsequent to annual publication. Such interim period could be as much as 90 days (60-day filing period and 30-day effectiveness period.)

Response to Comment:

The Commissioner rejects this comment. The proposed regulation has been amended to alter the timing of implementation of interim rates, which may never be placed in effect.

Summary of Comment (page 54):

There is also a possibility that maximum rates derived from the data published by the CDI would be effective immediately. In that case, regardless of the 60-day grace period for new filings, an insurer would be required to immediately begin charging no more than the maximum amount or provide refunds of amounts charged in excess of the new maximum rate.

Response to Comment:

The Commissioner rejects this comment. If an existing rate is excessive, the company is under an obligation to file a revised rate. If it does not do so, the Commissioner is to issue a notice of noncompliance, giving the company an opportunity to conform its rates to the proposed regulations.

Summary of Comment (page 55):

The Proposed Regulations conflict with Insurance Code Section 12401.3 by replacing a company-specific risk-based analysis of rates, with an industry-wide maximum rate determined by a mathematical formula.

Insurance Code Section 12401 establishes that title insurance rates "shall not be excessive, inadequate or unfairly discriminatory." The three rate standards in this section are each actuarial terms of art with historical meanings in insurance literature that precede use in California's rate laws. See Miller report p. 2. Each of these three standards is cost-based. "This means that title insurance rates satisfy each of the standards if the rates reflect all of the expected costs associated with the risk transfer. Expected costs include the expected losses, expected claims settlement expenses, expected operational and administrative expenses, and expected cost of capital." *Id.*

Insurance Code Section 12401.3 establishes that no title insurance rate is excessive unless the rate is "unreasonably high" and a reasonable degree of competition does not exist in the marketplace. A determination that a rate is "unreasonably high" requires a finding that the rates for a specific title insurer are unreasonably high in relation to the expected costs. See Miller Report (no page reference provided.) This test is an actuarial determination as to whether or not an insurer's rates reasonably reflect its expected losses, expenses and cost of capital. Insurance Code Section 12401.3(b).

The Proposed Regulations change this statutory rule by reaching the conclusion that a reasonable degree of competition does not exist in the title insurance marketplace and "correcting" this situation by establishing a maximum rate that applies uniformly to all title insurers. Any rate higher than the industrywide maximum rate is deemed excessive. No consideration is given to each insurer's expected losses, expenses, and capital costs as provided for under current law.

Miller's report shows how the Proposed Regulations conflict with the Insurance Code by demonstrating an insurer's rate that is reasonable under the statute can be unreasonable under the Proposed Regulations, and vice versa.

Response to Comment:

The Commissioner rejects this comment. The absence of reference to inadequate or unfairly discriminatory rates is appropriate because those issues lie outside the scope of the proposed regulations. The regulations are not intended to define the lower bound of an adequate rate or the conditions of unfair discrimination. The Commissioner has determined that there is a lesser need for such a regulation at this time, such that any allegation of inadequacy or unfair discrimination can be assessed on an ad hoc basis in an adjudicatory hearing. The Commissioner has responded to the remainder of the Miller comments separately in this file.

Summary of Comment (page 56):

The operation of the Proposed Regulations would have the effect of discouraging, rather than encouraging, competition, thereby exacerbating the problem which the Commissioner asserts renders regulatory action necessary.

The Insurance Code states that the intent of title insurance regulation is to "permit and encourage competition" between title insurers on a "sound financial basis." The Proposed Regulations are likely to destroy price competition in California and set in action a chain of events that will destroy the financial strength and security of the California title insurance market. See Miller Report, no page reference given.

The chain of events will be a downward spiral in rates until there is only one title insurer or a small group of title insurers with the same cost situation. This downward spiral will be the inevitable result of establishing a maximum rate equal to an industry-wide-average rate.

There must necessarily be insurers with above-average costs. If insurers with above-average costs streamline their operations to reduce costs, the resulting reduction in costs will reduce the industry average cost, further driving down the "maximum rate." The maximum rate is a moving target. Those insurers who cannot keep pace with these reductions will drop out of the market until there is only one insurer or a small group of title insurers with the same cost situation left. Accordingly, the Proposed Regulations will reduce competition in the California market.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has found there does not exist a reasonable degree of competition, so the possibility of the proposed regulations injuring competition is highly remote. The commenter has proffered no evidence of the so-called downward spiral. The purpose of the proposed regulations is to require rates to conform to those that would obtain in a competitive market. Such markets do eliminate inefficient rivals, but they do not lead to just one company. The Commissioner has responded to the balance of the Miller comments separately in this file.

Summary of Comment (pages 56-57):

All companies are likely to charge the "maximum rate." Insurance rate-making is a "zero-sum" game in the sense that whenever an insurer lowers its rates for one class of business, it must increase its rates for other classes of business in order to maintain overall rate adequacy, to cover expected losses, expenses and capital costs. The Proposed Regulations allow title insurers to charge less than the maximum rates for all classes of business, but prevent them from charging higher rates for other classes of business. If title insurers are compelled to reduce rates for some classes of business, they will not be able to maintain overall rate adequacy. The most likely result of these restrictions is that insurer will all charge the maximum allowable rates for all classes of insureds.

Response to Comment:

The Commissioner rejects this comment. The maximum rate for each policy is separately stated and in each case allows the company to cover its reasonable costs and earn a fair return. If the commenter truly believes that all companies will charge the maximum rate, the commenter is agreeing with the commissioner's finding of the absence of price-competition, because in a competitive market some firms would strive for greater market share (and the ability to spread fixed costs over a larger base) by cutting prices.

Summary of Comment (page 57):

The relativities do not include all discounts and surcharges currently employed by the industry. Because the Proposed Regulations impose additional requirements on filings for products that are not encompassed in the Proposed Regulations, they serve as a disincentive to offering such products, discounts and services.

Response to Comment:

The Commissioner rejects this comment. The proposed regulations provide explicit means to offer new products and services. The proposed regulations recognize hundreds of relativities, so it is unlikely any important relativity is missing (a suspicion confirmed by the fact that the commenter has not identified any). Nothing in the proposed regulations prohibits a company from filing a different relativity, so long as all premiums under the proposed rate do not exceed the regulatory maxima.

Summary of Comment (page 57):

The Proposed Regulations define "full escrow" which is subject to a maximum rate, by enumerating the activities that comprise a "full escrow." By defining "full escrow" as a minimum list of activities, the Proposed Regulations set the parameters of the escrow product. Title insurers would have little incentive to innovate or include other functions within the services of "full escrow" since additional services would have to be provided without additional charges and the cost of providing those services could not be incorporated into the calculation of the maximum escrow charge. For a title insurer to file a rate to add or charge for additional services, the entity would need to go through the arduous task of obtaining regulatory approval under new, more intensive rate filing procedures established under the Proposed Regulations.

Response to Comment:

The Commissioner rejects this comment. The major premise of this comment appears to be that a company may levy an additional charge for a service offered in conjunction with a full escrow so long as the category of charge is not listed in the regulation. That is an erroneous assumption. The definition is clear that the enumerated functions do not represent an exhaustive list. (See § 2355.3(l), defining "full escrow" as "the complete set of escrow activities associated with a typical residential transaction, including, at a minimum" the enumerated functions.)

Summary of Comment (pages 57-58):

By making the finding that there is a lack of reasonable competition within the Proposed Regulations without providing a mechanism for periodically evaluating the continued validity of that finding, the Proposed Regulations establish a system of rate regulation in perpetuity on the basis o a finding that is particular to current market conditions. This illustrates the inappropriateness of using the rule-making process, rather than the hearing process embodied in Article 6.7 of the Insurance Code (discussed above) to determine that title insurance rates are excessive. Because the Commissioner may only find a rate excessive if "a reasonable degree of competition does not exist in the particular phase of the business of title insurance to which the rate is applicable," and the state of competition can change over time, it is inappropriate to embody this finding and a detailed system of rate restrictions in regulations that would remain in effect until struck down by the judiciary or revised through the rule-making process.

Response to Comment:

The Commissioner rejects this comment. If conditions change, the finding can be reviewed on the Commissioner's own motion or in response to a rulemaking petition from any member of the public. Given the fact that studies over several decades have reported an absence of competition in the relevant markets, the likelihood that this finding will require revision in the near future is sufficiently remote to create no need for any other process.

Summary of Comment (Bates pages 676-703):

Bates pages 676-703 are the comments of David Appel, submitted on behalf of Fidelity National Title Group.

Commentor: David Appel, 1-2

Summary: The commentor summarizes his background and qualifications.

Response: Because this is not a comment specifically directed at the proposed regulation text, no response is required.

Commentor: David Appel, 3

Summary: To the extent that the regulations deem any rate that exceeds the average to be excessive, and they contain no variances or provisions to allow insurers individualized relief, they are confiscatory.

Response: See responses to common comments A.9 and A.10.

Commentor: David Appel, 3-4

Summary: A return of the average of government bonds plus a 3 ¾% risk premium is confiscatory, on its face. The risk premium should be 6.0% to 6.5%.

Response: The regulations have been revised. The risk premium is now 6%.

Commentor: David Appel, 4

Summary: Averaging the CAPM and discounted cash flow model gives a return of 13 5/8%. The Department allows a 10.7%

Response: The commentor's discounted cash flow model relies on growth estimates of dividends and earnings based on five- and 10-year historical growth rates and on forecasts, and on five-year historical retained earnings. The title insurance industry has experienced a windfall of profitability since 2000, which the interim rate reduction was designed to address. This windfall has resulted in inflated five- and 10-year growths rates and, as a result, these should in no way form the basis for future returns in a rate-regulated environment. We note that the commentor has said that the title insurance and property-casualty insurance industries have very similar risk levels and that the other rate of return calculation methods produce very similar rates of return between them, but that the calculations based on historical growth rates shows substantially higher numbers for title. The calculations based on forecasts are considerably lower and are very comparable to the returns that would be allowed under the revised proposed regulations, but the forecasts themselves are suspect as the reputations of the Wall Street analysts making the forecasts are not firmly established. The calculations based on retained earnings are also questionable. The windfall profits since 2000 have given the title insurers to pursue acquisitions and to expand into unregulated areas. The ability to grow in such ways should also not form a basis for rates within the regulated area.

