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Testimony of

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**Before the House Committee on Financial Services
Subcommittee on Housing and Community Opportunity**

Title Insurance Cost and Competition

**Also Delivered on Behalf of
Center for Economic Justice
Consumers Union
National Association of Consumer Advocates
National Consumer Law Center
U.S. Public Interest Research Group**

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Introduction

Mr. Chairman and members of the Subcommittee, I appreciate the invitation to appear before you today to discuss current issues related to title insurance. I am J. Robert Hunter, Director of Insurance for the Consumer Federation of America (CFA).¹ I am a former Federal Insurance Administrator under Presidents Ford and Carter and have also served as Texas Insurance Commissioner. This testimony is presented on behalf of CFA, Center for Economic Justice,² Consumers Union,³ National Association of Consumer Advocates,⁴ National Consumer Law Center⁵ (on behalf of its low-income clients) and U.S. Public Interest Research Group (U.S. PIRG).⁶

In 2005, consumers paid almost \$17 billion in premiums for title insurance countrywide.⁷ Title insurance remains one of the most costly items at the closing of a real estate transaction, yet consumers poorly understand it. Title insurance assures the lender and buyer that the person selling a property actually has a clear title to transfer to the buyer. Unlike other forms of insurance that protect against future unexpected events, title insurance is essentially a guarantee that the title agent or title insurance company has diligently reviewed the relevant title information and identified any problems with the title prior to the sale.

¹ CFA is a non-profit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy and education.

² The **Center for Economic Justice** is a non-profit organization that works to increase the availability, affordability and accessibility of insurance, credit, utilities, and other economic goods and services for low income and minority consumers.

³ **Consumers Union**, the nonprofit publisher of Consumer Reports magazine, is an organization created to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. Consumers Union's publications carry no advertising and receive no commercial support.

⁴ The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

⁵ The **National Consumer Law Center** (NCLC) is a non-profit organization specializing in consumer issues on behalf of low-income people. NCLC works with thousands of legal services, government and private attorneys, as well as organizations, who represent low income and elderly individuals on consumer issues.

⁶ **U.S. PIRG** serves as the federal lobbying office for the state Public Interest Research Groups, which are non-profit, non-partisan public interest advocacy organizations.

⁷ American Land Title Association, "Preliminary 2005 Market Share – Family-Company Summary at <http://www.alta.org/industry/financial.cfm>

There are two types of title insurance policies. The lender's policy – demanded by mortgage lenders – protects the lender for the loan amount. Although the lender requires the lender's title insurance policy, the lender never pays for it. Rather, the buyer pays for the lender's policy. An owner's policy protects the buyer up to the purchase price of the property. In addition to errors and omissions in the review of title records, title insurance also protects against unknown problems with the title. Title insurers guarantee that the title ownership is sound, defend the buyer against challenges to their title, and compensate the buyer and the lender if there is a problem with the clear ownership of the title.

Title insurance facilitates homeownership by mitigating the risks related to the transfer of ownership for both the buyers and the lenders that finance their purchase. However, if there is a problem with the title, title insurance policies only reimburse the homeowner at the level of the purchase price, meaning that any market appreciation is lost equity for the homeowners.⁸ Title insurance is important because some titles may have problems that are not clearly discernable in the public records due to errors or omissions that have not yet been uncovered, such as an earlier defective transfer due to fraud. However, the overwhelming majority of title problems are discoverable with a routine search of public records, including tax or mechanics' liens, possible heirs, errors or omissions in deeds or possible forgery.

The \$17 billion in title insurance premiums paid by consumers in 2005 was roughly twice the amount paid in 2000 and four times the amount paid in 1995.⁹ The increase in title insurance premiums was driven by an increase in the number of title insurance transactions – home sales and mortgage refinancings – and the increase in home values and mortgage amounts. Title insurance premiums are based on the amount of the sales price or mortgage loan. As home prices have soared in some parts of the country, title insurance premiums have jumped solely because of the increase in home price rather than legitimate increases in the cost of providing services. Clearly, revenue growth has far exceeded the reasonable costs of providing the title insurance service.

