

# 30th India Fellowship Seminar

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RERA Act - need for new insurance products - provisions of the RERA Act,  
insurance needs of the property developers, title insurance, Inherent defects  
insurance - coverages, rating factors, pricing and reserving challenges

- Presenters: Arun Vijay, Ryan Rakitha Samaratunga, Kunal Kishore Jha
- Mentor: Saket Singhal



Institute of Actuaries of India

# RERA Act: Reforming Real Estate market



- Real estate accounts for about 12-15% of India's GDP
- Landmark legislation that pushes for transparency, protection of interests of buyers and accountability in the real estate sector
- Decentralized implementation, legislation by states/union territories, regulated by state Real Estate Regulatory Authorities



# RERA Act: Intended Impact



- **Benefits visualized for home buyers**
  - Eliminates one-sided agreement, buyer exploitation, unfair trade practices
  - Prevents diversion of funds and protects buyer's interests
  - Equal rate of interest paid by developer and buyers in case of delays or default
  - Fast track dispute resolution
- **Benefits visualized for developers**
  - Entry barrier against fly-by-night operators
  - Improve confidence of customers, financial institutions
  - Growth, development of the industry
  - Promotes investment

# RERA Act: Creating Insurance demands



- Chapter II Point 4-I
  - Declaration supported by an affidavit by promoter regarding legal title to the land
- Chapter III of the Act (Functions and Duties of Promoter)
  - Obligation on promoter to rectify structural defect or any other defect in workmanship, quality or provision of services reported within a period of five years
  - The promoter shall obtain all insurance notified regarding (i) title of the land and building as a part of the real estate project; and (ii) construction of the real estate project

# Real estate: Insurance needs



Stakeholders	Insurance products
Developers	Erection all risk, Contractors all risk, Commercial general liability, Workers Compensation, Contractor's Plant and Machinery, Title Insurance, Inherent Defects Insurance
Allottee	Building and Contents
Financiers	Mortgage indemnity

# Title Insurance: Need



- Real estate is one of the fastest growing sectors in India
- Increasing participation by the organised sector

## What is Title Insurance?

- Title is the legal ownership to property
- Obtained when the owner of property signs a deed in favour of the buyer
- Not all Titles are 'clean'
- Title Insurance protects against any defects in the title of the land that compromise the insured's ownership rights of the property



# Title Insurance: Uniqueness



- **Long-term product:** not uncommon for coverage in perpetuity;  
Recommended policy term of 7 years in India
- **Claims-made:** covers a risk that has happened in the past, but is unreported on the issue date
- **High operational costs:** globally loss ratios around 5-10%
- **Cyclical nature:** demand is highly dependent on strength of real estate market
- **Claims incidence:** most claims are incurred in first 2-3 years; long-tail
- **Wide market:** primarily a commercial product; potentially a large retail market

# Title Insurance: Current State



- Miscellaneous class of business by IRDAI
- Strong customer appetite for Title Insurance
- Limited local pricing expertise
- Scarcity of specialised talent for Title Insurance administration and underwriting
- Infrastructure for Title registration and recording still developing
- Reinsurers driving supply and spearheading pricing
- Handful of primary insurers currently engaged with very low risk retention



# Title Insurance: Product



- Insurer agrees to defend the insured against 3<sup>rd</sup> party claims and litigation
- **Common defects:** (1) fraud, forgery (2) Recording errors (3) Erroneous description of land (4) Outstanding taxes and liens (5) Restrictive covenants on Title limiting the use of land (6) Invalidity of documents
- Policy lapses if the entire land is sold to a 3<sup>rd</sup> party. In apartment developments, benefits of Title Insurance are automatically allocated to the allottees at time of transfer of possession
- At policy issuance, insured must: (1) disclose all material information (2) Agree that the information submitted is true and accurate



# Title Insurance: Underwriting



- Most important function as each policy will have to be individually underwritten
- Title Servicing Administrator (TSA)
  - 30 year history of the land's transactions
  - Detailed Title checks and legal due diligence reports
  - Digitise records and maintains them in Title Plant
  - Standardise approach to achieve operational efficiencies
  - Coordinate entire claims defence between lawyer, reinsurer and insurer
  - Not an IRDAI regulated entity as TSA is approved and managed by reinsurer