Commentor: David Appel, 4

Summary: The Department allows a 10.7% return for property casualty insurance, which is of similar risk.

Response: With the revision, the proposed regulation would current allow about an 11% return for title insurance.

Commentor: David Appel, 4

Summary: The proposed regulations for property casualty insurance allow an 11% return.

Response: The proposed title regulation has been revised to be consistent with the allowed return in the proposed property casualty regulation.

Commentor: David Appel, 5

Summary: Investment grade corporate bonds offer 7%; the prime rate is 8.25%. The California Public Utilities Commission has recently allowed 10% for water utilities and 11% for electric utilities.

Response: The proposed regulation has been revised to allow an approximately 11% return.

Commentor: David Appel, 5-6

Summary: Using the three year-average investment yield and the five-year average capital gain is not reasonable. The current investment yield should be used, not the historical average. For capital gains, more than five years should be used.

Response: The Commissioner rejects this comment. The three-year average yield for the industry is a reasonable proxy for a prospective investment yield. Use of the industry average is appropriate for the maximum title insurance rate, which applies to all companies. A five year average for capital gains is a reasonable basis to estimate future capital gains, balancing the need to use a long-term average for stability with the need to use more recent numbers to respond to changing market conditions.

Commentor: David Appel, 6

Summary: The prospective state and federal income tax should be used, not the four-year historical average.

Response: The three-year average for the industry is a reasonable proxy for a prospective tax rate. Use of the industry average is appropriate for the maximum title insurance rate, which applies to all companies.

Commentor: David Appel, 6-7

Summary: Applying a uniform number for the interim rate reduction is potentially confiscatory. Different companies have different costs. There should be variances or individualized relief.

Response: The interim rate reduction is only a fallback if the stat plan is not in place by the specified date. If by 2009 sufficient data are not available to base rates on costs derived from the statistical plan, it is reasonable to implement the interim maximum rates to protect consumers from excessive rates while the statistical plan data are obtained. The rates in 2000 are those which the companies themselves chose to use, not only in 2000 but for many years prior. In recent years these rates have allowed the insurers to reap a windfall of title insurance premium from rapidly increasing real estate prices. The rate reduction allows for increased claims and expenses in the year of the reduction, so average profit levels from years before the windfall will not be substantially affected. See also responses to common comments A.9 and A.10.

Commentor: David Appel,

Summary: The commentor summarizes his previous remarks.

Response: No additional response is required, as the comments are already responsed to, above.

Commentor: David Appel

Summary: The commentor provides a series of mathematical calculations to support his rate of return position.

Response: Responses on the reliability of the discounted cash flow analysis are made above. The commentor's version of the capital asset pricing model for the property-casualty industry is based on an unrepresentative sample of the property-casualty business as a whole. In addition, the choice of the 1926-2005 historical market risk premium as a forecast for the prospective market risk premium is questionable. Other methods produce a range of market risk premia, most generally lower. One such method is contained in the notice for the November revision. The Swiss Re Sigma Report asserts that the prospective market risk premium is 4%.

Summary of Comment (Bates pages 704-714):

Bates pages 704-714 are the comments of Norris Clark, submitted on behalf of Fidelity National Title Group.

Norris Clark 45 Comments and Responses

Summary of Comment, Pages 1 - 2: The commenter describes his qualifications and work experience.

Response: Because this is not a comment specifically directed at the proposed regulation text, no response is required.

Summary of Comment, Pages : The proposed rate regulations are unprecedented in length and complexity. The Department's current regulations for prior approval of most property and casualty insurance rates are only a fraction of the length of the proposed regulations and, in the commenter's opinion, are more clear and understandable.

Response: The Commissioner rejects this comment. As the commenter notes, a significant portion of the proposed regulation is the statistical plan and financial reporting requirements. In the case of the cited property and casualty prior approval regulations, a statistical plan exists outside of the regulations. Consequently, a proper comparison would be the maximum rate formula sections of the proposed title and escrow regulations with the cited prior approval regulation and the regulations are comparable in terms of length and complexity. In addition, the length and detail of the proposed regulations, including detailed definitions, detailed explanations of how data from the statistical plans and financial reports will be utilized and detailed explanations of how the maximum charge formula will operate are all directed at providing clarity for compliance with the regulation and for transparency of the implementation of the regulation. In addition, the greater detail of expense reporting in the proposed statistical plan and financial reporting reflects the fact that the vast majority of the title premium and escrow fee goes towards expenses instead of towards claims costs. In contrast, in property casualty statistical plans, there is great detail on claim costs.

Summary of Comment, Page 3: The guidance in Section 2356.8(a) is unclear: if a transaction may consist of any combination of activities, it is also possible that a combination of activities may not represent one transaction.

Response: The Commissioner rejects this comment. The instructions are clear that one record represents one transaction and that one transaction is the set of activities association with a single property transaction.

Summary of Comment, Page 3: The guidance in Section 2356.8(a) is unclear: if title company A does a work/charge premium split with title insurer B, which title insurer reports the activity in its TI01?

Response: The Commissions rejects this comment. Section 2356.8(a)(2) states clearly that a transaction involving a work charge/premium split should be reported by both organizations involved in the transaction.

Summary of Comment, Page 3: The guidance in Section 2356.8(a) is unclear: does the foregoing sentence mean a work charge/premium split within an affiliated underwritten title company's would be included in the title insurance company's TI01?

Response: The Commissions accepts this comment and has added a clarifying sentence at the end of Section 2356.8(a)(2) and removed the prior references in the paragraph to non-affiliated underwritten title companies.

Summary of Comment, Page 3-4: The overall guidance in Section 2356.8(a)(2) is, at best, ambiguous.

Response: The Commissions rejects this comment. However, to the extent any ambiguity existed, the changes described in the previous comment address any ambiguity.

Summary of Comment, Page 4: Another example of unclear instructions is found in the guidance for Report TI08, Columns TI08.C and TI08.E. There is no guidance when it is acceptable to include the experience of a controlled escrow company within a title insurance company's report.

Response: The Commissioner rejects this comment. The data field description states clearly that a A separate report is required for each controlled escrow company which is controlled by the title insurance company and whose experience is not otherwise included in the TI08 report of the title insurance company.

Summary of Comment, Page 4: Another example of unclear instructions is found in the guidance for Report TI08, Columns TI08.C and TI08.E. To what does a controlled escrow company refer?

Response: The Commissioner rejects this comment. A controlled escrow company is a well-defined term in the California title insurance statutes.

Summary of Comment, Page 4: Another example of unclear instructions is found in the guidance for Report TI08, Columns TI08.C and TI08.E. How can an "Other Service" be coded 1, 2, or 3 when "Other Services" are defined in the Proposed Rate Regulations in Section 2355.3 (q) to mean "a service or product related to the business of title insurance other than a preliminary report, a title insurance policy, full escrow, or sub-escrow."

Response: The Commissioner rejects this comment. Other services are part of the business of title insurance. Other services are specifically defined as something other than four specific products in the business of title insurance: preliminary report, a title insurance policy, full escrow, or sub-escrow. However, the other services are related to these four specific-products and the instructions are clear about reporting which of these principal products the other service is related to.

Summary of Comment, Pages 4-5. Transactions involving escrows are to be included in Reprot TI01. However, the definition of "full escrow" found in Section 2355.5(1) reads, in part, "means the complete set of escrow activities associated with a typical residential transaction..." How will a title insurance company complete its response in its TI01 Report for commercial transactions that involve escrow?

Response: The Commissioner rejects this comment. The eight codes provide an option for commercial transactions as well as an option for Other if the transaction does not fit into one of the first seven category codes.

Summary of Comment, Page 5: The foregoing represent a small fraction of the many, many examples that could be cited. The length of the regulations is compounded by ambiguity and lack of clarity throughout. Most companies will have a difficult, in not impossible, task of meeting the data quality acceptance standards of a 1% error rate.

Response: The Commissioner rejects this comment. The commenter has not cited many examples of ambiguous or unclear instructions or provisions. Of the alleged ambiguities cited, the Commissioner disagrees with all but one and the change made in response to that single item is very minor. The Commissioner believes the reporting requirements are sufficiently clear that companies will be able to achieve the data quality acceptance standards.

Summary of Comment, Page 5 - 6: The determination of title insurance totals, Section 2357.3, are extremely difficult to understand. I am confounded by the provisions in Section 2357.3 (y). How can any reader verify that the above calculation really equals total search, examination and underwriting cost? I do not believe the proposed regulations meet the standard of "clarity" defined as "written or displayed so that the meaning of the regulations will be easily understood by those persons directly affected by them."

Response: The Commissioner rejects this comment. Section 2357.3 (y) is the definition of total search, examination and underwriting cost. It is defined as the amount of total search, examination and underwriting cost to be used in the maximum title charge formula. The definition enables the reader to both understand how the amount is calculated and to verify the calculation made by the statistical agent. The commenter has offered a conclusory statement that the provision is unclear, but not explained why or how the provision is unclear. In fact, the provision is explicit and unambiguous and meets the standard of "clarity" as set out by the commenter.

Summary of Comment, Pages 6 -7: Statutory Accounting Princples (SAP) are the basis for financial reporting, solvency regulation and clearly authorized rate regulation in California. The proposed regulations require reporting of data on a Generally Accepted Accounting Principles (GAAP) basis. This deviation from SAP creates an undue burden on title insurance companies and is not warranted.

Response: The Commissioner rejects this comment. The principal solvency reports for underwritten title companies are the annual audit reports and quarterly reports submitted to the Financial Analysis Divisoin of the Department of Insurance. These reports are prepared according to GAAP and not SAP standards. The commenter is therefore incorrect in terms of what underwritten title companies currently report. Clearly, there is no additional burden on underwritten title companies for GAAP reporting, since they are already reporting under that basis. In addition, all the major title insurers are publicly traded companies or members of a corporation that publicly traded and, as such, must prepare financial statements on a GAAP basis in addition to the statutory annual statement prepared on a SAP basis for insurance regulators. It is not an undue burden for these companies to report GAAP information to insurance regulators.

