

File No. SF 15404-A
OAH No. N-2002070670

BEFORE THE INSURANCE COMMISSIONER OF THE
STATE OF CALIFORNIA

In the Matter of

RADIAN GUARANTY, INC.,
AMERIN GUARANTY
CORPORATION, AND
RADIANEXPRESS.COM, INC.

Respondents.

AMICUS CURIAE BRIEF OF
GENERAL ELECTRIC MORTGAGE INSURANCE CORPORATION,
MORTGAGE GUARANTY INSURANCE CORPORATION,
PMI MORTGAGE INSURANCE CO.,
REPUBLIC MORTGAGE INSURANCE COMPANY,
TRIAD GUARANTY INSURANCE CORPORATION, AND
UNITED GUARANTY RESIDENTIAL INSURANCE COMPANY
IN SUPPORT OF THE POSITION OF THE DEPARTMENT OF INSURANCE
AND THE PROPOSED DECISION OF THE ADMINISTRATIVE LAW JUDGE

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I.

INTRODUCTION

This amicus brief is submitted on behalf of the following mortgage guaranty insurers: General Electric Mortgage Insurance Corporation, Mortgage Guaranty Insurance Corporation, PMI Mortgage Insurance Co., Republic Mortgage Insurance Company, Triad Guaranty Insurance Corporation, United Guaranty Residential Insurance Company (collectively, the “Mortgage Guaranty Insurer Amici”).¹ The Mortgage Guaranty Insurer Amici have a collective market share in the State of California in excess of 80 percent. Each of the Mortgage Guaranty Insurer Amici maintains offices and employees in the State of California, and is licensed by the California Insurance Commissioner (“Commissioner”) to transact mortgage guaranty insurance.

* * *

As persuasively argued by the Department of Insurance (“Department”) in its Closing Argument and Final Closing Argument and determined by the Administrative Law Judge (“ALJ”) in the Proposed Decision in this matter, the Radian Lien Protection (“RLP”) policy developed by Radian Guaranty, Inc., Amerin Guaranty Corporation, and Radian Express.com, Inc. (collectively, “Radian”) insures a title risk. (See Department’s Closing Argument, Section III(A)(1), pp. 4-8.) Consequently, if the Commissioner were to permit the RLP to be written by a mortgage guaranty insurer, such action would conflict with the requirements of the California

¹ The Mortgage Guaranty Insurer Amici have an interest in the outcome of this matter, since a final disposition will have a direct impact on them and on the manner in which mortgage guaranty insurance will be made available in California.

Insurance Code that prevent mortgage guaranty insurers from writing title insurance and title insurers from writing mortgage guaranty insurance.

Mortgage guaranty insurance essentially covers a credit risk linked to overarching economic conditions and therefore poses the possibility of numerous claims over a brief period of time. In contrast, title insurance covers latent risk of title defects and is largely independent of general economic conditions. When the legislature enacted the Mortgage Guaranty Insurance Act (“Act”) in 1961, it included provisions to prevent the recurrence of widespread failure of mortgage guaranty insurers, as occurred in the Great Depression,² and to prevent such action from impacting upon coverage provided to purchasers of other forms of insurance.³ The monoline restriction of the Act is a key component of this protective regulatory structure, as it ensures that the regulatory provisions related to mortgage guaranty insurance are not obscured or obstructed through combination with other types of insurance. Thus, to allow a mortgage guaranty insurer such as Radian to insure a title risk through the RLP would frustrate the underlying goals of the monoline restrictions of the Act. Therefore, any change to the monoline restriction should only be undertaken after careful consideration of the overall regulatory framework established by the legislature.

II.

ARGUMENT

The central issue in connection with this proceeding is whether the RLP policy constitutes only title insurance or whether it also represents a form of mortgage guaranty insurance. If it provides both types of insurance, then permitting the RLP to be written by a

² The failure of mortgage insurers during the 1930s essentially eliminated the private mortgage insurance industry in California for over 25 years. As such, the scope of failure in the mortgage insurance industry during the Great Depression was more substantial and far reaching than in other financial industries. (State of California, Department of Insurance, “In the Matter of the Proposed Adopting of the Rules and Regulations of the Insurance Commissioner Relating to the Transaction of Mortgage Guaranty Insurance,” Ruling No. 124, File No. RH-85, 1962.)