# Title Insurance: Ratemaking



- Premium = Loss & LAE + Acquisition/Operating Expenses + Profit Contingency  
- Investment Income
- Globally, loss 5-10% and expense 80-90% of premium
- **Rating factors:** (1) Sum Insured. (2) Policy duration. (3) Geographic location. (4) Due diligence report findings. (5) Co-insurance/deductible
- **Expenses:** (1) Maintaining title plant. (2) Search and examination of titles. (3) Resolving existing defects. (4) Policy issuance. (5) Distribution commissions. (6) Marketing costs.
- **Add-ons:** (1) Annual escalation in land value. (2) Business interruption cover

# Title Insurance: Accounting and Reserving



- All premium collected at issuance
- High acquisition costs: (1) leaves less money for reserves. (2) Deferring acquisition costs is not allowed by IASB as in IFRS.
- Premium earning method: (1)  $1/n$ : evenly over policy term. (2) Front-load earning: align with claims incidence.
- Reserving challenge:
  - New product; scarcity of data and benchmarks
  - Expected loss ratio method will potentially be most widely used
  - Policy year classification recommended

# Title Insurance: Succeeding in the Market



- Government initiatives to digitise all Titles and land surveys (National Land Records Modernisation Programme)
- Understand regional differences in real estate practices and customs
- Develop and train specialised Title Service Administrators, Agents and Litigators
- Maintain internal Title Plants containing more richer information Increase awareness of product benefits through strategic marketing and lobbying
- Insurers must gather more data before they retain higher level of risk



# Inherent defects insurance: Need



Strongly felt need brought to the spotlight by RERA act

- Inherent defects can manifest long after transfer of property
- PI and contractual warranties do not offer complete protection
- Trust deficit from buyer's POV
- Unfair premium for quality
- RERA requirements



# Inherent defects insurance: Value



Big demand from customer groups after RERA because IDI offers better cover

- Protects against financial risk from
  - Physical damage from inherent defect
  - Demolishing and removal of debris
  - Professional fees
  - Additional costs of repair and strengthening
- Long duration cover: 5 years but can be extended up to 10 years.
- First party policy: Proof of legal liability is not required
- Freely Assignable: To future tenants or purchasers
- Non cancellable



# Inherent defects insurance: Indian Market



- Evolving legal environment
- Increase in demand in near term
- Future outlook influenced by trends in real estate market
- Supply gap and skill gap yet to be bridged
- Regulatory interest to keep rates fair & manage risks
- Few insurers have started underwriting
- Reinsurance support essential





# Inherent defects insurance: Conditions



Managing risks and protecting against adverse selection through exclusions and conditions

- Non structural damage excluded
- Some consequential losses excluded
- High deductible to manage cost of claim
- General exclusions like war and allied perils, extended nuclear risks, wilful acts and gross negligence, terrorism
- Other special exclusions like non standard material, improper use, inadequate maintenance, known defects etc
- Prevent of accumulation by excluding subsidence, flooding etc
- Technical inspection mandatory
- Indexation, subrogation apply



# Inherent defects insurance: Rating and underwriting



- Indemnity basis; repair defect, take remedial action. Sum insured is the actual value of insured property.
- Rating factors
  - Characteristics of property
  - Characteristics of construction
  - Characteristics of property developer/contractor/designer
  - Geology /location
  - Experience rating
- Underwriting heavy
  - Differentiate contractors that are new/low reputation
  - Mindful of legal requirements, fairness to policyholders
  - Known losses exclusion
  - Technical inspection



# Inherent defects insurance: Pricing challenges



- Scarcity of data: reinsurer driven
- Long duration: capital cost, investment return, recoveries and subrogation uncertain
- Heterogenous risks
- Economic and systemic risks
- Uncertainties in legal and regulatory environment
- High expense ratio & operational costs



# Inherent defects insurance: Reserving challenges



- Data challenges: Actuary needs to be mindful of
  - Scarcity of data
  - Lack of benchmarks
- Actuary has to assess if
  - Has access to expertise, skills and knowledge
  - Should mitigate risks while reserving
- Analyse and understand the idiosyncrasies
  - What is the accident date?
  - Definitions not consistent for construction defect
  - Long duration of cover
- Traditional claims reserving techniques not appropriate: so a mix of approaches
- Actuarial control cycle, compliance with standards



# Conclusion



- RERA act has a big impact on commercial insurance market
- Increase in demand for title insurance and inherent defects insurance
- Capability building to overcome challenges in underwriting, pricing and reserving



Thank you!



Questions?



For list of references please contact me at  
[arunid833@gmail.com](mailto:arunid833@gmail.com)