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'Risk aversion will continue with the economic recovery'

Secure Legal Title is the only entity in the Lloyd's market writing title insurance on a direct basis in Europe

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Title insurance, which covers both known and unknown legal risks associated with private property or commercial real estate transactions, has been available in Europe for the past 15 years. But while the market in Europe is nowhere near the size of the US, it is expected to grow significantly over the next few years as a result of a number of developments in the region.

To a large extent, the model for the expected growth of the title insurance market in Europe is the US, where the market is close to 130 years old. Indeed, title insurance is so prevalent in the US that Sean Dalton, co-founder and chairman of Secure Legal Title (SLT), a Lloyd's-based company specialising in title insurance, which celebrated its first anniversary in October this year, describes it as near to being a compulsory insurance. "It is bought as a matter of course in every real estate transaction because the banks and mortgage companies insist on it. The situation in the UK and Europe is, of course, very different," he says.

But Europe has experienced some significant developments in recent years. There is the increasing interest shown by international banks and investment funds in central and eastern Europe (CEE) and the changes in the regulatory landscape being wrought by Basel III and, more recently, by the Alternative Investment Fund Managers Directive, which came into force over the past three months. This means banks and real estate funds now have to provide a much greater degree of assurance about the quality and security of their invested assets than was the case previously.

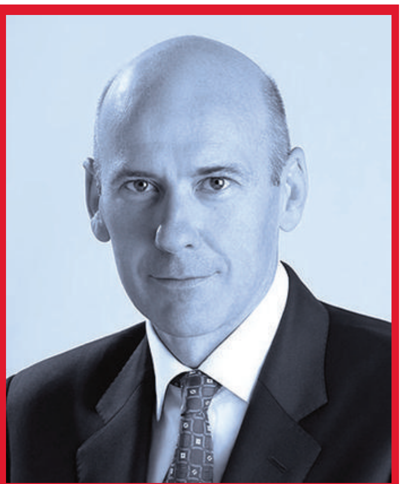
First anniversary

If that investment happens to be real estate, there is nothing more reassuring than a title insurance policy, according to Dalton. SLT writes a large part of its business in Poland and Romania and is in the process of expanding into other countries in the CEE region. Title insurance is still relatively new in western Europe – in the past people had always assumed because a cadastral system (regional registries that detail the size, value and ownership of land holdings, typically for tax purposes) was in place there was little need for title insurance, but this is changing as investors conduct more intensive due diligence.

However, in the UK a very defined form of title insurance – a legal indemnity cover for risks mainly associated with residential property transactions – is doing very well and generates premium income of between £100m ($161m) and £125m a year. This compares with a premium income approaching €75m ($101.33m) for the whole of continental Europe, where the cover is structured more along the lines of the US model and almost entirely focused on commercial real estate transactions.

"There are no strict definitions in terms of what the cover is called. But there is quite a big market for that kind of legal indemnity cover here in the UK. Nowadays, people buying and selling houses are much more used to the idea of buying such a policy. And for insurers, mainly the big composites such as Aviva, RSA, CLI, CRS and Zurich but also including smaller agencies, it is very much a volume-orientated business, which is why we don't write that business. There are other companies that can do it much better than we can. We generally become involved as part of a process of commercial acquisition or disposal. This usually involves a number of complex and complicated issues, which are different depending on where you are. We prefer to work with the difficult cases. That is the space in which we prefer to operate."

Sean Dalton CV



Sean Dalton is a former chief executive of Liberty Syndicates Management, one of the largest managing agents at Lloyd's. Dalton is also a former member of the Council of Lloyd's. Dalton's experience includes the start-up of new insurance businesses, including Lloyd's syndicates and managing agents and also the role of non-executive director.

Dalton has significant experience of governance matters, both as chief executive and non-executive, having been chairman of a Lloyd's managing agent audit committee and a member of the Lloyd's audit committee.

During his career at Liberty Syndicates, Dalton was responsible for the development and ongoing management of the legal indemnities and title insurance account for that company. This encompasses all areas of the business, as well as the oversight of the coverholders involved. Dalton is also a trustee of a UK charity, Cardboard Citizens.