Summary of Comment, Page 7: Consolidated GAAP basis financial reporting is rejected for virtually every other financial regulatory purpose not only in California, but in every other insurance department in the United States. Therefore, requiring GAAP financial reports places an increased and unwarranted burden on title insurers.

Response: The Commissioner rejects this comment. Title insurers, by virtue of being publicly-traded companies prepare GAAP financial statements for financial regulatory purposes, including review by federal regulators, investment analysts and investors. Other states do require GAAP financial reporting of title insurers pursuant to statistical plans similar to the proposed California statistical plan and financial report. In fact, the balance sheet and income statement reports in the proposed regulations are largely derived by the Uniform Financial Reporting Plan published by the American Land Title Association which requires reporting on a GAAP basis and is used by other state insurance departments for reporting of experience by title insurers.

Summary of Comment, Page 7-8: Reconciliation with SAP documents reports will be not be easily or readily accomplished because the expense categories of Report TI03 do not coincide with the expense classifications of SAP and the Expense Page of the Statutory Annual Statement and the data report is consolidated while SAP data is reported and audited on an entity basis.

Response: The Commissioner rejects this comment. The reconciliation procedures are clearly set out the reporting instructions and follow the procedures used in the Uniform Financial Reporting Plan published by the American Land Title Association which requires reporting on a GAAP basis and is used by other state insurance departments for reporting of experience by title insurers.

Summary of Comment, Page 8: Furthermore, the expenses required to be reported in TI03 do not capture all the expenses which are typically incurred by a title insurance company. For example, Report TI03 does not explicitly capture real estate expenses for owned real estate and certain title plant expenses.

Response: The Commissioner rejects this comment. Report TI03 does provide for the reporting real estate expenses for owned real estate and for title plan expenses. In addition, Report TI03 also has a provision for write-ins for expenses that the reporting company feels do not fit into any specific line item. Consequently, all expenses will be captured in either an existing line item or a write-in.

Summary of Comment, Page 8. The proposed regulations do not comply with the intent of the statute. Section 12401.3(a) provides that rates shall not be excessive or inadequate, as defined herein, nor shall they be unfairly discriminatory. The Department has ignored the determination of inadequate and discriminatory rates.

Response: The Commissioner rejects this comment. The Commissioner recognizes the requirement that rates not be inadequate. The regulations are not intended to define the lower bound of an adequate rate. The Commissioner has determined that there is a lesser need for such a regulation at this time, such that any allegation of inadequacy can be assessed on an ad hoc basis in an adjudicatory hearing.

Summary of Comment, Page 9. I see at least to significant flaws in the approach taken. First, it assumes that all title insurers and underwritten title companies have expense structures substantially similar to the composite title insurance industry, and that a title insurance charge that may be excessive for one insurer could not be inadequate for another. Second, it provides no criteria under which an insurer can seek art exemption if it is forced to charge a premium or rate that is inadequate. By establishing a "maximum title insurance charge" for all title insurers, the Proposed Rate Regulations do not allow title insurance companies and underwritten title companies to establish rates based upon their own operational experience and expense structures, including policy losses.

Response: The Commissioner rejects this comment. The commenter erroneously assumes a company is entitled to recover its own costs in rates regardless of how unreasonable those costs may be. That is contrary to sound regulatory practice and contrary to law. Insurance Code section 12401.3 defines an "excessive" rate as one that is "unreasonably high for the insurance or other services provided" – not that is unreasonably high for the costs the seller claims to have incurred. In a competitive market a business that cannot meet competitors' prices because it has higher costs is forced to lower its costs or leave the market.

Summary of Comment, Page 9: The "maximum title insurance charge" concept ignores a significant amount of the remainder of the provisions within Section 12401.3. For example, a rate is defined as inadequate in the statute if its "continued use...endangers the solvency of the person or entity using it." Cal. Ins. Code § 12401.3(a). By not regulating inadequate rates on an entity case-by-case basis, the Proposed Rate Regulations provide that an insurer could be barred by regulation from charging an adequate rate, based upon its own particular circumstances. Given the Department's recent experience with insolvencies stemming from inadequate pricing, it certainly does not seem to be a prudent regulatory position to provide the possibility of mandating that certain title insurance companies charge inadequate rates because their reasonably justified projected losses and expenses exceed those used by the Department in establishing a "maximum title insurance charge."

Response: The Commissioner rejects this comment. The Commissioner recognizes the requirement that rates not be inadequate. The regulations are not intended to define the lower bound of an adequate rate. The Commissioner has determined that there is a lesser need for such a regulation at this time, such that any allegation of inadequacy can be assessed on an ad hoc basis in an adjudicatory hearing.

Summary of Comment, Page 10. As with the requirements to use GAAP instead of SAP, the provisions of Section 2357.2 appear to be in conflict with the "consistency" standard of the APA.

Response: The Commissioner rejects this comment. The Commissioner has considered the two accounting systems and has provided for reporting on bases that permit consistent analysis across companies and conforms to industry and regulatory requirements.

Summary of Comment, Page 10. The commenter offers a summary of previous comments.

Response: Because those comments have previously been responded to, no further response is required.

<u>Summary of Comment (Bates pages 715- 722)</u>:

<u>Bates pages 715-722 are the comments of John Crowley, submitted on behalf of Fidelity National Title Group.</u>

Summary of Comment, Pages 1: The commenter describes his qualifications and work experience.

Response: "This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comment, Page 1: The proposed regulations would require Fidelity National Title Group to spend hundreds of millions of dollars to comply with the data collection and reporting provisions of the proposed regulation by the April 30, 2008 deadline including building a complete new information system to replace Fidelity's existing information system.

Response: The Commissioner rejects this comment. The costs cited by the commenter are implausible and are based on the creation of a completely new enterprise-wide information system for Fidelity. The information required in the proposed regulation is either information routinely collected by underwritten title companies, information that should be routinely collected as part of sound business practice or information required by statute. The commenter has not identified any specific data elements that are difficult to collect or report, but has only provided vague complaints about the data reporting requirements. In addition, the Commissioner has extended the implementation of the reporting requirements by a year to ease the burden on reporting companies and to enable reporting companies to modify existing systems in the ordinary course of business.

Summary of Comment, Pages 1 -2: Fidelity's existing title production systems are not capable of collecting and reporting the majority of data required by the proposed regulation, cannot support the calculations specified and are not configured to respond to the reporting requirements of the proposed regulation. The cost of modifying Fidelity's existing system would exceed the cost of creating and deploying a new system.

Response: The Commissioner rejects this comments. As discussed in the response to the previous comment, the commenter's claims are vague, non-specific and implausible. Fidelity, like First American and Stewart, have affiliates that develop and deploy transaction management software for participants in the real estate business, including title agents, title insurers, real estate agents, lenders and others. The purpose of this software is to track transactions in real time and assist participants in carrying out the transactions by carrying out functions and adding information electronically. It is

unreasonable to expect that Fidelity, which can develop and deploy such transaction management software, is not in a position to utilize that same type of software to capture basic information about its own title and escrow transactions. Because the costs cited by the commenter are based on the development of a completely new system and because the Commissioner does not credit the claim that a new system is necessary to comply with the regulations, the Commissioner finds the alleged costs to be unreasonable and irrelevant.
Summary of Comment, Pages 2 -9: The comment provides a detailed explanation of the costs of developing a new information system for Fidelity.

Response: The Commissioner rejects this comment. Because the costs cited by the commenter are based on the development of a completely new system and because the Commissioner finds implausible the claim that a new system is necessary to comply with the regulations, the Commissioner finds the alleged costs to be unreasonable and irrelevant.

Summary of Comment (Bates pages 723-737):

Bates pages 723-737 are the comments of Mark Folk, submitted on behalf of Fidelity National Title Group.

Summary of Comment, Page 1: The commenter describes his qualifications and work experience.

Response: "This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comments, Page 1.

The commenter provides an overview of his comments. The proposed regulations represent a radical departure from prior rate setting standards. Regardless of the accuracy of the Commissioner's findings regarding a lack of competition, the "solution" presented by these proposed regulations is a counterintuitive one. The proposed regulations, spanning well over 200 pages, require extremely detailed reporting at the transaction level, will require significant expenditures on new data systems, arbitrarily limit sales expenses, radically limit concurrent policy fees and limit companies return on investment. History suggests that such "central planning" is unlikely to increase the degree of competition in the title insurance industry in California.

Response:

The Commissioner rejects this comment. The proposed regulations do not change rate setting standards, but simply enforce existing standards. The proposed regulations represent a logical response to a lack of competition in the business of title insurance in California. The commenter provides no specifics to support the claim of significant new expenditures to comply with new data reporting requirements. The Commissioner has extended the initial reporting to ease any such burden on reporting companies. Moreover, the reporting requirements refer to information that is routinely collected by underwritten title companies, title insurers or controlled escrow companies in the ordinary course of business, should be collected for sound business practice or is otherwise required by statutory provision. The proposed regulations limit sales expenses, but not in an arbitrary manner. The sales expenses are the main conduit for unreasonable and excessive expenses caused by reverse competition and it is reasonable and necessary to limit such expenses. The limits on concurrent policy fees are reasonable and reflect the very modest costs of providing such concurrent policies. The regulations do not limit a company's return on investment, but utilize a reasonable rate of return for purposes of calculating a maximum title insurance premium or maximum escrow fee.

Please review the following comment and response.

Summary of Comment, Page 2:

In limiting the sales cost factor to 15 percent, the Commissioner has failed to meet• .several key requirements of the rulemaking standards of the Administrative Procedures Act. He has failed to describe reasonable alternatives to the 15 percent limitation and his reasons for rejecting these alternatives; identify each technical, theoretical and empirical study, report or similar document, if any, upon which the Commissioner relied in proposing the proposed regulations; and assessed the potential for adverse economic impact on California business including avoiding the imposition of unnecessary or unreasonable regulations, reporting or recordkeeping or compliance requirements.

Response:

The Commissioner rejects this comment. The Commissioner selected a 15% sales factor among many possible values. The staff report on the sales factor explains the basis for the selection of 15%. The notice of revised rulemaking sets out the studies and reports relied upon by the Commissioner, including the staff report on the sales factor. The economic impact analysis assessed the impact of the regulation on businesses in California.