³ For additional background on the history of mortgage guaranty insurance and the purpose and function of the monoline restriction, see Paper Prepared by Professor Dwight Jaffee entitled, “The Monoline Restriction on Mortgage and Title Insurance, With Special Application in California”, dated May 30, 2003. (Attached hereto as Exhibit “A.”)

mortgage guaranty insurer would be inconsistent with the requirements the California Insurance Code that were intended to prevent mortgage guaranty insurers from writing title insurance and title insurers from writing mortgage guaranty insurance. Moreover, the matter also has significant regulatory and public policy implications because the respective operations of title insurers and mortgage guaranty insurers are each conducted pursuant to a statutory scheme that specifically and specially regulates that form of insurance and preempts entry by other types of insurers.

A. The RLP Includes a Title Insurance Risk That May Not Be Written by a Mortgage Guaranty Insurer

California Insurance Code §12360⁴ prohibits title insurers from writing any other line of insurance in the state, including mortgage guaranty insurance. Similarly, §12640.10 precludes mortgage guaranty insurers from writing other lines, including title insurance. Title insurance and mortgage guaranty insurance are commonly referred to as “monoline” because insurers licensed to transact them must limit their business solely to the class of insurance in question.

Title insurance is defined in §§104 and 12340.1 to include insuring, guaranteeing or indemnifying the holders of liens on real property against loss or damage by reason of liens, encumbrances on or defects in title to that property, as well as incorrectness of title searches. This includes loss represented by the nonpayment of a mortgage if based upon an undisclosed lien, the basic risk presented by the RLP. Radian refers to the RLP as an “alternative” to title insurance and seeks to market this product to lenders that would, in its absence, purchase title insurance. (Department Closing Argument, Section III(A)(4), p. 12.) They also concede that “. . . a lender’s title policy typically requires a loan default as a condition precedent to any right to receive indemnity payments . . .” (Radian Closing Argument, Section IV(A)(4), p.24.) It is not contested that title insurers have issued and continue to issue policies of title insurance which reflect that risk, and were doing so prior to the existence of legislation authorizing the writing of

⁴ All section references herein are to the California Insurance Code unless otherwise indicated.

mortgage guaranty insurance in 1961. By contrast, the undisclosed lien risk included in the RLP represents a type of coverage that has not previously been written by mortgage guaranty insurers.⁵

Radian takes the position that the RLP is mortgage guaranty insurance, but does not and can not dispute the fact that the coverage is title insurance. Accordingly, although the Mortgage Guaranty Insurer Amici do not believe that the RLP is mortgage guaranty insurance, Radian must concede that the underlying risk covered by the RLP is both title insurance and mortgage guaranty insurance, notwithstanding the presence of clear and unambiguous provisions in each of the applicable underlying monoline statutes prohibiting the transaction of the kind of insurance defined therein by an insurer licensed under another insurance line.

The Proposed Decision of the ALJ correctly concluded that the RLP must be construed as a whole and that the nature of the coverage is defined by the risk insured, not just by its insuring clause as Radian has contended. (ALJ Proposed Decision, Legal Conclusion 5, p. 12; *Rosen v. Nations Title Insurance Company*, 56 Cal.App.4th 1989 (1997).) If one adheres to this legal holding, and looks to the RLP as a whole, it is clear that it covers the risk associated with undisclosed lien coverage and falls within the scope of title insurance.

The result in this matter should therefore be dictated by the application of the “monoline” requirement of §12640, which unambiguously prohibits an insurer that transacts mortgage guaranty insurance from also writing a title insurance risk. It is well settled that, where a statute is clear, it must be interpreted according to its plain and ordinary meaning.⁶ (*Lennane v. FTB*, 9 Cal.4th 738, 744-46 (1995).)

⁵ None of the Mortgage Guaranty Insurer Amici have ever provided lien protection coverage similar to that found in the RLP.