The US title insurance market generates an annual premium income widely thought to be more than $10bn but Jean-Bernard Wurm, co-founder and managing director of SLT, takes the view this figure is down on pre-2008 numbers. "At the time a lot of people were refinancing their mortgages and every time they refinanced, they had to purchase a new title insurance policy. At one point, the size of the market was thought to be more than $12bn, but that was pre-crisis, so the market in the US is down a bit but it is growing again as economic activity recovers."

Restitution

While title insurance typically mitigates the risks relating to planning and building permissions and zoning regulations in a real estate transaction, it also provides protection against defects in land title, a significant problem for investors in central and eastern Europe. According to Wurm, even in a relatively mature market such as Poland, investors continue to be concerned about two issues: restitution of assets, including properties, and negligent or "sloppy" privatisations.

"Restitution is an issue which stems from the German occupation of the region during the Second World War, as well as from the confiscation of private property that occurred during the communist period. The vast majority of the privatisations in the region in the very early 1990s were very badly managed. They were done in a hurry. For example, if a co-operative sold a piece of land, the buyer will need to prove the co-operative is the rightful owner of the land. It might be it had the right to use the land but did not own it. You are quite often presented with property sale documents where the official who signed the document cannot be traced or identified and there is no indication whether that particular official had the authority to dispose of those properties. You have cases where certain ministries disposed of assets they had no right to dispose of. We often insure transactions where the buyers have no way of verifying whose signature it is that authorised the sale of a piece of state-owned land 20 years ago."

Wurm adds in countries like Poland, the Czech Republic and Romania most banks, investors and real estate lawyers know about title insurance. "It has become a standard product over the past 15 years," he says.

LandAmerica and Fidelity

Wurm is a former investment banker who specialised in real estate investment and who, in the middle of the last decade, headed the European sales operations of LandAmerica and Fidelity National Title, two of the largest title insurance groups in the US. However, LandAmerica and Fidelity, for different reasons, respectively withdrew from the European title insurance market in 2007 and 2010.

Indeed, it was Fidelity's decision to exit the market that made it possible for SLT to be set up in London in October 2012 by Wurm and two other partners. These partners were Dalton, a former chief executive of Liberty Syndicates, one of the first companies in the Lloyd's market to write title insurance; and Joel Peck, a lawyer and investment banker who, together with Wurm, managed the international operations, including the European operations, of LandAmerica and Fidelity Title.

But in April 2010 Fidelity had a change of heart and closed most of its operations outside North America. "It kept its Mexican, Canadian and Puerto Rican operations, but closed down Asia, Europe and Brazil, so that was when the three of us got together and decided there was still a thriving business opportunity there. We had clients and we had a number of deals in the pipeline. We felt there was a reason to continue with it and that was how we came to set up SLT a year or so later," Wurm says.

Lloyd's

Once Fidelity decided to exit the European title insurance, it was agreed among the partners that the new venture, structured along the lines of an MGA, would get its underwriting capacity from Lloyd's. Indeed, Secure Legal Title, which has FSA approval as an appointed representative of a Lloyd's coverholder, operates under a binding authority which is led by Catlin Syndicate 2003. Canopius, Liberty and Catlin are among the few syndicates in the Lloyd's market which write title insurance. A few other syndicates write title business from both the US and Europe on a reinsurance basis. According to Dalton, no Lloyd's entity other than SLT provides title insurance capacity in Europe on a direct basis.

"Lloyd's is a differentiating factor for us. No-one else in the market is writing this kind of business in Europe. Geoffrey Lynch and I, our heritage, our tradition is Lloyd's. I have been in the market all my life and able to talk to people in the market about this strange class of business. I also liked the idea of the long history of Lloyd's balancing the long-term nature of our policies. Some of our policies provide cover in perpetuity. These are in the minority, but generally, they last for the length of the buyer's interest in the property."

Lloyd's, Dalton says, traditionally deals with difficult, complex risks. "And you come across some very difficult issues in the title insurance, particularly in countries such as Romania, Poland and Hungary. I remind clients we have got the tradition of Lloyd's behind us. We have the skill-sets and are quite happy to deal with these issues. We insured one risk where there had already been notice of a restitution claim, something most of the market would run away from. Because we can think about it flexibly, we were able to deal with it. It took a long time but we were able to put together a policy for the client."