Summary of Comment, Page 2:

Limiting the *"Sales cost factor"* to 15 percent ignores not only the true costs of providing title insurance to consumers in California; it ignores insurance market forces in their entirety.

Response:

The Commissioner rejects this comment. The sales factor specifically considers the reasonable cost of providing title insurance to consumers in California and is created specifically to respond to the actual reverse competitive market forces in title insurance and escrow markets in California.

Summary of Comment, Page 2:

Private passenger auto has less underwriting effort than title insurance, yet average commissions for this line for independent agency companies are 17.5% of premium collected over the life of the policy. Insurance agencies are generally sold at a multiple of commissions in the 1.5 to 1.75 range, making the true market value of commission in the range of 37-40 percent.

Response:

The Commissioner rejects this comment. The sales cost factor covers the reasonable costs of marketing and sales of title insurance and escrow, including personnel and non-personnel costs of sales, marketing and "customer" support, where "customer" refers to the referrers of title insurance business. In contrast, the commission earned by an independent agent for auto insurance covers other things in addition to sales and marketing, including underwriting and claims settlement, both of which are covered by other components in the proposed regulations. In addition, the reference to collecting premiums over the life of the policy is irrelevant because the comparison is what auto insurers spend on sales and marketing on average versus what title insurers spend on sales and marketing on average. As the staff report on the sales factor points out, auto insurers spend about 15% on commissions, which covers more than sales and marketing. Similarly, the value of an agent's book of business is not comparable to or relevant to determining the reasonable cost of sales and marketing expenses. The so-called "true market value" of agent commissions is inapplicable and irrelevant to the determination of reasonable sales and marketing expenses for auto insurance, let alone for title insurance and escrow.

Summary of Comment, Page 2.

The sale of an average auto policy provides more money in commission to an agent than 15% of the price of the median sales transaction in California.

Response:

The Commissioner rejects this comment. The commenter's comparison provides no insight into the reasonable costs of sales and marketing for either auto or title insurance. As stated above, the proper comparison is the industry cost of sales and marketing as a percentage of premium in title insurance to that cost for auto insurance. As explained in the staff report on the sales factor, that comparison justifies the 15% value selected by the Commissioner.

Summary of Comment, Page 2:

In credit insurance, California regulations limit commissions to 35% for credit life and 30 percent for disability coverages and the level of underwriting for these products is low.

Response:

The Commissioner rejects this comment. The commission levels for credit insurance cited by the commenter are maximum amounts, not the reasonable average amount for the credit insurance industry. In addition, the commission for credit insurance covers the underwriting and issuance of the policy as well as claims support and, consequently, is payment for more than sales and marketing activities.

Summary of Comment, Page 3:

Both auto insurance and credit insurance are regulated by the Commissioner and in the case of auto insurance, there is no statutory limitation on commission. The commenter repeats earlier comments about auto insurance and credit insurance commissions

Response:

The Commissioner rejects this comment. As with auto insurance, the proposed regulations do not limit what a title insurer can spend on sales and marketing expenses. The establishment of a reasonable value for sales and marketing as an input into an overall rate regulation formula is precisely analogous to the review of rates for auto insurance, which also inputs a reasonable value into an overall rate regulation formula.

Summary of Comment, Page 3:

One can only surmise the Commissioner's purpose of establishing a 15% sales factor is to address reverse competition. The payment of commissions to some parties in the real estate transaction does not distinguish title insurance from insurance products or other consumer products.

Response:

The Commissioner rejects this comment. Reverse competition is not the payment of commissions to some parties in the real estate transaction. It is a market structure that leads title insurers and underwritten title companies to expend large sums on activities that benefit the entities who are in a position to refer the ultimate paying consumer to the title insurer and underwritten title company and which expenditures do not benefit the paying consumer. The presence of reverse competition in title insurance and escrow markets distinguishes the business of title insurance from most other lines of insurance and other consumer products.

Summary of Comment, Page 3:

In title insurance, the insurance purchaser is represented by a real estate professional who is capable and ethically required to address the consumer's best interest at it relates to the purchase of title insurance.

Response:

The Commissioner rejects this comment. The frequent occurrence of illegal kickbacks to real estate professionals by title insurers and underwritten title companies and the creation of affiliated business arrangements to funnel a portion of the premium dollar to real estate professionals in the position to refer business is powerful evidence contradicting the commenter's claim that real estate professionals protect title insurance consumers and impose market discipline on title insurers and underwritten title companies.

Summary of Comment, Page 3-4:

The Commissioner has failed to demonstrate that the limitation on the charge for a concurrent policy will not be excessive, inadequate or unfairly discriminatory. The regulation will decrease the amounts charged for concurrent policies and will require increases in the costs of owner's policies and non-concurrently issued policies. The Commissioner's intent may be to drastically reduce premium for lender's policies without permitting an increase in premiums for owner's policies and such a limitation would result in a catastrophic reduction in total industry premiums and an inability to recover its costs or achieve a reasonable profit.

Response:

The Commissioner rejects this comment. The charge for a concurrent policy is based on the reasonable costs of providing that policy, which consist essentially of printing and producing a second policy. There is no additional liability associated with a concurrent policy nor any additional title search, examination and underwriting nor any additional sales and marketing expenses. The proposed regulations provide for a price that reflects the reasonable costs of providing a concurrent policy. A reduction in the charge for a concurrent policy does not require an increase in the charge for the owner's policy. The charge for the owner's policy is based on the reasonable costs of providing that product. The commenter's dire predictions about the industry failing to recover its costs or achieve a reasonable profit are based on a false assumption that the proposed regulations are intended to suppress prices below costs. This assumption is incorrect as the regulations are predicated on cost-based pricing, which the Commissioner finds does not currently exist in California title insurance and escrow markets because a reasonable degree of competition does not exist in those markets.

Summary of Comments, Page 4:

The proposed regulations will likely force companies to charge a flat rate per dollar of insurance exposure which represents a departure from current practices. A flat cost per dollar fails to reflect that title search costs, for example, do not vary with amount of insurance and appears to run counter to the purpose that rates not be excessive, inadequate or unfairly discriminatory.

Response:

The Commissioner rejects this comment. The commenter provides no basis for the claim that the proposed regulation will force companies to charge a flat rate per dollar of exposure and the argument is incorrect. The maximum title rate formula includes costs that vary with the number of transactions (fixed costs) and costs that vary with the amount of exposure (variable costs). Consequently, a company charging the maximum rates for all exposures would not have a flat rate for dollar of insurance coverage. In addition, the maximum title charges are maximum charges and a title insurer could introduce a steeper rate slope if the title insurer wanted to. The maximum title formulas specifically respond to and meet the standards of not excessive, inadequate or unfairly discriminatory by moving to cost-based pricing that the Commissioner finds does not currently exist in the business of title insurance in California.

Summary of Comment, Page 4:

With regard to the issue of lack of clarity, note that the reference to Section 2357.6 is actually a reference to "Maximum average title insurance charge" an altogether different thing, both as to definition and, in all likelihood, amount than "Maximum title insurance charge for a policy".

Response:

The Commissioner rejects this comment. The reference cited actually states "Maximum average title insurance charge *for that policy"* and is clearly consistent with term "Maximum title insurance charge for a policy."

Summary of Comment, Pages 4-5:

The definition of Total Amount of Insurance is incorrect. The definition ignores the fact that there may exist a Lender's Policy 2, or 3 or more.

Response:

The Commissioner agrees with this comment and revised the definition of Total Amount of Insurance to correct the references to Table TI14, including specific reference to Lender's Policy 1. The definition does not ignore the potential existence of a second, third or more Lender's policies, but creates a rule for calculating the total amount of insurance that does not require manual inspection of each transaction.

Summary of Comment, Page 5:

The data quality acceptance standards of Section 2356.7 fail to meet the clarity standard. It is unclear what constitutes an error and there is no guidance given as to an acceptable error rate for findings under 2356.7(b). In addition, the error rate relates to an entire record, regardless of the relative importance of a particular data element.

Response:

The Commissioner rejects this comment. The section states clearly that there is a 1% error rate tolerance for invalid formats, invalid codes and illogical entries. These are clear standards and error definitions.

Summary of Comment, Page 5:

The 1% error tolerance is excessively low. Traditionally, "acceptable" error rates for the California Department of Insurance have ranged from 5% to 10% and have as their basis the concept of materiality. The National Association of Insurance Commissioner's Examiners Handbook provides detailed guidance on error rates and are established in relation to materiality, basing it primarily on 5% of capital and surplus. In addition, examiners must consider "tolerable" error.

Response:

The Commissioner rejects this comment. The comparison between error rates used by market conduct examiners and the 1% error tolerance for title statistical plan and financial reporting basic edit checks of invalid formats, invalid codes and illogical entries is inappropriate. The 1% tolerance is an error rate for the threshold review of the data to ensure the most obvious errors are addressed by reporting companies prior to submission of reports to the Commissioner. The data quality reporting standards provide for additional data quality review beyond the basic edit checks, and the Commissioner and the statistical agent will consider the issues of materiality and tolerable error when employing, as stated in the proposed regulation, other means to for verifying the accuracy of the reported data, including audits of the accuracy of the data submissions with particular attention to the reporting company's categorization of revenues, expenses, assets and liabilities.

Summary of Comment, Page 6:

The commenter cites further from the NAIC Examiners Handbook regarding sampling standards. Clearly, the 1% error threshold rate is significantly more stringent than the standard error rates recommended by the NAIC.

Response:

The Commissioner rejects this comment. As discussed in response to a previous comment, the 1% tolerance for basic edit checks in the proposed regulation is not comparable to the sampling error tolerances in the NAIC Market Examiners' Handbook.

The review of data submitted on an ongoing basis to a statistical agent is qualitatively different from the review of a data sample by a market conduct examiner.

Summary of Comment, Page 6:

The cost of meeting the "acceptable" error rates will increase the costs of reporting companies and work at cross purposes to the Commissioner's intent to reduce title insurance and escrow costs for residential homeowners.