⁶ The failure of an administrative agency to properly construe and follow the law amounts to a prejudicial abuse of discretion and is subject to reversal through administrative mandamus. (*People ex rel. Fund American Companies v. California Ins. Co.*, 43 Cal.App.3d 423, 431 (1974).)

B. Allowing Radian to Write the RLP as Mortgage Guaranty Insurance Would Abrogate the Legislative Intent behind the Monoline Regulatory Restriction

Adoption of Radian’s position results in the same risk being written through two different types of insurers. While allowing a single insurer to write different types of insurance or combining multiline coverage in a single policy is common in other types of property-casualty insurance, such action would be directly contrary to both the wording and intent of the monoline statutes, which are intended to assure that neither line will be written by an insurer licensed to write another. There is simply no basis in the respective monoline statutes governing mortgage guaranty and title insurance for issuance of coverage under one line that overlaps or is a subset of another. A determination in favor of Radian would therefore administratively nullify the monoline restrictions governing those lines of insurance. This conclusion is bolstered by the legislative policy concerns supporting the monoline restrictions, the legislative intent concerning the type of coverage that may be included within the definition of mortgage guaranty insurance, and subsequent amendments to the mortgage guaranty statutes which demonstrate that, had the legislature intended to allow title risk to be covered under mortgage guaranty insurance, it could and would have provided for that in statute.

1. The Mortgage Guaranty Insurance Act Included Specific Provisions to Regulate Risk Associated with Mortgage Insurance and Specifically Intended to Prohibit the Erosion of these Protections by Including a Monoline Restriction

Chapter 719, Statutes of 1961 (Senate Bill 1656), the Mortgage Guaranty Insurance Act, added the basic statutory provisions governing mortgage guaranty insurance in California to the Insurance Code. The Act established a comprehensive system for the licensing and regulation of a new line of insurance called mortgage guaranty insurance.⁷ The Act provided for minimum

⁷ A predecessor line of insurance, Land Value Insurance, was deleted from the types of insurance that could lawfully be issued in California by Chapter 936 of the Statutes of 1939, which also made guaranteeing or insuring land value a public offence. Prior to 1961, mortgage insurance had been a lawful class of insurance, but no insurer had been licensed for that purpose since the early 1940s. (State of California, Department of Insurance, “In the Matter of the

capital and surplus requirements for mortgage guaranty insurance significantly in excess of those required for other property-casualty lines (§12640.03) and required a contingency reserve equal to 50% of earned premiums (§12640.04). Mortgage guaranty insurers were restricted to insuring loans secured by “authorized real estate security”, a definition which incorporated requirements regarding the nature of the lien and the permissible loan-to-value ratio. (§12640.07.) Most importantly, the law prohibited a mortgage guaranty insurer that transacted any other class of insurance in any other jurisdiction from being eligible for issuance or renewal of a certificate of authority to transact such insurance in California. (§12640.10.)

The last restriction represents an attempt to address significant concerns that existed in connection with this new line of business. More specifically, the monoline requirement was imposed to protect other lines of insurance from the volatility presented by mortgage guaranty insurance, while at the same time permitting a more focused regulatory supervision of the latter line. The commentary to the legislature concerning the proposed bill evidences the fact that the risk of insolvency of mortgage guaranty insurers on a large scale prompted these protections. As articulated in testimony before the Assembly Finance and Insurance Committee in March 1961:

[T]he kind of risks that [mortgage guaranty insurers] assume are quite different from the ordinary casualty type. It is even different than life insurance *or title insurance* and/or any other form. This is because the time of greatest risk would be a period of deflation when all valuation of real estate would be deflated at the same time and losses would be concentrated. In such a deflation or recession, all the claims would come at once. It reminds me of my experience in the ‘30s . . . (emphasis added.)⁸

The legislative history of the Act illustrates a concern that surrounded enactment of laws to permit issuance of mortgage guaranty insurance and the reasons why protective measures, such as the monoline restriction, were put in place. To allow Radian to issue the RLP as mortgage guaranty insurance would undermine the legislature’s desire to provide protections through the establishment of the monoline restriction.

