

PLAN OF OPERATION GUIDELINES

1. The Plan of Operation must be verified by an officer of the underwritten title company who has knowledge of the facts set forth in the plan. For your convenience, a sample verification form is enclosed with this packet. It should be in narrative form and should address, but should not be limited to, the issues in these guidelines. Please use tabs or captions to indicate where the following provisions are located.
 - A. Where and how business will be developed.
 - B. Sales and advertising techniques to be employed.
 - C. How salespersons will be compensated. If compensated by other than solely a fixed salary, provide a detailed description of the methodology used for compensation and attach a sample employment contract.
 - D. How the personnel involved in underwriting, escrow and claims (e.g., title and escrow officers) will be compensated.
 - E. The location of the branch offices the applicant plans to open in its first year of operation.
 - F. A copy of all existing (or unsigned copies of all proposed) underwriting agreements with any admitted title insurers under which the applicant intends to transact business. Please use tabs or captions to indicate where the following provisions are located within the agreements.
 - (1) The agreements cover all of the counties in which the applicant intends to transact business.
 - (2) The agreements do not allow for the placement of any liens upon the applicant.
 - (3) If the applicant does escrow, the agreements provide for one or more of the following provisions:
 - (a) A fidelity bond or insurance policy in conformity with the requirements of Section 12389.6; or,
 - (b) A review of the escrow disbursements by a title insurer employee in compliance with the requirements of Section 12389.6; or,
 - (c) An account review process in compliance with the requirements of Section 12389.6 or utilization of either the American Land Title Association's (ALTA) Escrow Internal Control Guidelines for Title Insurance Companies, Agencies and Approved Attorneys or the California Land Title Association's (CLTA) Account Review Processes and Oversight and Internal Control Guidelines as approved by the Department on April 1, 1996; or,
 - (d) Utilization of written procedures approved by the Commissioner in compliance with the requirements of Section 12389.6.
 - (4) Please note that subsection 7d (or 6d or 10d or 4) of the form has been removed as the \$5000 limitation is the subject of a proposed regulation filed by the California Department of Insurance, CDI # REG-2009-00019, OAL Z-2009-0811-03.
 - (5) The agreements affirmatively state whether or not the applicant is authorized to handle policy claims on behalf of the title insurer. (Cal. Ins. Code Section 790; Cal. Code of Reg.

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Title 10, Chapter 5, Section 2695.2(m))

- (6) The agreements clearly indicate that the applicant is responsible for the maintenance of records regarding all escrow receipts and disbursements. (Cal. Ins. Code Section 12389(b))
 - (7) The agreements clearly indicate that the applicant is responsible for the maintenance of records of title orders sufficient to indicate their source. (Cal. Ins. Code Section 12397.5(a))
 - (8) The agreements clearly indicate that the applicant is responsible for the maintenance of adequate records regarding commissions paid, including the recipient(s) thereof, the amount(s) paid, and detailing the conditions to receipt of any commissions, incentive compensation, or bonuses. (Cal. Ins. Code Section 12408.5)
 - (9) The agreements require the establishment of a separate deposit account for escrow funds. (Cal. Ins. Code Section 12413.5)
 - (10) The agreements provide for notice to be given by the title insurer to the Commissioner in the event of termination of the underwriting agreement. (Cal. Ins. Code Section 12408.1)
- G. Description of the title plant arrangements, including the historical scope of coverage. If coverage is not comprehensive, describe in detail the methods and procedures upon which the applicant intends to rely to obtain comprehensive title plant data.
- H. If the applicant intends to transact business in more than one county, please include charts in addition to the narrative descriptions of items E, F, and G above which correlate these items by county.
- I. If the applicant intends to conduct escrow services, a description of its business location(s) as defined by Section 12340.13 and how business will be conducted, including how and where applicant will maintain and preserve its escrow records and whether or not applicant will be transacting internet escrow business.
- J. Description of the company's policies and procedures to ensure that there will be no conflict of interest among employees.
- K. Demonstrate that the applicant's intended course of business conduct will not involve reliance for more than 50% of its closed title orders from controlled business sources.
- L. If the applicant intends to use independent notaries for escrow signing services, the applicant must describe the arrangement and attach a form of agreement. Please use tabs or captions to indicate where the following provisions are addressed within the agreement:
- (1) A description of the services to be performed by the notary.
 - (2) A provision for training of the notary by the UTC or the title insurer.
 - (3) A prohibition on the notary handling any funds, escrow or otherwise.
 - (4) A covenant that the notary shall refer any calls of a substantive nature regarding the document contents to an appropriate employee of the UTC or title insurer.
 - (5) A requirement that the original executed documents be promptly forwarded to the UTC or title insurer.