Response:

The Commissioner rejects this comment. While the introduction of any statistical plan will increase costs to reporting companies from a situation of no reporting, the proposed reporting requirements will prove beneficial to reporting companies and consumers. By institutionalizing reporting requirements and providing a detailed description of the information to be reported on an ongoing basis, the cost to reporting companies will likely be less than the costs of ad hoc special data calls would be. In addition, the statistical plan is necessary to ensure that reporting companies collect the relevant data so it can be reported. Further, the primary goal of the statistical plan and financial reporting requirements is not to reduce costs but to provide the Commissioner with accurate cost information to ensure that prices charged to consumers reasonably reflect the costs associated with providing title insurance products and escrow services. Finally, the Commissioner notes that the proposed regulations will apply to over $4 billion in annual revenues, and the evidence indicates that excessive charges run well into the hundreds of millions of dollars a year, providing context to the costs of compliance.

Summary of Comment, Page 6:

The necessity of allowing the Commissioner to challenge data up to eleven years after review and resubmission is suspect. It is burdensome and totally unnecessary for the companies to continue to be subject to the risks of resubmission of filed data after regulators have conducted at least two arduous examinations of the data, including the review by the statistical agent and the triennial examination by the California or other Department of Insurance.

Response:

The Commissioner rejects this comment. The commenter misstates the provisions in the regulation for review, which states the Commissioner may reject faulty data and require resubmission of faulty data at any time up to five year after the initial required submission date of the report. In addition, the commenter is incorrect that a triennial examination will necessarily involve an audit or review of information reported pursuant to the proposed statistical plan. The ability of the Commissioner to require correction of data that goes back five years is not unreasonable and is necessary to ensure that sufficient and correct data are available to use in calculating industry totals that flow into the maximum rate and charge formulae.

Summary of Comment, Page 7:

The transactions growth rate referenced in Section 2357.4 is not defined.

Response: The Commissioner agrees with this comment. The reference to transactions growth rate has been changed to transactions growth factor, which is a defined term.

Summary of Comment, Page 7:

The key factor "market value growth rate" is not defined

Response:

The Commissioner agrees with this comment. The reference to market value growth rate has been changed to market value growth factor, which is a defined term.

Summary of Comment, Page 7:

Neither the expense inflation factor nor the productivity growth factor is adjusted to reflect relevant measures for only the state of California. As such the Commissioner has failed to demonstrate their accuracy for measuring the historical results in the California marketplace.

Response:

The Commissioner rejects this comment. The expense inflation factor utilizes an inflation series published by the Bureau of Labor Statistics. As discussed in the staff paper on the interim rate reduction, the selected national inflation series is superior to other series, including regional or local inflation series. Similarly, the productivity growth factor relies on a national series published by the Bureau of Labor Statistics. Each series represents a reasonable basis for the required measurement.

Summary of Comment, Page 7:

The Commissioner has failed to demonstrate that the most recent historical statistics projected into the future, as required by the proposed regulations, represent a reasonable projection of future results.

Response:

The Commissioner rejects this comment. The proposed regulations specifically address issues raised by various commenters about the nature of costs faced by the title and escrow industry. The regulations rely on the most recent cost data, which is a standard and uniform approach in insurance ratemaking. The regulations specifically consider changes in real estate activity to modify this most recent data and specifically consider the fixed and variable costs of title insurance and escrow.

Summary of Comment, Page 7:

Implicit in the productivity and inflation adjustment is the virtual requirement that companies subject to the proposed regulations meet the Commissioner's unique measure of inflation adjusted productivity. It is difficult to imagine companies finding California an attractive place to continue to do business and the most apparent strategy to earn market rates of return is to reduce the amount of capital devoted to California and outsource as many jobs as possible to lower cost and/or offshore markets.

Response:

The Commissioner rejects this comment. The regulations specifically consider expense inflation, which increases the historical expenses for use in the future period the rates will be in effect. This provision to increase rates is reasonably balanced by any productivity gains that can be achieved to lower historical costs in the future. The title industry has made great strides in moving from paper title plants and paper transactions to electronic search and electronic transactions and that improvement continues. It is very likely that national productivity numbers understate the productivity gains of title insurance companies, underwritten title companies and escrow providers because the transition from paper to electronic transactions. Further, title plant operators are already outsourcing jobs to foreign countries for processing real estate transactions into electronic title plant records. California is a relatively high-cost business location for reasons completely unrelated to the proposed regulations. But, the proposed regulations strikes a fair and reasonable balance between the Commissioner's responsibility to ensure that title insurance rates and escrow charges are not excessive and to minimize the cost of reasonable regulation.

<u>Summary of Comment (Bates pages 738-757)</u>:

<u>Bates pages 738-757 are the comments of Michael J. Miller, submitted on behalf of Fidelity National Title Group.</u>

<u>Response to Comment</u>:

Commentor: Michael Miller, 2

Summary: The commentor summarizes his background and qualifications.

Response: Because this is not a comment specifically directed at the proposed regulation text, no response is required.

Commentor: Michael Miller, 2-3

Summary: “Excessive, inadequate or unfairly discriminatory” are cost-based. A rate satisfies each of the standards if it reflects all the expected losses, settlement expenses, operational and administrative costs and cost of capital associated with the risk transfer. Section 12401.3 is a two-prong test. The determination that rates are unreasonably high is cost based. The regulations establish a maximum rate that applies uniformly to all insurers, with no consideration to each insurer’s expected costs.

Response: See response to common comment A.9.

Commentor: Michael Miller, 3

Summary: There is no provision that the degree of competition will ever again be reassessed.

Response: No such provision is necessary. If the title insurance market were to become competitive, and that competition could sustain itself even in the absence of these regulations, then the Commissioner could, on his own initiative or in response to a petition, begin a new rulemaking procedure to change or delete these regulations.

Commentor: Michael Miller, 3-4

Summary: Some title insurers will have costs above average. A rate that reflects their expected costs is not excessive under the statute but is excessive under the regulation.

Response: See response to common comment A.9.

Commentor: Michael Miller, 4

Summary: If the proposed regulations foster a return to a reasonable degree of competition, then they should be immediately null and void.

Response: The regulations address the problems faced by consumers because of the absence of competition. At the same time, the regulations cannot change the basic reverse-competitive structure of title and escrow insurance markets. Consequently, the regulations by themselves cannot transform title and escrow markets into a competitive structure that eliminates the need for the regulations.

Commentor: Michael Miller, 4-7

Summary: The regulations will destroy price competition and the financial strength and security of the market. Setting the maximum rate at the average will create a downward spiral. When North Carolina did this for personal auto liability, the result was the largest residual market in the nation. California has no residual market for title, so there will be availability problems. Eventually there will be a monopoly, likely a single insurer operating as a quasi-government insurer.

Response: The history of Proposition 103 shows the fallacy of this argument. Maximum rates for property-casualty insurance in California have been based on industry average expenses, returns and surplus since 1991. In those 15 years, there has been no discernable effect on the number of insurers or on their ability to operate or any tendency toward monopoly. Residual markets remain relatively small and much smaller than they were before the Proposition 103 regulations went into effect.

Commentor: Michael Miller, 8

Summary: Section 2355.3(g) gives the Commissioner unfettered discretion to delete certain data that he deems to be erroneous. He will have full authority to create a database from whole cloth which will seemingly justify whatever rate level he arbitrarily predetermines.

Response: The Commissioner rejects this comment. The provision to reject erroneous data is reasonable and necessary to ensure the data used in calculating maximum title insurance rates and escrow charges actually reflect the experience of underwritten title companies, title insurers and controlled escrow companies. This responsibility and authority is no different from that employed by insurance industry statistical agents who reject erroneous data and exclude such data from compilations submitted to regulators. The proposed regulation provides for both a statistical agent and a statistical adviser to ensure proper review of data submitted and to provide advice to the Commissioner regarding data quality. The Commissioner will not be able to create a database from whole cloth.

Commentor: Michael Miller, 8-9

Summary: Section 2355.5 establishes new advisory organizations which are either duplicative or completely unnecessary. Data necessary to regulate financial strength is already available in the annual statement. For rate regulation, there is no need for such an extensive database. For no other line of insurance in California or any other state is there a required database with a comparable level of detail. Ordinarily, insurers submit all the necessary data in their rate filings. There is nothing unique about title insurance in California that requires such a database.

Response: See response to common comment T.7.

Commentor: Michael Miller, 9

Summary: The extent and detail of the data required will make it impossible to be reasonably accurate and usable. Terms such as “basic edit check”, “illogical entries”, “other means for verifying the accuracy” and “faulty data” are too vague.

Response: The Commissioner rejects this comment. The statistical plan is designed specifically, among other things, to facilitate review of data quality and accuracy. The level of detail prescribed is, in part, for enabling the statistical agent and statistical adviser to assess data accuracy. Additional detail in reporting enables greater review of data accuracy. For example, for private passenger auto, the Insurance Services Office transaction-based statistical plan enables ISO to perform greater data accuracy procedures than the summary-based statistical plan of the Property Casualty Insurers Association of America. The terms cited by the commenter are standard terms for statistical agents and have substantive meaning in that context.

Commentor: Michael Miller, 9-10

Summary: Section 2356.8(b)(6) prescribes allocation methods for IBNR and GAAP Net Worth. There is no valid reason for prescribing the method. The GAAP Net Worth method is vague. Revenue and reserves are not defined. Do revenues include investment income? Do reserves include statutory premium reserves?

Response: The Commissioner rejects this comment. The allocation methods for IBNR and GAAP net worth are reasonable and valid and ensure a consistent approach across insurers so a compilation of insurers' submissions is a compilation of the same measurements. GAAP Net Worth, revenue and reserves are well defined. Investment income and statutory premium reserves are specifically addressed.

Commentor: Michael Miller, 10

Summary: The commentor repeats a comment that the regulations redefine excessive.

Response: The comment is already responded to, above.

Commentor: Michael Miller, 10

Summary: The regulations allow a company with below average costs to charge the maximum rate based on average costs. Thus they will be allowed to overcharge.

