

OFFICE OF THE
NEW MEXICO PUBLIC REGULATION
COMMISSION
INSURANCE DIVISION



CERTIFICATE

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FILED

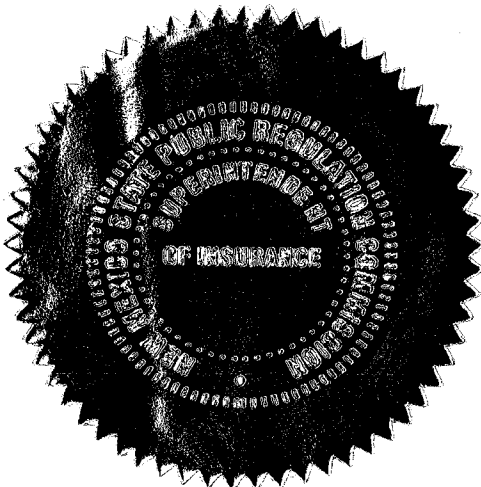
I, Morris J. Chavez, Superintendent of Insurance of the State of New Mexico, do hereby certify that the attached Report of Examination for the period ending December 31, 2006 on:

First American Title Insurance Company
1 First American Way
Santa Ana, CA 92707

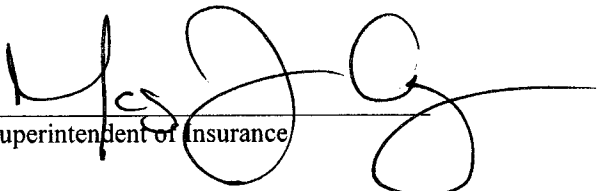
Was recently completed by *Richard Kramer*, Examiner-In-Charge with the Insurance Division.

Due consideration has been given to the comments of the Examiner regarding the financial condition and business affairs as reflected in this report.

The report as of this date is hereby adopted, filed and made an official record of the Division.



In Witness Whereof, I have hereunto set my official seal On this 19th day of July, 2007 A.D.


Superintendent of Insurance



LIMITED SCOPE EXAMINATION REPORT OF THE
FINANCIAL CONDITION AND MARKET CONDUCT OF

FIRST AMERICAN TITLE INSURANCE COMPANY

FOR PERIOD JANUARY 1, 2005 THROUGH DECEMBER 31, 2006

CONDUCTED BY THE NEW MEXICO PUBLIC REGULATION
COMMISSION INSURANCE DIVISION

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SALUTATION

May 10, 2007

The Honorable Morris J. Chavez
Superintendent of Insurance
New Mexico Public Regulation Commission
Division of Insurance
1120 Paseo de Peralta
Santa Fe, NM 87501

Superintendent Chavez:

In compliance with instructions and pursuant to statutory provisions, a limited scope examination of the financial condition and market conduct has been conducted of:

First American Title Insurance Company

hereinafter referred to as the "Company" or "First American".

The on-site phase of the examination was conducted at First American's Albuquerque divisional office located at 9400 Holly Avenue NE, Albuquerque, NM 87122.

The report of examination thereon is respectfully submitted.

SCOPE OF EXAMINATION

This report was prepared by independent examiners contracting with the New Mexico Public Regulation Commission Division of Insurance (NMPRC) for the purpose of auditing certain business practices of insurers licensed to conduct the business of title insurance in the State of New Mexico. This procedure is in accordance with NMSA (1978) § 59A-4-5 which empowers the Superintendent of Insurance to examine insurance companies. The findings in this report, including all work products developed in the production of this report, are the sole property of the NMPRC.

The purpose of this limited scope financial condition and market conduct examination was to review the Company's arrangements with captive reinsurance companies and to verify payments made to New Mexico policyholders as a provision following the Company's settlement with the Colorado Division of Insurance investigation.

The title insurance industry has been under scrutiny for several years. It started when an investigation conducted by the Colorado Division of Insurance uncovered a payment arrangement between title companies and captive insurance companies. First American was just one of the many companies investigated. In general, homebuilders, banks and realtors create their own reinsurance companies. They agree to refer all of their business in a particular geographic area, such as a subdivision, to certain title insurers, provided the title insurer agrees to "reinsure" with their wholly-owned reinsurer. In exchange for the reinsurance, the builder, lender or realtors' reinsurance company splits the premiums. The investigation asserts these reinsurance premiums are nothing more than premium discounts given to large builders and lenders in exchange for their business.