- (6) There is no exculpatory clause providing that the UTC or title insurer be relieved of any responsibility to the underlying consumer by virtue of the use of the independent notary.
- M. If the applicant offers or intends to offer escrow services over the internet, the applicant must provide a description of the applicant's procedures to ensure compliance with the requirements of California Financial Code Sections 17403.1 through 17403.5 and 17409.1.
- N. In the case of a Request for Transfer of Shares of an Underwritten Title Company or for a Reissued License, if the transaction will result in changes to the plan of operation, an updated and verified plan must be submitted.

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2. Financial Projections

- A. Projections for at least three years or until a profit is shown, whichever period is greater, including balance sheets and income statements, and number of title and escrow orders projected to open and close.
 - (1) For applicant not purchasing an existing operation:
 - (a) First year projections on a quarterly basis.
 - (b) Second, third and subsequent years (if necessary) projections on an annual basis.
 - (2) For an applicant purchasing an existing operation:
 - (a) Financial projections for at least three years on an annual basis.
 - (b) Income statements of the existing operation for the past three years.
- B. Projections should reflect two views:
 - (1) Assuming current economic and market conditions and
 - (2) Assuming a more pessimistic viewpoint (e.g. an increase in the current mortgage rates by 3.0%), supported by a complete set of assumptions.
- C. In the case of an Application for a Reissued License to Act as an Underwritten Title Company, where the applicant is adding a county or counties, these financial projections should focus on the new business intended to be conducted in these additional counties.

3. Ownership and Control of Shares

- A. Financial information requirement:
 - (1) Stock of underwritten title company to be owned by individuals - In the case of individuals each owning 10% or more of the Applicant, each must submit his/her preceding fiscal year-end audited financial statement and current unaudited financial statements as of the date that is within 30 days of the filing of the application; or the preceding year-end unaudited financial statements and current unaudited financial statements as of the date that is within 30 days of the filing of the application, supported

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by federal income tax returns for the previous three years.

- (2) Stock of underwritten title company to be owned by a corporation directly or indirectly - The previous three years audited or unaudited consolidated financial statements of the corporation, supported by federal income tax returns. Separate unconsolidated financial statements of the holding company for the last three years are also required.
 - (a) In the case of a closely held holding company which is not required to file annually with the SEC, information required in item 3(A)(1) may be required for all shareholders owning 10% or more shares of the holding company, in addition to the financial statements required for the corporation as stated above.
- (3) Additional information will be requested as needed (e.g. bank statements, appraisal reports, supporting schedules, etc.).

B. Source of funds:

- (1) Cash currently available in bank (non-borrowed funds) - FAD confirmation from depository bank of investor cash in bank may be required.
- (2) Cash to be available from the sale of owner's assets - FAD will not give a financial clearance until evidence is received indicating that the assets were sold and that the cash is in the depository bank account in the name of the owner.
- (3) Borrowed funds - independent sources for repayment must be proved. See "Guidelines for Purchases of Underwritten Title Companies with Borrowed Money."
- (4) Owner's assets will be used in exchange for applicant's shares:
 - (a) If these assets were acquired recently with borrowed funds, see section 3(B)(3) above.
 - (b) If the fair market value of these assets cannot be readily determined, then an appraisal may be required.
 - (c) The applicant should be aware that only unencumbered tangible assets will be counted in determining whether the applicant is adequately capitalized.
- (5) In the case of a Request for Transfer of Shares of an Underwritten Title Company, the following requirements also apply:
 - (a) The applicant must disclose whether the source of funds or other consideration for the transaction can be directly or indirectly traced back to any other individual or entity involved in the transaction.
 - (b) The applicant must provide a detailed itemization, which fully discloses and documents the source and method of payment of funds or other consideration.
 - (c) The applicant must identify any other individual or entity involved in the transaction which does business with the underwritten title company.
 - (d) The applicant must disclose whether there is any debt instrument or other consideration submitted by any transferee which is based upon the number of title orders and/or business generated by said transferee to the applicant.