Response: The rate regulation moves all insurers and UTCs closer to pricing based on reasonable costs than the current market situation. The regulation will not transform a market that is not competitive into a competitive market, but will better protect consumers than the current absence of rate oversight or any alternatives to the proposed regulation.

Commentor: Michael Miller, 11

Summary: Section 2357.3(u),(w),(x),(y),(z),(aa) and (ab) use only one year of data for expenses. This is actuarially unsound, especially when the premium has not been adjusted to reflect past rate changes or adjusted for changes in real estate prices and activities. The rates will be unstable and may not reflect the expected market conditions.

Response: The formulas in section 2357.6 and following are based on a pure premium method rather than a loss ratio approach, therefore there is no need to adjust the premium to reflect past rate changes. Section 2355.4 defines several projection factors, including for changes in the number of real estate transactions and for the median value of real estate transactions, so expenses are adjusted for changes in real estate prices and activities. Using industry total expenses and adjusting will avoid instability and will reflect expense expected market conditions.

Commentor: Michael Miller, 11

Summary: Subsections (ab) and (ac) use a five-year historical average for income tax. The prospective rate should be used.

Response: The five-year historical average for the industry is a reasonable proxy for and is expected to be roughly equal to the prospective rate.

Commentor: Michael Miller, 11-12

Summary: Subsection (ae) uses a historical five-year average for capital gains. Five years is too short. Unrealized gains and losses are paper losses which may never be realized, so at least a ten-year average should be used.

Response: The Commissioner rejects this comment. A five year average for capital gains is a reasonable basis to estimate future capital gains. The fact that unrealized capital gains are paper losses which may never be realized is irrelevant to the selection of a five-year or ten-year average.

Commentor: Michael Miller, 12

Summary: Subsection (ai) uses a historical five-year calendar-year average for loss and loss adjustment. Title is long-tail. It could be 15 or 20 years from when a policy is issued to when a claim is settled. Calendar year data are never used for long-tailed coverages. If a five-year average is to be used, then there should be an adjustment for changes in ultimate losses for prior years. If unadjusted calendar-year losses are to be used, then at least ten years should be used.

Response: Loss development, as used for long-tailed coverages, is not appropriate for determining ultimate title insurance losses because title insurers are unable to track policies in force over time. A title insurance policy remains in force unless and until the property whose title is insured is sold. Title insurers do not track when their policies are no longer in force due to property sales and, consequently, are unable to track exposures over time. Therefore, the approach used by the regulation -- a five year rolling average of losses to initial exposure -- is appropriate.

Commentor: Michael Miller, 13

Summary: The formula in subsection (aj) is convoluted and cannot be applied as written.

Response: The formula is intended to reflect the standard actuarial method for calculating an average relativity. The Commissioner believes that it does so correctly. The comment is general and vague and fails to identify any specific error.

Commentor: Michael Miller, 13

Summary: There's no need for a uniform maximum rate of return. Capital structures and distributions of insurance by state vary from one insurer to the next, therefore cost of capital varies. There is no basis for the risk margin; 3 ¾% could just as well have been 4%, or 6%, or more.

Response: While it is common for rate regulation to be based on company-specific data, it is also permissible to base rate regulation on industry-wide averages, and such systems have been approved by the courts for insurance and other industries. (E.g., 20th Century Ins. Co. v. Garamendi (1994) 8 Cal.4th 216; Permian Basis Area Rate Cases (1968) 390 U.S. 747.) The Commissioner has raised the risk premium above the risk free rate from 3¾% to 6%. The risk premium is derived from historical data based on the returns of property-casualty insurers. Reliance on those firms, rather than on title insurers, is necessary because the Commissioner has found that the title markets are not reasonably competitive, rendering their performance an inadequate measure of a fair return in a competitive market. Property-casualty insurers are a reasonable proxy for title insurers operating in a reasonably competitive market. The November 27 notice included a study relied upon for Calculation of the Profit Factor.

Commentor: Michael Miller, 13

Summary: If the Commissioner can dictate what constitutes a reasonable expenditure for salaries and commissions, then he could also dictate what is paid for paper, computers, and per-foot rents. There is no basis for the 15 percent sales costs factor and it is completely arbitrary.

Response: See response to common comment T.23. The November 27 notice included a study relied upon for Calculation of the Sales Cost Factor.

Commentor: Michael Miller, 13-14

Summary: The effect of section 2357.17 is to prescribe a uniform class plan. This is noncompetitive and will destroy innovation. Effective rate regulation is being accomplished throughout the US without prescribing a uniform class plan and mandated class relativities.

The Commissioner will argue that he's not mandating because insurers are being allowed to use lower factors. However, when an insurer lowers a factor on one class, there needs to be an offsetting increase in another class or classes to maintain an overall adequate rate level. The inability to off-balance decreases will cause insurers to move to the uniform set of factors.

Response: See responses to common comments A.8 and T.25.

Commentor: Michael Miller, 14

Summary: The interim rate reduction arbitrarily assumes without actuarial analysis, that every title insurer is currently charging rates above its expected costs and the degree of excessiveness is exactly the same for each insurer. Even the lowest cost insurer is being required to implement the same rate reduction.

Response: The interim rate reduction is only a fallback if the stat plan is not in place by the specified date. If by 2009 sufficient data are not available to base rates on costs derived from the statistical plan, it is reasonable to implement the interim maximum rates to protect consumers from excessive rates while the statistical plan data are obtained. The rates in 2000 are those which the companies themselves chose to use, not only in 2000 but for many years prior. In recent years these rates have allowed the insurers to reap a windfall of title insurance premium from rapidly increasing real estate prices. The rate reduction allows for increased claims and expenses in the year of the reduction, so average profit levels from years before the windfall will not be substantially affected.

Commentor: Michael Miller, 14

Summary: My experience is that whenever a Commissioner has concerns, each insurer has been given an opportunity to justify its rates based on its own expected costs. If traditional methods of rate regulation were applied, all of the proposed regulations, including the extensive and expensive data calls, would be completely unnecessary.

Response: Because the stat plan is not in place, there is no reliable source of data to analyze rates at the individual company level. See response to common comment T.7.

Commentor: Michael Miller, 15-19

Summary: The commentor provides his curriculum vitae.

Response: Because this is not a comment specifically directed at the proposed regulation text, no response is required.

<u>**Summary of Comment (Bates pages 758-904)**</u>**:**

<u>Bates pages 758-829 are the comments of Gregory S. Vistnes dated August 30, 2006, submitted on behalf of Fidelity National Title Group.</u>

Summary of Comment, Page 1: This passage discusses the commenter’s affiliations and summarizes the commenter’s conclusions.

Response: Responses to the comments summarized in the executive summary are provided below, so no response to the summary of comments is needed.

Summary of Comment, Page 2: This section details the commenter's education and other qualifications.

Response: This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comment, Pages 3-6: The commenter offers an overview of the title insurance industry.

Response: This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comment, Pages 6-7: The commenter argues that title insurance encompasses two distinct markets. One market is the title insurance market concerned with losses associated with title defects comprised of title insurance companies, and the second market is title search services comprised of title companies. The commenter claims that title companies in the title search market compete for the business of consumers and also compete for the recommendations of real estate professionals.

Response: The Commissioner rejects this comment. The commenter's description of title insurance markets is incorrect. The issuance of a title insurance policy is not possible without title search and cannot be separated, and the two activities are no more separate markets than an auto insurance company and its agency sales force. The commenter is also incorrect that title companies compete for the business of consumers. There is no evidence that title companies compete for the business of anyone but the referrers of consumers. The commenter is also incorrect in claiming that both alleged markets are local in geographic scope. In California, title insurers are licensed on a statewide basis. The commenter's analysis of "relevant" markets is replete with errors and, to the extent that his further analysis relies upon his definition of markets, his further analysis is likewise incorrect.

Summary of Comment, Pages 7-10: The commenter describes the structure of the title insurance market and claims that numerous underwriters compete and that there is no evidence that smaller rivals face a competitive disadvantage relative to the two larger rivals who together control about two-thirds of the market. The commenter argues that market concentration has little significance in assessing the intensity of competition and too simplistic to provide a useful measure of competition. The commenter argues that HHI measures of market concentration have limited significance to economists and policymakers.

Response: The Commissioner rejects this comment. The commenter's characterizations of the structure of the California market and of the role the HHI are incorrect. There are relatively few title insurers operating in California – ten at the time of his report and soon to be nine after a recent merger – and the market is very highly concentrated with extremely an extremely high HHI on a statewide basis – at a level defined as highly-concentrated by the Department of Justice Merger Guidelines. The commenter is also incorrect about the role of market concentration measures in evaluating competition. The HHI continues to be the standard measure of market concentration. The federal Department of Justice, the Federal Trade Commission, and the National Association of Attorneys General all continue to use HHI measurements in their analysis of horizontal mergers. The Birnbaum Report measured title insurer market concentration at the county level – the geographic area the commenter argues is the relevant market – and found even higher HHIs than at the state-wide level. The commenter provides no facts to support his claim that there is no evidence that smaller rivals face a competitive disadvantage versus the dominant title insurers and, consequently, the claim has no probative value.

Summary of Comments, Page 10-11: The commenter argues that the evidence suggests that today's small rivals could readily increase their size if consumer became unhappy with the prices or service quality of the larger rivals and that expansion is a relatively simple process. The commenter argues that the ease with which rivals can increase market share in California is demonstrated by looking at rivals' market share in other states and claims that a rival who has a significant market share in another state could expand in California without difficulty. The commenter provides a chart of the market shares of California title insurers in other states and claims that because Stewart has a 20% market share in some states and only an 8.9% market share in California, it would be easy for Stewart to expand in California.

Response: The Commissioner rejects this comment. The commenter's arguments are not supported by any facts or evidence, represent unsubstantiated opinion and run counter to actual experience. The commenter provides no support for the claim that small rivals could increase their size if consumers became unhappy. Given that title insurers do not market to consumers, but to the referrers of business, it is unclear how or why the commenter believes this result would occur. The analysis of market shares in other states disproves the commenter's own theory. If Stewart, which has a 20% market share in some states, could easily expand in California on the basis of Stewart's "success" in the other states, then why has Stewart's market share remained about the same in California for an extended period of time? The answer is clearly that expansion is difficult. Further evidence of this fact is demonstrated by the preferred method of acquiring market share – acquiring other title insurers and underwritten title companies or by buying referrals through affiliated business arrangements.