⁸ Romano, Jay, "Title Insurance: Is a Rider Needed?" *New York Times*, March 26, 2006.

⁹ Title Insurer Statutory Annual Statements, Schedule T, various years.

The title insurance industry is highly concentrated, with only five insurer groups controlling about 92 percent of the market nationwide.¹⁰ The costs of the policy (a one-time premium) are usually based on the loan amount and can range from several hundred dollars to \$2,000 on a median priced home, depending on the state. Theoretically, buyers have the ability to shop for title insurance and to negotiate the rate. In fact, this seldom occurs. Even when they do, rates among the title companies remain essentially the same.

Numerous studies over the past thirty years have documented how inefficiencies in the title insurance market have harmed consumers through higher premium prices.¹¹ In 1977, the U.S. Department of Justice examined the impact of pricing and marketing of title insurance on consumers. In 1980, Peat Marwick performed a study for the U.S. Department of Housing and Urban Development of market competition based on price in title services that found that the structure of the title insurance market encouraged reverse competition,¹² which drove up prices. A 1986 Texas Department of Insurance report found widespread reverse competition as a result of real estate intermediaries driving the market for title insurance and homeowners exerting “no pressure on price at all.”¹³

These and other studies have documented the fundamental market problem with title insurance – reverse competition. Reverse competition refers to a market structure in which the seller of a product markets the product to an intermediary instead of to the ultimate purchaser of the product. In the case of title insurance, title insurers market their products to real estate

¹⁰ American Land Title Association, “Preliminary 2005 Market Share – Family-Company Summary” at <http://www.alta.org/industry/financial.cfm>.

¹¹ See Birnbaum, Birny, Report to the California Insurance Commissioner, “An Analysis of Competition in the California Title Insurance and Escrow Industry,” December 2005, at 28-37.

¹² “Reverse competition” is a feature of certain insurance transactions in which the buyer of the insurance is not shopping for insurance but for a large item such as a car or a home and insurance is required or suggested as part of that process. At that point a third party (such as a car dealer or a real estate broker) is in a position to steer the customer to a single insurer. The third party is influenced in making the selection of an insurer by legal or illegal financial inducements or “kickbacks.” The inducements can take many forms including commissions, under priced services, captive reinsurance arrangements and other arrangements. The competition focuses on rewarding the third party for steering a buyer to the insurer. Since this increases the price of the insurance product, the competition is the reverse of normal competition where the ultimate buyer selects the insurer with a focus on lowering, not raising the premium charge. Insurance products with well-documented reverse competition effects include title insurance, credit insurance and lender forced-placed insurance.

¹³ Cited in Birnbaum at 35.

professionals – real estate agents, mortgage lenders, mortgage brokers, homebuilders – who, because of their position in the real estate transaction, are able to steer the consumer who is actually paying for the product to a particular title agent or title insurer. The ultimate consumer has little or no market power in the title insurance transaction because title insurance is required for obtaining the loan or purchasing the property and because the consumer, who infrequently purchases real estate, has relatively little knowledge of title insurance. The entities with the market power in title insurance are those people who are able to steer consumers to particular title agents or title insurers. And the competition among title agents and title insurers for the business of the real estate professionals – title insurers identify real estate brokers, mortgage lenders, mortgage brokers and homebuilders and not the consumers paying for the title insurance as their customers – causes title insurance premiums to increase as title agents and title insurers spend money and provide various considerations to the referrers of title insurance business. The provision of considerations to real estate professionals by title agents and title insurers takes both legal and illegal forms.

