International Journal of Finance, Insurance and Risk Management
Volume XIV, Issue 4, 2024

pp. 67-72

Top Three Underwriting Risks in Title Insurance: Identifying Risks and Implementing Internal Controls

Submitted 08/10/24, 1st revision 20/11/24, 2nd revision 06/12/24, accepted 30/12/24

Mr. Mert Ozbilgin[1]

Abstract:

Purpose: *This article aims to provide insights into three key underwriting risks and relevant internal controls for risk management and internal audit practitioners in the title insurance industry.*
Design/Methodology/Approach: *The article explores in detail the three key underwriting risks faced by title insurance companies and discuss the corresponding internal controls that practitioners may consider employing to effectively manage these risks.*
Findings: *There are several risks involved in drafting and submitting the policy during the underwriting process, which can have significant implications for the title insurance company. One major risk is the potential for human errors in drafting the title insurance policy. If the policy template is not properly designed to reflect the title research's findings accurately and completely, the title insurance company may be exposed to unexpected risks or liabilities. Another critical risk involves the use of ambiguous policy language. When the language in the policy is not clear and precise, it can lead to significant interpretation issues.*
Practical Implications: *When potential errors and fraudulent activities is identified and addressed at an early stage, title insurance companies can safeguard their financial stability, allocate their resources more efficiently and minimize the defalcation costs that may impact their bottom line.*
Originality/Value: *The disputes as explained in the article can be lengthy and expensive to resolve, further increasing the company's financial exposure.*

Keywords: *Title insurance, underwriting risks, risk management, internal controls insurance regulation.*

JEL codes: *G22, G32, K12, L84, M42.*

Paper type: *Research article.*

[1]*University of Malta, mmertozbilgin@gmail.com;*

1. Introduction

Title insurance companies face unique risks during their underwriting process, which includes assessing property titles, identifying potential legal disputes, and issuing title insurance policies to protect against losses arising from defects in the title. The effective management of these underwriting risks plays a crucial role in the success of title insurance companies.

By proactively identifying and addressing errors and fraudulent activities at an early stage, these companies can safeguard their financial strength and reputation. Therefore, it is very important for risk management and internal audit practitioners of title insurance companies to be knowledgeable in these risks and the corresponding control activities.

This article aims to provide insights into three key underwriting risks and relevant internal controls for risk management and internal audit practitioners in the title insurance industry. In the subsequent sections, the article will explore in detail the three key underwriting risks faced by title insurance companies and discuss the corresponding internal controls that practitioners may consider employing to effectively manage these risks.

2. Risk of Inappropriate or Insufficient Title Search

Performing a title search is a critical part of the underwriting process in title insurance. While it helps identify potential title defects and evaluate the insurability of a property, there are certain risks associated with carrying out a title search.

Firstly, the title search typically relies on the accuracy and completeness of information obtained from public records, land registries, and other relevant sources.

If the title search is incomplete or inaccurate or if this research relies on inaccurate and incomplete information obtained during the underwriting process, it can lead to the failure to identify potential title defects, liens, encumbrances, or restrictions.

The fact that the underwriter does not identify and highlight these circumstances in an accurate and complete manner can result in the issuance of a policy without a comprehensive understanding of the property's title history, which pose the title insurance company to higher risks of future claims and financial losses.

Furthermore, title searches are usually conducted within specific timeframes to meet transaction deadlines. The burden of completing the search within a limited time can result in rushed or inadequate searches, increasing the risk of overlooking a crucial information.

2.1 Potential Internal Controls

- The initial proposal including the preliminary premium ratio (also called "non-binding indications document") is standardized and includes a clause stating that the initial premium ratio is subject to changes in the event of new risks identified as a result of the title search to be conducted at later stages;

- The process for conducting title search requires the underwriter to use appropriate and reliable resources such as public records, surveys, and other relevant information sources to detect potential defects and risks;

- The company has certain procedures in place to document the results of the title search conducted clearly and in a standardised format. These results are subject to a review of a more experienced individual within the underwriting unit;

- The company has a structured procedure to engage in local experts who are specialized in legal requirements of the jurisdiction where the property is located, or the transaction takes place; and

- End-to-end underwriting training is provided to underwriting staff at the onboarding and on an ongoing basis.

3. Risk of Failing to Accurately Reflect the Underwriting Decision in the Title Insurance Policy

There are several risks involved in drafting and submitting the policy during the underwriting process, which can have significant implications for the title insurance company.

One major risk is the potential for human errors in drafting the title insurance policy. These errors can include inaccuracies in the policy terms, such as incorrect descriptions of the property, misstatements about the coverage limits, or errors in listing the covered parties. Such inaccuracies can lead to misunderstandings and disputes over what is covered under the policy and can ultimately result in costly claims and litigation.

Aside from human errors, If the policy template is not properly designed to reflect the title research's findings accurately and completely, the title insurance company may be exposed to unexpected risks or liabilities.

For example, if a lien is discovered during the title search but not properly noted and excluded in the policy because of the poor design of the policy template, the title insurance company might be liable for covering the lien, leading to substantial financial losses.