Summary of Comments, Pages 11-12: The commenter argues that title insurance company entry is easy and claims that insurers who currently do not offer title insurance in other states are well positioned to begin offering title insurance in California if price increases by incumbents were to create a profit opportunity. The commenter cites Investors Title in North Carolina and Attorney's Title in Florida as candidates.

Response: The Commissioner rejects this comment. The commenter's claims about ease of entry are unsupported, illogical and contrary available facts. The commenter claims that a title insurer not currently operating in California is poised to jump in if the incumbents were to create a profit opportunity. The Birnbaum Report demonstrated substantial and excessive profitability in the California title insurance industry over the past ten years, yet the number of title insurers has declined. The commenter also misunderstands the nature of regional or state-specific title insurers. Attorney's Title in Florida could not enter the California market because it is a cooperative of attorneys licensed in Florida. The commenter's arguments are clearly incorrect.

Summary of Comments, Page 12: The commenter discusses market shares for title search services and claims that all underwritten title companies not affiliated with title insurers are independent for purposes of calculating market share. The commenter concludes that there are numerous firms competing to sell title search services.

Response: The Commissioner rejects this comment. Title search services are not a separate market from title insurance, as explained above. In addition, the commenter's assumption that any underwritten title company not affiliated with a title insurer is a competitor of that title insurer is incorrect. Many non-affiliated underwritten title insurers utilize only one title insurance company for title insurance policies. In such a situation, the appropriate measure of market share is the title insurance company's share of the market for title insurance.

Summary of Comments, Page, 13: The commenter claims that entry and expansion for title services is generally easy, that licensing requirements can be met with a two-year period, that entry is not impeded by barriers to key information because access to local records is readily available at county government offices, and that entrants are at no disadvantage to incumbents in areas with title plants. The commenter states that the main difficulty faced by an entrant in achieving competitive significance is obtaining customers and this may be difficult, but also states that the personal relationships and reputations necessary for obtaining customers is not a barrier to entry because such relationships can be obtained by hiring someone with these relationships from a rival.

Response: The Commissioner rejects this comment. The commenter's claims are without support, illogical and contradictory. Requiring a two-year wait is clearly a barrier to entry. Being forced to do title searches at county government offices is not a feasible way to compete with an incumbent who owns or has access to a title plant. Being able to subscribe to a title plant does not put an entrant on the same footing as the owner of the title plant who is in the position to use the title plant as a profit center when the entrant cannot. If obtaining customers is difficult because of the need for personal relationships – which makes title insurance entries different from entries in most consumer product markets – it is unclear why the commenter concludes this requirement is not a barrier to entry. Finally, the commenter's solution – buying the personal relationships from a rival – does not create a true entry in the marketplace because there is no new supply added, but only a shifting of supply from one company to another. The commenter's analysis is fundamentally flawed.

Summary of Comments, Page 14-15: The commenter claims that discounted rates are frequently available and cites examples of discounts. The commenter states that new internet sites have started that allow individuals to compare rates. The commenter references a survey by Bankrate.com and argues that the survey confirms California rates are competitive. The comment states that most insurers do not advertise to consumers to win business and that consumers choose to delegate the choice of title insurer to a real estate professional.

Response: The Commissioner rejects this comment. The commenter provides no analysis of the frequency in which discounts are awarded. The Commissioner has found that most discounts are narrowly targeted and have limited impact. The commenter provides no analysis of the impact of the internet price sites, but simply concludes that such sites lead to price competition. There is no evidence of price reductions resulting from these sites. The Bankrate.com survey provides no reasonable basis for concluding California title insurance rates are competitive. Even if the survey were accurate, a comparison of rates across states does not indicate if prices in California reflect reasonable costs associated with a competitive market or not. However, the Bankrate.com survey is not even useful for a comparison across states because it uses the same value property in each state – a very low value amount in California versus a high value amount in other states. The appropriate comparison must be made using the median-priced home in each of the states because title insurance costs are based mostly on expenses which do not vary with amount of coverage as opposed to liability which does vary with amount of coverage. Finally, and most importantly, the commenter mischaracterizes reverse competition. Reverse competition does not refer to consumers seeking advice or guidance of third parties; it refers to a market structure in which the seller markets the product to a third party who refers the paying customer to the seller, the consequence of which is that the referrer of the business has the market power and is able to extract considerations from the seller who passes the cost of the considerations onto the paying consumer who has no market power to discipline the pricing of the seller.

Summary of Comment, Page 15-16: The commenter states that price competition is more common and vigorous for large commercial customers and residential developers than for residential consumers. He claims that regulations which simply require rates to be filed can impede price competition by slowing responsiveness to the market. The commenter explains the greater price competition than for commercial customers comes about because individual home buyers opt to delegate their choice of title agent while large commercial customers are knowledgeable about the market and because the higher commercial premiums give the commercial buyer a greater incentive to shop for the best price. The commenter also cites the example of lenders who award all their business to a particular title insurer, using their business volume to exert market power on price.

Response: The Commissioner rejects this comment. The commenter accurately explains why residential customers lack market power, why large commercial customers have market power, why price competition can exist in commercial markets and how referrers of business, such as national lenders, have great market power and can extract considerations from title insurers. The commenter errs by claiming that residential customers opt to delegate their choice. As described in the response to the previous comment, the residential consumer simply has no market power in the title insurance and escrow markets and, consequently, the title insurers, underwritten title companies and escrow companies compete for the referrers of business by providing a variety of considerations to these referrers at the expense of the paying consumer. The frequent occurrence of illegal rebates as well as legalized rebating through, for example, affiliated business arrangements, attest to this market structure.

Summary of Comments, Pages 16-20: The commenter discusses non-price competition and argues that the costs of a delayed closing can be substantial and that concerns about quality increase the importance of non-price competition. One form of non-price competition is innovation, such as new products.

Response: The Commissioner rejects this comment. The Commissioner agrees that title insurers and underwritten title companies compete on bases other than price, but disagrees that this type of competition is relevant for determining whether a reasonable degree of competition exists in business of title insurance in California. As set out in the Birnbaum Report, the review of competition is placed squarely in a statute regarding rate regulation. It is therefore logical that the type of competition at issue is price competition, else rate regulation would not be at issue. In addition, the Commissioner disagrees that non-price competition benefits the paying consumer. Title insurers and underwritten title companies have engaged in reverse-competitive non-price competition with frequent illegal kickbacks, including captive reinsurance agreements, through affiliated business arrangements which provide a legalized method of funneling a portion of the premium to the referrer of the business and through the provision of other considerations, such as free services to real estate agents. This so-called non-price competition has largely not benefited consumers.

Summary of Comments, Pages 20-26: The commenter discusses principal-agent relationships and notes that competition among title insurers is largely directed towards the real estate professionals to whom consumers typically delegate the title insurance purchase decision and argues that this arrangement does not eliminate or necessarily reduce competition. Principal-agent relationships work well when interests of the principal and agent are aligned and poorly when the interests are antagonistic. The commenter argues that the principal-agent relationship is efficient in title insurance, meaning it is more efficient for the principal – the referrer of business – than the agent – the paying consumer – to decide which title insurer to use. The commenter argues that consumers benefit from the principal-agent relationship, explains that title insurance prices do not vary much between title insurers and that the small savings from shopping around would not be worth the consumer's time to make an informed decision. The commenter argues that real estate professionals' interests are generally aligned with those of the consumer and that existing anti-rebate laws help align incentives and limit potential problems. The commenter concludes that competition directed at real estate professionals benefits consumers and that the term “reverse competition” has no analytic value. The commenter argues that marketing costs are legitimate forms of competition.

Response: The commenter mischaracterizes the reverse competitive market structure by euphemistically describing the steering of consumers by real estate professionals as consumers opting to delegate their decision. The fact is that many of the professionals in a position to refer the business do not represent the consumer or have a fiduciary responsibility to the consumer, but have a financial stake in which title insurer the consumer uses. As explained above, competition in title insurance markets – reverse competition – does not refer to consumers seeking advice or guidance of third parties; it refers to a market structure in which the seller markets the product to a third party who refers the paying customer to the seller, the consequence of which is that the referrer of the business has the market power and is able to extract considerations from the seller who passes the cost of the considerations onto the paying consumer who has no market power to discipline the pricing of the seller.

The commenter is incorrect about reverse competition. "Reverse competition" is a well-established concept in insurance economics and has been used to describe the market structure of title insurance and credit insurance markets for at least 30 years. The term has been used, in reference to title insurance, for nearly 30 years, apparently first having been coined by the 1977 Department of Justice study. Since then, it was repeated in several other studies, including the Peat Marwick report for HUD and the California Insurance Commissioner’s Bulletin 80-12. The term has been codified in regulations, including the New York State credit insurance regulation and has been used and defined in work products of the National Association of Insurance Commissioners. The time has passed when the industry could credibly object to the phrase “reverse competition.”

The commenter has unwittingly provided evidence to support the absence of price competition with his example of the narrow price range for a title insurance policy. If there were market participants seeking to gain market share by cutting prices, we would expect greater price diversity. Rather, the commenter has demonstrated why it makes no sense for a title insurer to cut prices; the title insurer would have less revenue, would not gain market share with a lower price and would have fewer resources for marketing to the referrers of the business and, consequently, would end up losing market share with a price cut.

The commenter’s claim that competition directed at real estate professionals benefits consumers is without any support and is contradicted by the facts of frequent illegal kickback and legalized kickbacks that pad the costs of title insurance at the expense of the paying consumer.

Summary of Comment, Page 26: The commenter argues that the Birnbaum Report is flawed and has been criticized by several analysts. The commenter summarizes his earlier review of the Birnbaum Report.

Response: The Commissioner rejects this comment. The Commissioner notes that the other analysts cited by the commenter are all consultants hired by the title insurers or title insurance trade associations and that there are no critiques of the Birnbaum Report by an independent analyst.