Proposed Adopting of the Rules and Regulations of the Insurance Commissioner Relating to the Transaction of Mortgage Guaranty Insurance,” Ruling No. 124, File No. RH-85, 1962.)

⁸ See Comments of B.J. Zimmerman before the Assembly Finance and Insurance Committee, March 23, 1961. (The differences between title insurance and mortgage guaranty insurance are discussed in III(A)(1) of the Department’s Closing Argument.)

2. **The Legislature Understood that it was Enacting a Counterpart to the Insurance Provided under the Federal Housing Act, which is Limited to Mortgage Risk**

The Legislature in enacting the Mortgage Guaranty Insurance Act intended to cover the risk of mortgage default resulting from economic conditions. This is reflected in the California Insurance Department's submission to Governor Edmund G. Brown with respect to the bill:

Our analysis indicates the insurance contemplated by this bill is in essence an insurance against changing economic conditions. Any insurance of that general category has inherent hazards that are difficult or impossible to measure. We believe that this bill as it now stands (amended in Assembly May 4, 1961) contains about every limitation and safeguard which could be provided looking to the continued solvency and stability of such an insurer without going to the extent of making it impractical for any organization to successfully operate under it.⁹

The Department's submission summarized the basic arguments for and against the bill, which are illustrative of an underlying belief that the new line of insurance was intended to mirror existing public sector activities in this area.

Under the circumstances, the framers of the initial mortgage guaranty insurance statute viewed mortgage guaranty insurance as a private sector counterpart to the Federal Housing Administration, whose objective is to reduce the risk of lending on residential property and not to insure title to such property.¹⁰ This is further indicated in a memorandum from the Legislative Secretary to the Governor recommending approval of the Act, which described it as providing for "the issuance by private insurance companies of policies comparable to the Federal Housing Authority insurance against the possibility of default by the borrower."¹¹ Therefore, to permit Radian to market the RLP product would nullify the legislative intent to cover only economic risk associated with mortgages of real property.

⁹ Letter dated June 1, 1961 from Insurance Commissioner F. Britton McConnell to Honorable Edmund G. Brown.

¹⁰ "The Federal Housing Administration . . . neither makes loans nor builds housing. Instead, it ensures private lenders (mortgagees) against the risk of default on mortgages they originate under the National Housing Act." (Charles L. Edson, Barry G. Jacobs & Bruce S. Lane, Housing Development Reporter, Section 10:011.)

¹¹ See Bill Memorandum dated June 5, 1961 from Alexander Pope, Legislative Secretary, to Governor Brown on AB 1539.

3. **The Legislature Subsequently Amended the Act to Allow Credit Insurers to Issue Mortgage Guaranty Insurance, Demonstrating that, had the Legislature Desired to Allow Mortgage Guaranty Insurers to Cover Title Risk, it Could Have Done So**

The Act was amended by Chapter 559 of the Laws of 1983, which authorized coverage with respect to junior liens. This enactment also amended the monoline provision of §12640.10 to specifically authorize an insurer licensed to transact the business of credit insurance in the state to transact mortgage guaranty insurance with respect to such loans, provided that it receives the prior written permission of the Commissioner.

In contrast to this express grant of authority, there is no evidence that the legislature ever intended to confer on mortgage guaranty insurers the authority already held by title insurers to provide undisclosed lien coverage. Such coverage was never contemplated by the legislature upon the mortgage guaranty insurance statute's initial enactment, nor was it addressed at the time of the 1983 amendment. More significantly, the second enactment, which carved out certain activities of credit insurers from the mortgage guaranty insurance monoline restriction, provides clear evidence of the legislature's willingness to restrict the applicability of a monoline statute and its ability to do so in a clear and unambiguous manner. The absence of any comparable exception in the title insurance statute for specialized activities of mortgage guaranty insurers provides further evidence that the underlying risk of the RLP has been and continues to be a form of title insurance.