First American reached a settlement agreement with the Colorado Division of Insurance during February 2005 ending an investigation into the Company's captive reinsurance arrangements which were with homebuilders only. As a condition of the settlement, the Company agreed to pay a total amount of approximately \$24 million to affected policyholders in the eight states in which the Company had captive reinsurance agreements. This payment included approximately \$635,000 paid to New Mexico policyholders whose policies were reinsured by First American. It should be noted that as a business practice in New Mexico, the seller, in this case the home builder of the property, will purchase an owners' policy for the buyer. The Company also agreed to cease participating in captive reinsurance arrangements and terminate all its captive reinsurance agreements.

File sampling was based on a review of escrow files that were systematically selected by using ACL, a licensed statistical software program. Sample sizes were chosen based on guidance from procedures developed by the National Association of Insurance Commissioners.

COMPANY PROFILE

First American, a California domiciled title insurance company, is a wholly-owned subsidiary of The First American Corporation, an insurance holding company also domiciled in California. The First American Corporation is a FORTUNE 500 company traded on the New York Stock Exchange. The First American Family of Companies operates within five primary business segments: title insurance and services; specialty insurance; mortgage information; property information; and First Advantage. The Company is the largest subsidiary of The First American Corporation.

The Company is engaged in the title insurance business on both a nationwide and international basis. Nationally the Company is licensed in 47 states, District of Columbia, Guam, US Virgin Islands and Puerto Rico, and actively writes in all jurisdictions. The states excluded are Iowa, Kansas, and New York. The Company operates internationally and is currently authorized to provide title insurance coverage in the Bahamas, Canada, Caribbean, Hong Kong, Korea, and Mexico.

The Company is authorized in New Mexico and was first licensed in this state on September 5, 1969. The Company wrote direct premiums of \$31,963,854 and \$29,344,457 during 2006 and 2005 respectively.

PERTINENT FACTS OF THE CURRENT EXAMINATION

Complaints

In response to a prior examination, the Company began maintaining a separate complaint file for each year, which includes the written complaint and the response to the complaint. However, no formal log is maintained. The failure to maintain a complaint log is an apparent violation of NMSA (1978) § 59A-16-22 and NMAC 13.3.7 through 13.7.3.12.

It is recommended that the Company begin maintaining a register of complaints pursuant to New Mexico statutes.

Internal/External Audits

In response to the examiner's request for information regarding internal and external audits, the Company stated that, as required by NMAC 13.14.4.11, it has an agreement with an independent certified public accountant to perform the required annual review. The review procedures include the examination of escrow files. In addition, the Albuquerque divisional office personnel review escrow files when issues come to the attention of management.

Underwriting and Rating

A review was performed of policies for which risk was ceded through arrangements with two captive reinsurers identified in the settlement reached with the Colorado Division of Insurance during 2005. The review established that reinsurance arrangements existed with Westview Company through KB Homes and First American Homebuilders Reinsurance Company through Artistic Homes.

Random samples of policy files were reviewed to verify whether refund checks were processed for appropriate amounts based on correctly calculated premiums and to determine compliance with NMAC 13.14 and NMSA (1978) § 59A-30. Documents included in this review were the Disbursement Summary Report, Fee List, and HUD-1 Final Statement.

A random sample of 50 policy files out of a total population of 784 for captive reinsurer Westview Company was reviewed. The examiner determined that the premium for 49 was incorrectly calculated resulting in an error ratio of 98% and an overpayment of \$4,823 for this sample alone. It was noted that the same escrow agent completed each of the files in the sample. Assuming the same agent was responsible for all 784 policies issued through KB Homes, the amount of overpayment would be significantly greater. The failure to calculate and charge the correct premium is an apparent violation of NMAC 13.14.9.18. In re-calculating the reinsurance premium refunds, it was determined that the variance resulted in an overpayment of refunds in some instances due to policies having been issued prior to the date of the reinsurance agreement, and in underpayment in some cases due to different amounts used in the calculations for the endorsement fees.