Summary of Comment, Pages 27-28: The commenter argues that the Birnbaum Report incorrectly fails to acknowledge price competition and claims there is competition for the business of lenders and that there have been recent rate reductions by California title insurers. He asserts that title insurers compete for recommendations of mortgage lenders and real estate professionals and that these professionals are positioned to stimulate price competition. The commenter claims that the Birnbaum Report's statement about the absence of base rate reductions is irrelevant, misleading and wrong and cites discounts offered by title insurers.

Response: The Commissioner rejects this comment. The commenter provides no support for the contention that competition among title insurers for the referrals of business leads to price competition. The evidence is overwhelming to the contrary; this competition for referrals has led to frequent instances of illegal kickbacks that have inflated costs and prices to consumers as well as legalized methods of providing portions of the premium dollar to the referrers through affiliated business arrangements that inflate costs without commensurate benefit to consumers. The Commissioner finds that although title insurers have filed a number of discounts, there is little or no evidence that these discounts affect a significant number of consumers. The Department of Insurance staff is typically unable to obtain such information from insurers. In addition, title insurers have misrepresented the impact of rate filings made to the Department. In one instance, a Fidelity company made a filing in December 2005 claiming an overall rate reduction of more than 20%. Upon review by Department staff, the rate filing resulted in an overall rate increase of 1% to 2%. The commenter provides no substantive evidence to support the claim of price competition in the business of title insurance in California.

Summary of Comment, Pages 29-30: The commenter argues that the Birnbaum Report focuses solely on price competition and that such a focus renders the conclusions unreliable. The commenter argues that non-price competition is important, that the Birnbaum Report was wrong not to consider the benefits of non-price competition and simply assumes that non-price competition has no benefits.

Response: The Commissioner rejects this comment. The commenter mischaracterizes the Birnbaum Report, which does examine both price and non-price competition. However, the commenter is incorrect and the Birnbaum Report is correct to define the type of competition at issue to be price competition. The statutory requirement for the Commissioner to make a finding whether a reasonable degree of competition exists in the business of title insurance sits in a provision for rate regulation. It is only logical that the type of competition at issue is price competition or else the provision would go beyond rate regulatory authority. Further, the Birnbaum Report looked at non-price competition. Whereas the commenter has no empirical evidence to support his claims that non-price competition benefits consumers, the Birnbaum Report cited numerous instances of non-price, reverse competition that has inflated costs at the expense of consumers. The captive reinsurance schemes that funneled almost half of the premium dollar back to the homebuilders referring the business is the type of non-price competition that the commenter claims benefits consumers when such an arrangement clearly indicates that title premiums are inflated beyond the costs of providing the product.

Summary of Comments, Pages 31-35: The commenter argues that the Birnbaum Report deviates from the commonly accepted approach that economists use for conducting a complete and correct competitive analysis. The commenter states that economists rely upon the framework in the Department of Justice Merger Guidelines and the Birnbaum Report fails to both acknowledge and follow the Merger Guidelines methodology. The commenter claims the Birnbaum Report has little or no discussion of key market considerations, including expansion possibilities, entry conditions, product differentiation, competitive responses and cost considerations. The commenter argues that the Birnbaum Report fails to reconcile its conclusion with that of the Federal Trade Commission which approved the 1999 merger of Fidelity National and Chicago Title and the 2005 merger of First American and United General. The commenter argues that that Birnbaum Report incorrectly relies on HHIs, incorrectly assesses barrier to entry, incorrectly looks at profits to assess competition and employs a flawed price/cost sensitivity analysis.

Response: The Commissioner rejects this comment. The Commissioner finds that the commenter has severely mischaracterized the Birnbaum Report and, consequently, the critique is not persuasive. The Birnbaum Report uses a commonly accepted approach for evaluating competition in insurance markets. There is a long history of competition analysis in insurance markets and the procedures for such analysis have been codified in model laws of the National Association of Insurance Commissioners. The Birnbaum Report is consistent with these standard procedures. The commenter is incorrect that the Birnbaum Report does not reference or rely upon the Merger Guidelines. The Birnbaum Report specifically cites those guidelines. The commenter is incorrect that the Birnbaum Report incorrectly relied upon HHIs. HHI continues to be the standard measure of market concentration. The federal Department of Justice, the Federal Trade Commission, and the National Association of Attorneys General all continue to use HHI measurements in their analysis of horizontal mergers. The Birnbaum Report used the HHI as only one indicator of competition and market structure, among several others, as indicated in the Merger Guidelines. The Birnbaum Report discussed entry into the market and barriers to entry in detail and reported that there have no title insurance company entries, that the number of title insurance groups has declined, that new underwritten title company entries have all been affiliated business arrangements that added no new supply capacity to the market, that independent underwritten title companies are being acquired by national title insurance companies and that the key barrier to entry is access to and an established relationship with a referrer of business. The Commissioner does not find the Federal Trade Commission approval of mergers, which are specifically cited in the Birnbaum Report, evidence of price competition in California. The standard for approval of a merger is whether the merger will lessen competition and does not determine whether the existing market is reasonably competitive. The commenter make a contradictory claim by criticizing the Birnbaum Report for considering profitability as one measure of the degree of competition since this is an aspect of the competition analysis specifically cited in the Merger Guidelines the commenter suggests should be followed. The commenter mischaracterizes the Birnbaum Report conclusion about base rate changes over time. The Birnbaum Report analyzed rate filings and rate changes over time and found not only little diversity among insurers in price, but virtually no change over time. In fact, the changes that did occur were rate increases for companies after a merger to make the acquired company's prices equal to the acquiring company's prices. The absence of price competition was evidenced not by a narrow range of prices among insurers at a particular point in time, but by the absence of change over time and the absence of any company to use a price change as a method for gaining more market share. The Commissioner finds the commenter's critique of the Birnbaum report unpersuasive and finds the Birnbaum Report to provide a sound basis for the finding that a reasonable degree of competition does not exist in the business of title insurance in California.

Summary of Comment, Pages 35-38: The commenter argues that the Birnbaum Report never tests whether the market is "reasonably" competitive and that criteria used for a "reasonably" competitive market is subjective and not based on basic economic principles. The Birnbaum Report's use of the term "workably competitive" is ambiguous, at best and fails to use economically-based criteria for determining "reasonable" competition. The commenter suggests that the proper criteria for determining whether markets are "reasonably" competitive is if consumers would likely be better off under that more regulated system. The Birnbaum Report fails to consider what would occur under a more regulated system or whether consumers would be better off under a more regulated system.

Response: The Commissioner rejects this comment. The commenter seeks to rewrite California statutes by defining the criteria for reasonable competition as whether consumers would be better or worse off with rate regulation. California statutes require the Commissioner to initiate regulation of rates under certain circumstances. By enacting this statute, the California Legislature determined the situations under which consumers would be better off with rate regulation in the business of title insurance – if a reasonable degree of competition does not exist and if the rate is unreasonably high for the insurance or other service provided. It is inappropriate for the commenter to attempt to substitute his views about the propriety of rate regulation for those of the Legislature. Birnbaum was not tasked to answer the questions the commenter raised about the benefits of rate regulation and the Birnbaum Report appropriately did not address that issue. The Birnbaum Report provided an extensive and meticulous review of the degree of competition in California title insurance markets – price competition and non-price competition – found substantial evidence that the reverse-competitive market structure is a major impediment to price competition and substantial evidence that the competition among title insurers and underwritten title companies and escrow providers does not lead to price competition. The Commissioner finds that the Birnbaum Report provides a substantial amount of empirical evidence to support its conclusions and that the commenter has provided little or no empirical evidence to support his conclusions.

Summary of Comment, Pages 38-41: The commenter summarizes the submissions of other commenters in this proceeding.

Response: The Commissioner has provided responses to the comments of these other comments elsewhere and need not repeat those responses here.

Summary of Comments, Pages 41-48: The commenter explains his view that rate regulation will likely harm California consumers.

Response: The comments are directed against rate regulation generally and not the specific provisions of the proposed regulation so no response is necessary.

Summary of Comment, Pages 49-50: The commenter summarizes his comments in a conclusion.

Response: The Commissioner has responded to these comments above and need not repeat the responses.

Summary of Comment, No Page Number: The commenter provides charts and tables referenced in the text of his comments.

Response: The charts and tables are discussed in the text of the comments and the Commissioner has responded to those comments above. No further response is needed.

Summary of Comment, Exhibit 1: The commenter provides his resume.

Response: This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comment, Exhibit 2: The commenter provides a copy of his March 2006 report "An Economic Analysis of Competition in the Title Insurance Industry."

Response: The report is referenced and summarized in the comments summarized above and no additional response is needed.

<u>Bates pages 830-890 are the comments of Gregory S. Vistnes dated March 20, 2006, submitted on behalf of Fidelity National Title Group.</u>

All comments contained in this report are responded to when they are cited in other comments or reports, the comments are restated in later reports of Dr. Vistnes and those reports are responded to, or portions may not be specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations and require no response.

Bates pages 891-895 are the "Inconsistencies in Use of Defined Terms" submitted on behalf of Fidelity National Title Group.

Summary of Comment:

This comment consists of a table of inconsistencies in the use of defined terms within the proposed regulations.

Response to Comment:

The Commissioner has reviewed the list of inconsistently used terms and where he has found the comments to be well-founded, he has corrected those provisions in the November 27 changes. Where comments have not resulted in changes, it is because the Commissioner has found no inconsistency.

Bates pages 896 are the "Undefined Terms Within the Proposed Regulations" submitted on behalf of Fidelity National Title Group.

Summary of Comment:

This comment consists of a table of undefined terms within the proposed regulations.

Response to Comment:

See response to Common Comment X.21.

Bates pages 897-904 are the "Incorrect References" submitted on behalf of Fidelity National Title Group.

Summary of Comment:

This comment consists of a table of incorrect references and each entry shows the page number and section of the incorrect reference, the reference as drafted, and how the reference should be corrected.

Response to Comment:

The Commissioner has reviewed the list of references and where he has found the comments to be well-founded, he has corrected those provisions in the November 27 changes. Where comments have not resulted in changes, it is because the Commissioner has found no error.