C. **Administratively Expanding the Scope of Permissible Coverage under Mortgage Guaranty Insurance Contradicts Prior Department Policy and Creates an Unfortunate Precedent for the Statutory Monoline Protections**

The possibility that the basic regulatory framework established by the legislature can be subverted through artful drafting of policy provisions has significant and serious implications. The RLP grafts a title insurance risk represented by the undisclosed lien coverage onto a policy

utilized to provide mortgage guaranty insurance. If such action is permitted, would it not also be possible for an insurer to similarly fashion a mortgage guaranty insurance policy to cover earthquake and tornado (special hazard) or environmental (property contamination) risks simply by requiring liability to be triggered by a default on a mortgage? This erosion of the monoline restrictions by permitting unrelated types of risk to be combined with mortgage guaranty insurance would jeopardize the basic protections the monoline system is intended to provide.¹²

The Department addressed these concerns in Bulletin 84-3, which precluded the issuance of policies with a waiver of the required restoration of damages clause on the basis that such action created a liability on the part of the insurer for a physical loss, which fell outside the risk contemplated by mortgage guaranty insurance. (Department Closing Argument, Section III(C)(3), p. 23.)

Radian has contended that the RLP is less costly in a transaction than the purchase of title insurance and uses this argument in support of being allowed to issue the RLP.¹³ Assuming, arguendo, that cost issues exist related to title insurance, there are other means of addressing this problem that do not depend on an ad hoc revision to the regulatory system for mortgage guaranty insurance. Radian proposes to sell what is essentially title insurance under its mortgage guaranty insurance license. It thereby avoids the long-term commitment of capital and resources contemplated by the respective monoline structures. Radian is not precluded from entering the title insurance market. In fact, to do so, it only needs to comply with the applicable monoline

¹² The experience of Tigor Mortgage Insurance Co. (“Tigor”), a California domiciled insurer, in the 1980s serves as an example of the potential consequences that arise from a lack of clarity concerning the risk presented when a company sells products that arguably do not properly fit within the scope of the monoline requirements. In that case, Tigor issued mortgage guaranty coverage on hundreds of individual mortgages secured by newly built single family homes purchased for investment and held for resale by a series of limited partnerships formed by the same general partner or its affiliates. It classified them as first lien mortgages on single family dwellings under §12640.02(a)(1). Since there was a common borrower and the loan was for a commercial rather than an owner-occupancy purpose, the actual risk involved in the transactions should have been considered a commercial risk on more than five units under §12640.02 (a)(3) even though the subject properties might technically have fit within the one to four unit category. When the partnerships failed, all of the loans went into default at the same time, which led to Tigor's eventual insolvency and liquidation administered by the Department. It should be noted that Tigor's title insurance affiliate survived intact and continued in operation.

¹³ See Radian Closing Argument, Section I(A), p.3.

restrictions and acquire or form and license a title insurer, a process which many insurers undertake on a regular basis when they want to enter a new line of business.

D. RLP Would Not Be Permitted as a Form of Mortgage Guaranty Insurance in the Absence of a Statutory Prohibition

The lien protection provisions of the RLP by their terms provide coverage for undisclosed liens that are senior to the insured mortgage. However, “mortgage guaranty insurance” as defined in §12640.02(a)(1) specifically requires that the mortgage, deed of trust or other instrument constitute “...a first lien or charge....” on the real estate. This first lien requirement is reflected in the terms of the Radian policies. (Department Closing Argument, Section III(C)(3), pp.24-26.) However, the lien protection provisions of the RLP cannot come into play until there is an undisclosed lien that takes priority over the mortgage in question. The policy therefore provides coverage that is in contravention of the first lien requirement and thus outside the scope of the statute pursuant to which it is written. As such, this coverage is prohibited by §12640.10 from being written by a mortgage guaranty insurer in any jurisdiction, even if such coverage was not title insurance.

III.

CONCLUSION

The record fully supports the position of the Department that the RLP represents an impermissible form of insurance for a mortgage guaranty insurer. The monoline regulatory systems governing mortgage guaranty insurance and title insurance should be permitted to continue to operate as intended by the legislature.

Dated: June 18, 2003

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By: _____
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