The title insurance market in eastern Europe is relatively competitive, with two of the big US title insurers, which have been there for 12 to 15 years, providing most of the competition. "They are well established in the market. We are very much the new kid on the block," Wurm says. But SLT is the only entity in the market that offers Lloyd's capacity, which, according to Wurm, is a selling point, not least because Lloyd's has a higher financial strength rating than all the US title insurers.

Due diligence

Dalton says due diligence and moral hazard are huge issues for the title insurance market. "We have to work out what the motivation is for the buyer to buy the policy. We want to avoid a situation where somebody knowingly buys a piece of land or a property which is completely tied up with all sorts of covenant issues or with claims, so one of the key tests is always find out who the buyers and sellers are and who their advisers are. The motivation of the policyholder is a very important issue. As the insurer, you would hope and expect the policy is required to facilitate a transaction, as part of the process of providing the normal representations and warranties required by a commercial transaction. And the acquisition of the property is required to serve a specific purpose. These, for us, are usually the right clients."

Wurm says SLT usually provides cover for major real estate acquisitions by multinational groups. "These companies will hire a major international law firm to do the due diligence, so we are dealing with companies we know and when they ask for title insurance we normally don't have to try to guess what their real motivations are. Our underwriters will review the due diligence of the buyer and in certain cases we may ask for further third-party opinions."

According to Wurm, this typically involves another law firm, based in the country concerned, to provide SLT with an opinion on the conclusions of the first due diligence. "We also have the option of consulting a legal expert if there is a grey area in terms of the local laws to get an opinion. But the starting point for us is we will not do anything without a complete due diligence package from the buyer's law firm."

Dalton says the only time SLT does not necessarily do a thorough due diligence on every property is when it provides cover for a programme or portfolio of business. "We would talk to the buyer about the portfolio and take the list and do our own sampling. We would still expect some measure of due diligence from the buyer – anything that is important or controversial about the portfolio. But we save the time and expense of doing the due diligence on every single one of the properties and provide them with a policy that covers the whole portfolio. However, for us, the normal insurance ground rules apply. These include the spread of the risks, the various localities and so on. These factors very much come to the fore. And you can get a good feel for the overall level of risks presented by a portfolio."

Prospects

In terms of the future development of the title insurance market in Europe and the UK, Dalton points to the ruling in the *Highcross v Heaney* "right to light" case two years ago, when the court found in favour of and awarded huge damages to the claimant, who sued a property developer because the construction of a building near the claimant's apartment block obstructed the flow of natural light into the apartment. "Over the past couple of years the demand for right to light insurance policies by developers have gone through the roof," he says.

In terms of another positive development, Wurm is hopeful the economic recovery in the eurozone will see the return of the European real estate securitisation market, which collapsed during the financial crisis. Indeed, just before the market collapsed, Wurm, who was working for LandAmerica at the time, was involved in a €7bn property securitisation deal in Germany, the largest such deal in Europe. "We insured the mortgages. When that market comes back, it will represent a good source of business for us. Depending on how fast the securitisation market recovers and how the regulators respond, that growth could be substantial and relatively fast."

Dalton agrees. "One of the reasons we started SLT was because we thought risk aversion would continue with the economic recovery. I can't see why people would become less risk averse. Why would they want to take on extra risks over the next five years? I just don't see it. And banks are a huge influence in this business. Of course, different banks have different appetites but we are certainly seeing things where five years ago, the attitude would have been: let's not worry about this and go ahead with the deal. These days, the attitude of banks is very different." ■

"I can't see why people would become less risk averse. Why would they want to take on extra risks over the next five years?"

Sean Dalton
Secure Legal Title

Jean-Bernard Wurm CV

Jean-Bernard Wurm has considerable experience of the the European and US property markets as a real estate investment banker and private equity investor.

Before the launch of Secure Legal Title, Wurm was responsible for the European sales operations of the largest title insurance companies in the US. In this capacity, Wurm managed the underwriting and sourcing of insured deals in Bulgaria, Croatia, the Czech Republic, Denmark, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Poland, Romania, Russia, Slovakia, Slovenia, Spain, Ukraine and the UK. Furthermore, he represented the only non-Russian insurance company to have provided title coverage for acquisitions and mortgages in Russia and the only Western insurance company to have written title insurance policies in Ukraine.

Wurm is fluent in English, French and German, with a working knowledge of Italian.