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Purchases of Underwritten Title Company Shares with Borrowed Money

1. The borrower must put 20% of the purchase price down in non-borrowed funds.
2. Three popular types of loans from banks or individuals:
 - A. Loans that require collateral - borrower pledges its personal assets or assets of others.
 - B. Loans that do not require collateral
 - C. Loans that require a guarantor.
3. The borrower must submit a copy of the loan agreement/promissory note, the security agreement and any other supplemental or interpretative agreements relating to any of the foregoing.
4. The borrower must prove an independent source of repayment satisfactory to the Commissioner.
 - A. The borrower must prepare a cash flow statement showing how he/she intends to service the debt during the first three years of operation. This schedule should include:
 - (1) Amount of principal and interest due annually from all outstanding loans.
 - (2) Sources of funds for repayment listed in detail.
 - B. Satisfactory independent sources of repayment for an individual include:
 - (1) A reasonable percentage of wage income.
 - (2) Investment income. In most cases, income generated from other real estate-related businesses (e.g. UTC's, escrow companies, or real estate broker offices) which are owned by the borrower will not be considered or only a small percentage of the income will be considered as an independent source of repayment due to the volatility of the real estate-related industry in recent years and that the business cycle of these real estate-related businesses runs directly parallel with that of the applicant.
 - (3) Saleable investments or personal assets other than the personal residence and furnishings of the borrower.
 - (4) Dividends from applicant UTC are excluded.
 - C. Availability of sources of funds.
 - (1) The borrower must have adequate liquid assets (e.g. cash and readily-marketable securities) to meet all loan payments due within the first year.
 - (2) The borrower must show that there are adequate remaining liquid assets and other saleable assets to meet the loan payments due in the second and third year of the loan. If there are assets which the borrower intends to sell in order to service the loan, and the current market value is not readily available, an appraisal must be obtained from a reputable appraiser from the appropriate field. In the case of real property, an appraisal performed by an appraiser with the designation of MAI and a preliminary title report as of the current date will be required.
 - D. The ownership of stock of other UTCs will not be counted as available saleable assets.

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5. The personal residence or furnishings of the borrower cannot be used as collateral in securing the purchase loan.
6. The assets of an underwritten title company cannot be pledged to collateralize the purchase loan for the benefit of the stockholders.
7. Neither the underwritten title company or a holding company whose primary asset is a UTC can guarantee the loans of the stockholders.
8. Stockholders of the UTC and, if necessary, of its holding company must sign a restrictive agreement acknowledging that the shares of either entity may not be sold, transferred or encumbered without the express written consent of the Insurance Commissioner.
9. Borrower must obtain a statement from the lender and/or guarantor that the latter is aware that the stock of the UTC (and possibly that of a holding company) is legended and that it cannot be transferred or sold without the Insurance Commissioner's permission. Collateralizing purchase loans with title company stock is discouraged.
10. After acquisition, the outside debt (i.e., debts owed to non-affiliates) to equity of the consolidated group should not be in excess of:

<u>In Case Of</u>	<u>Ratio</u>
5 year loan	1 to 1
10 year loan	1.5 to 1
20 year loan	2 to 1

11. The applicant must submit to the Insurance Commissioner a properly certified resolution passed by its board of directors specifying that no advances or loans will be made to any shareholders, officers or directors of the company, affiliated companies or the parent holding company until written consent is received from the Insurance Commissioner after satisfactory proof has been submitted showing that the acquisition loan(s) has been fully repaid.
12. The applicant underwritten title company must submit to the Insurance Commissioner a properly certified resolution passed by its board of directors specifying that no dividend will be made so as to cause the applicant's statutory net worth to fall below 150% of its minimum required statutory net worth. Such dividend may only be declared and paid during the 30-day period following the submission to the Insurance Commissioner of its audited annual report for the fiscal year just ended. The amount of allowable dividends which the applicant can pay without the consent of the Insurance Commissioner shall be based upon the statutory net worth reported on the audited annual report. If the title company wants to declare and pay dividends at a time other than 30 days after the submission of the audited annual report, it must receive prior written consent from the Insurance Commissioner. The restriction on payment of dividends may be removed upon the written consent of the Insurance Commissioner after satisfactory proof has been submitted that the acquisition loan(s) has been fully repaid.

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SAMPLE VERIFICATION FORM

The following sample verification form meets the requirements of California Code of Civil Procedure Section 2015.5 for execution of documents outside California. It also may be used for documents executed within California. When required, the verification should be placed at the end of the document.

Title of Document: _____

Date: _____

VERIFICATION

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that I am authorized to execute the same.

Date:

Signature

Title