A random sample of 50 policy files out of a total population of 1,655 for captive reinsurer First American Homebuilders Reinsurance Company was reviewed. The examiner determined there were 5 premium calculation errors resulting in an error ratio of 10%. One error was the result of incorrectly using the 2003 premium rate schedule instead of the 2002 schedule. Four errors were the result of failure to round up on the liability per thousand pursuant to NMAC 13.14.9.14. In re-calculating the reinsurance premium refunds, it was determined that the variance resulted in an underpayment or overpayment in some cases due to different amounts used in the calculations for the endorsement fees.

It is recommended that an audit be performed by the Company on all policies issued through KB Homes during this period to determine the amount of overpayments received. An overall recommendation is proposed that procedures be written and implemented providing for internal review of closing statements on a random basis to verify premium calculations.

The Company maintains that the term “refunds” suggests that customers whose transactions were reinsured were charged more than customers whose transactions were not reinsured and as a result, were due a refund or payment in an amount equal to the suggested overpayment. The Company further maintains that all of its customers were charged according to the same rate schedule and that its payments to consumers whose transactions were reinsured represented a disgorgement of reinsurance premiums and not a refund of excess premium.

Reinsurance

The Company has provided reinsurance agreements where business is written in New Mexico. As a condition of the settlement reached with the Colorado Division of Insurance during 2005, the Company has agreed to cease participating in captive reinsurance arrangements. The Company provided letters “suspending the placement of any additional policies of title insurance” addressed to the parent company of each of the reinsurance company. The parent company of each captive insurer was the home builder. The Company could not provide notices of termination to any captive insurers.

A review of Schedule F – Part 2 of the 2004 Annual Statement disclosed the Company did not complete this schedule in accordance with the NAIC Annual Statement Instructions Manual and is an apparent violation of NMSA (1978) § 59A-5-29.A. There were ceded reinsurance agreements with six non-affiliated captive companies for which there was no Federal ID or NAIC company code included. It was also noted that the domiciliary jurisdiction listed for these five of the six companies was incorrect. A review of the 2005 and 2006 Annual Statements disclosed Schedule F to be correct and complete.

SUMMARY

FINDINGS

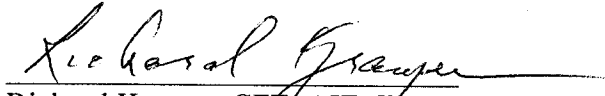
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|----|--|---|
| 1 | <p>NMSA (1978) § 59A-16-22: An insurer shall maintain a complete record of all complaints it has received during the next preceding three years, or since date of last examination by the superintendent or other similar supervisory authority, whichever period is shorter. The record shall show the total number of complaints, classification by line of coverage, nature of each complaint, disposition of the complaint and time it took to process each complaint. For purposes of this section "complaint" means any written communication primarily expressing a grievance.</p> <p>NMAC 13.7.3.8: NMAC 13.7.3.11 sets forth the minimum information required to be contained in an insurer's complaint record in order to comply with the statute. Refinements and additions to the information specified may be maintained in the complaint record. NMAC 13.7.3.12 contains an explanation of the various headings, codes and other notations contained in NMAC 13.7.3.11. The codes are used in order to simplify both the classification of the action underlying the complaint and the keeping of the records.</p> | 4 |
| 50 | <p>NMAC 13.14.9.18: Premium rates for original owner's policies shall be in effect from July 1, 2005 until modified by the Superintendent. A different table appears in the regulation for each year during the scope.</p> | 4 |
| 4 | <p>NMAC 13.14.9.14: To compute any charge on a fractional thousand dollars of liability, consider any fraction of one thousand dollars as a full one thousand dollars.</p> | 5 |

ACKNOWLEDGEMENT

The examiner in charge would like to acknowledge that the Company's personnel were cooperative and helpful during the examination process.

The examination was conducted by the undersigned and Ann McClain, CIE, FLMI, FLHC, AIC, CCP, AIRC, AIAA, ARA, ACS, AIS and is respectfully submitted.



Richard Kramer, CFE, AIE, FLMI
Examiner-In-Charge