I. The Title Insurance Market is Not Competitive

Title insurance remains one of the most expensive items at closing, yet consumers poorly understand it and they have little ability to shop around for this product. Title insurance costs are presented to homebuyers at the point of closing on real estate transactions along with many other closing costs. Purchasing a home is the largest and most complex financial transaction most households undertake. Many homebuyers, especially first-time and financially unsophisticated buyers, are especially vulnerable during the closing process and are under the impression that the transaction terms and costs are fixed. If a consumer does question the title insurance charge, the threat of a delayed closing can be raised. Moreover, homebuyers assume that the transaction intermediaries (real estate agents, mortgage brokers and title agents) are acting in the buyers' interests, when in fact most intermediaries are acting in their own financial interests.

Under these circumstances, homebuyers are not positioned to be the most diligent consumers, but they are further hindered by the unique complexities of the title insurance marketplace. Title insurance is not sold in a competitive marketplace. Consumers lack information about title

insurance and are poorly situated to exert pressure on terms or prices. Homebuyers are not even the “consumers” of title insurance; instead they are driven to title insurance policies by real estate intermediaries through referrals. Additionally, lenders require homebuyers to pay for both the lender’s title insurance policy as well as their homeowner’s title policy but do not help borrowers achieve similar savings that lenders receive on their policies through exerting economies of scale. Third, the market for title insurance demonstrates marked price inelasticity, meaning that even large increases in title insurance prices will not cause consumers to stop buying title insurance. This result occurs because title insurance is a required part of the real estate transaction.

As mentioned above, title insurance is not marketed directly to the consumers who buy it, but instead is marketed to the intermediaries that service real estate transactions. As a result, there is almost no competition for consumers as there is with the marketing of auto and homeownership policies. Instead, title insurers compete to secure referrals from the real estate service providers who steer title insurance buyers to their businesses.¹⁴ For example, Stewart Information Services Corporation, the nation’s fourth largest title insurer, does not include homebuyers in its list of customers in its Securities and Exchange Commission filing, only “attorneys, builders, developers, lenders and real estate brokers.”¹⁵

Since consumers almost never solicit their own quotes for title insurance and there is very little consumer knowledge or understanding of the title insurance product, consumers can and often do pay more for insurance than necessary. Although consumers can legally purchase title insurance on the open market from any carrier, as a practical matter, most home buyers have title insurance chosen for them by their real estate agent or mortgage broker.¹⁶ A 2003 Consumers Union survey found that although a title insurance industry representative reported that a title insurance policy on a \$250,000 refinancing should cost \$275, major title insurers were offering quotes for a

¹⁴ Birnbaum at 26.

¹⁵ Stewart Information Services Corporation, Securities and Exchange Commission 10-K filing, Fiscal Year December 21, 2005, at 2.

¹⁶ Gandel, Stephen, “Congressman Calls for Title-Insurance Investigation,” *Money*, February 24, 2006.

\$250,000 policy for \$750, nearly three times higher than the industry representative suggested was a fair price.¹⁷

Since the title insurance companies are effectively marketing to the real estate or lender intermediaries, the incentives to compete on the basis of cost are eliminated. Since the lenders requiring the insurance don't pay for it, they are indifferent to the price. Indeed, lenders may have an incentive for higher prices if they are part of an affiliated business arrangement that profits from title insurance. Consumers are unable to exert market pressure on title insurance prices because of their weak position in the real estate transaction and because the title insurance cost – while substantial – is a small portion of the total real estate transaction size. The individual homeowner has an incentive to keep costs low and shop for the cheapest insurance, but because the overwhelming majority of home buyers use their real estate or mortgage brokers, or perhaps their lenders to choose title insurance the home buyer's incentive to seek low cost insurance is lost. Instead, the intermediary that is selecting the title insurance policy for the home buyer has no incentive to hold down the cost of the policy. The real estate intermediaries have incentives to allow the title policies to become more expensive because the added costs are merely passed on to the buyers and because higher cost policies generate higher rebates, referrals or other financial inducements from the title insurer.¹⁸

Secondly, lenders use this product to protect themselves, yet require consumers to purchase the protection as a separate, stand-alone product. Competitive markets cannot function when the entity making the decision to purchase a product is not the same entity paying for the product.

