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Uncertainty and opportunity in the Mexican title insurance market

With consolidation and the growing influence of Lloyd's in the market, title insurance is evolving to take a broader approach to property risk

Sector demand for title insurance in Mexico is around 60% for hotels and resorts



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Secure Legal Title

In the US, title insurance is used to cover legal risk for every property purchase and bank mortgage. When title insurance was launched in Mexico more than 10 years ago by US title insurers, the idea was to provide the same level of security for cross-border investment, particularly as Mexico was perceived as carrying greater title risks.

This gave rise to a demand for title insurance by property developers, equity investors, residential buyers and, perhaps most important, mortgage lenders.

The introduction of two major financial instruments by the Mexican government increased demand for title insurance, with the client base shifting from 100% American to approximately 50% Mexican and 50% American and other foreign investors.

First, Mexico introduced Fideicomiso de Inversión en Bienes Raíces (Fibras), investment trusts dedicated to the acquisition and development of real estate in Mexico held for leasing.

Similar to real estate investment trusts in the UK and the US, Fibras became significant vehicles for tax-advantaged investment in income-producing properties, both for Mexican and foreign investors.

As trustees of their clients' investments, Fibras became significant customers for title insurance.

Second, the Mexican financial regulator introduced Certificados de Capital de Desarrollo (CKDs) to provide a type of structured equity security for investment by the Mexican mandatory pension funds (Siefos) in private equity, infrastructure and real estate projects. Previously, Siefos had been prohibited from such investments. As fiduciaries for the pensions, Siefos are risk-averse and also became significant purchasers of title insurance as a risk mitigation tool.

While Fibras and CKDs were introduced as far back as 2010, over the last few years, revised versions of these instruments have sparked the interest of international and national investors to invest in Mexican infrastructure.

Consolidation

Over the past five years, while the demand for title insurance in Mexico has been growing, the industry itself has consolidated. At the same time, driven by Mexico's turbulent relationship with the US – and the 35% decline in the Mexican peso against the US dollar – there have been major shifts in real estate investment

toward hotels and resorts and away from the industrial sector.

However, while the Mexican title insurance market was growing, with CKDs and Fibras becoming major new customers, US title insurers started to lose interest in international business in general and in Mexico in particular.

First, Fidelity National Title, as part of its plan to divest all its international operations, sold its Mexican insurer (now rebranded Armour Secure Insurance) to London-based Trebuchet/Armour Group. Armour Secure Insurance continues as the largest Mexican title insurer, with its policies reinsured by Secure Legal Title at Lloyd's. Then, First American sold its Mexican insurer, which subsequently discontinued operations.

In March 2018, Fidelity National Title, with 32% market share in the US, announced the acquisition of Stewart, with an 11% share. This merger will result in a major consolidation of the US title insurance industry and may impact Stewart's international operations, including in Mexico.

With the exit of the two largest US title insurers, and with the growth of UK-owned Armour Secure Insurance, reinsuring at Lloyd's, title insurance is evolving in Mexico to take a broader approach to property risk.

Title underwriting in the US, and therefore in Mexico, is an exercise in risk elimination, with the underwriters rectifying title defects, or excluding cover for

them, before issuing the title insurance policy. In contrast, title insurance in Europe may cover both non-disclosed, or hidden defects, as well as identified defects.

In Europe, title insurance is something of a misnomer. The policies often cover legal risks relating to real estate sales and purchases and financing which have nothing to do with ownership title to the property.

Such risks may arise out of defects in planning and zoning, or building and occupancy permits. And, in addition to traditional real estate, the policies may cover energy and alternative energy projects as well as infrastructure projects. The policies may even cover title to shares in property-owning firms, including authority and capacity of the seller to sell.

Mexico claims experience

Despite the differences between the US and Europe, claims experience has been remarkably similar. Title insurance claims typically arise from third parties challenging the insured's property ownership or the property's planning permission or permits. Costs generally are for legal expenses to defend against these challenges; limits losses are rare; and with direct access reinsurance, claims are managed by the reinsurers.

Many of these challenges are opportunistic rather than substantive, with the third party seeking to extract a ransom from the insured.

Finally, although title insurance policies generally cover the insured for the period of the insured's interest in the property, claims in all these markets tend to arise in the first three years following inception.

With the arrival of Donald Trump as the US president, there is increasing uncertainty about the North American Free Trade Agreement and the future of US investment in Mexico. The Mexican peso has plummeted.

The net result has turned out to be mixed. While investment in the industrial sector has dropped as US companies wait for a resolution of the crisis, the weak peso has encouraged investment in the hospitality sector. Resort developments are booming, driving both cross-border and domestic institutional investment and mortgage lending, as well as residential purchases.

Today, sector demand for title insurance is roughly 60% hotels and resorts, 25% residential (generally out-sales of condominiums and villas at resort developments) and 15% industrial and office.

Further, with the privatisation of the Mexican energy sector and the development of alternative energy projects, the market for title insurance in Mexico may expand beyond traditional real estate, as it has in Europe. ■

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