Another critical risk involves the use of ambiguous policy language. When the language in the policy is not clear and precise, it can lead to significant interpretation issues. For instance, there may be disputes between the policyholder and the title insurance company regarding the extent of coverage provided, the specific exclusions that apply, or the conditions under which the coverage is valid.

Ambiguity in the policy language can result in differing interpretations, which may lead to disagreements and potentially result in legal claims against the title insurance company. These disputes can be lengthy and expensive to resolve, further increasing the company's financial exposure.

3.1 Potential Internal Controls

- Underwriters utilize a standardised template when drafting the title insurance policy;
- Title insurance policies are prepared by an underwriter who is an expert in the language being used in the policy;
- The draft version of the policy is reviewed by a more experienced person. This review requires the reviewer to check the results of the title search against the policy;
- The company implements a policy approval procedure whereby new policies or amendments to existing policies require approval of an appropriate individuals (e.g., the Head of Underwriting Unit);
- The company invests in automation to streamline the policy drafting and delivery process, which will reduce the risk of errors or delays; and
- Training in policy drafting is provided to underwriting staff on an ongoing basis.

4. Risk of Internal and External Fraud

Fraud risk is a key risk that title insurance companies, like any other organization, may face during the underwriting process. Fraud refers to fraudulent activities committed by employees working within the company and/or external parties.

When it comes to the risk of fraud committed by employees, it can be said that underwriters might manipulate the risk assessment process to soften or disregard potential title defects. They may intentionally overlook critical information or misrepresent the severity of risks associated with a property to secure insurance coverage and avoid including red flags in their reports.

Regarding external fraud, external parties, such as sellers, buyers, or brokers, may engage in fraudulent property transactions to obtain insurance coverage for properties with defective titles or misrepresent the property's value or ownership details.

Furthermore, it is important to highlight that the Company’s underwriters may also collude with such external parties by providing false or misleading information, manipulating property values and ownership details, or participating in fraudulent property transactions to influence the underwriting decision internally and obtain personal gain.

External parties and underwriters involved in the underwriting process may falsify documents, including property titles and/or legal records with the purpose of deceiving the insurer during the underwriting process. This can lead to insuring properties with defective titles or incorrect information, resulting in financial losses and legal disputes.

4.1 Potential Internal Controls

- The company implements fraud detection systems, detection tools and techniques, such as identity verification and document authentication procedures;

- A structured procedure is designed to onboard and monitor in cases where the underwriting authority is delegated to an external party. An underwriting manual is required to be drafted between the company and the delegated underwriting authority. This manual should clearly determine underwriting limits and policy wordings;

- Onboarding checks (e.g., background checks, criminal records checks and reference checks) and continuous screening of employees involved in the underwriting process are carried out;

- The company encourages employees to report suspicious activities and there is rigorous process to protect whistleblowers; and

- Ongoing training and fraud awareness programs are organised for the employees involved in the underwriting process.

5. Conclusion

When potential errors and fraudulent activities is identified and addressed at an early stage, title insurance companies can safeguard their financial stability, allocate their resources more efficiently and minimize the defalcation costs that may impact their bottom line. By preventing errors and fraudulent activities at the underwriting stage, title insurance companies not only protect their financial interests but also preserve their reputation and maintain customer trust.

References:

Abdullahi, R., Mansor, N. 2015. Fraud Triangle Theory and Fraud Diamond Theory. Understanding the Convergent and Divergent for Future Research. International Journal of Academic Research in Accounting, Finance and Management Sciences, 5(4), 38-45.

ACCA Examining team, Forensic auditing. 2018. [Homepage of ACCA], [Online]. Available: https://www.accaglobal.com/ie/en/student/exam-support-resources/professional-exams-study-resources/p7/technical-articles/forensic-accounting.html.

Association of Certified Fraud Examiners. 2020. Who We Are, https://www.acfe.com/who-we-are.aspx

Atlas Insurance. 2020. Solvency and Financial Condition Report 2019.

Financial Intelligence Analysis Unit. 2019. Annual Report 2018. Luxembourg: Publ. Office.

Finance Malta. 2014. Insurance in Malta. Https://Www.Financemalta.Org/Sections/Insurance/.

Grima, S. 2019. Proportionality in the application of Insurance Solvency Requirements: The case of Small EU jurisdiction. 21st annual conference Modern Aspects of the Legal and Regulatory Insurance Concept. Palic Serbia, September, 222-233.

Malta Insurance Association. 2019a. Insurance Fraud. https://maltainsurance.org/what-is-insurance- fraud/ .

Malta Insurance Association. 2019b. Statistical Overview. https://mk0maltainsurantn807.kinstacdn.com/wpcontent/uploads/2019/07/MIA-Key-Facts-2018.pdf .

Legal References:

Laws of Malta. 1998. Insurance Business Act. Chapter 403. http://www.justiceservices.gov.mt/DownloadDocument.aspx?app=lom&itemid=8870 .

Laws of Malta. 1854. Criminal Code. Criminal Law edn. Chapter 9. http://www.justiceservices.gov.mt/downloaddocument.aspx?app=lom&itemid=8574 .