Lastly, there are a number of unique elements to title insurance that make it difficult for consumers to choose policies based on price, a condition known as price inelasticity. First, title insurance policies are never renewed and they do not have periodic premium payments. Title insurance is sold only when houses are purchased or refinanced. Homeowners and auto insurance policies are renewed annually, so consumers can renew with their underwriter or shop for cheaper policies when their coverage expires. Additionally, title insurance is a required

¹⁷ Consumers Union, "California Title Insurance Rates Remain High," April 3, 2003.

¹⁸ Guttentag, Jack, "Title Insurance Fees Paid by Borrowers Include Referral Costs," March 21, 2005.

precondition for lenders to be willing to write a mortgage, so consumers are less willing and able to exert effort to shop on the basis of price at the time of closing since the focus is on the new home, not the insurance transaction. That might require stopping the closing, something few consumers are willing to do. An inter-related factor is that title insurance premiums are a small portion of the entire real estate transaction. Even relatively higher title insurance premiums do not have a large impact on the aggregate purchase and closing price and are unlikely to deter consumers from a title insurance carrier presented to them.¹⁹ These unique title insurance elements mean that the number of title policies is unlikely to rise if the price of the policy declined, because demand is very inelastic, so title insurance underwriters have little incentive to lower prices to capture more of the market.²⁰

II. Product Costs are Excessive

The title insurance industry maintains that it has significant costs to offering title insurance policies, but the majority of the costs are not for losses or operating costs to generate the insurance policy. Instead, the majority of the premium is split with title agents who can receive as much as 90 percent of the premium dollars. Title insurance industry costs include maintaining the title plant database, searching and examining property titles, clearing titles and the claims costs of any title defects.²¹ Title insurers can clear titles very easily and with nominal costs in most cases where modest problems arise.²²

Many have estimated that the direct costs to generate the policies are quite low. In 2003, the industry magazine *The Title Report* estimated administrative and labor costs for title insurance were \$262 per policy, but those costs could be reduced to \$94 per policy if commonly used transaction management systems were utilized.²³

¹⁹ Boyer, M. Martin and Charles M. Nyce, "Banks as Insurance Referral Agents? The Convergence of Financial Services: Evidence from the Title Insurance Industry," *Scientific Series*, Centre Interuniversitaire de Recherche en Analyse des Organisations, 2002s-78, September 2002, at 9.

²⁰ Birnbaum at 28.

²¹ DasGupta, Neil and Richard McCarthy, "Clouds on Horizon After Title Industry's Bright Year," A.M. Best Special Report, October 2005 at 7.

²² DasGupta, Neil and Richard McCarthy, "Clouds on Horizon After Title Industry's Bright Year," A.M. Best Special Report, October 2005 at 13.

²³ "Exclusive Report: Integrated Title Technology (Part 2 of 3)," *The Title Report*, October 3, 2003, at 6.

Two other examples illustrate the excessive price of title insurance. Iowa has banned the sale of title insurance and, instead, has created the Iowa Title Guaranty, which is a state agency that provides title assurance and fixes the title in the event of a title problem. Iowa Title Guaranty charges a flat rate of \$110 for a title guaranty. Combined with typical costs for an abstractor and attorney, the cost of title protection in Iowa is about \$500 – less than half of what title insurance costs in other states.²⁴

In 2005, a number of states took action against title insurers for a form of illegal rebating called “captive reinsurance.” Under this arrangement, a homebuilder, for example, would establish a captive reinsurer – a reinsurance company owned and controlled by the homebuilder. In exchange for the homebuilder referring home buyers for title insurance, the title insurer reinsured the title insurance policy with the homebuilder’s captive reinsurer and paid a premium to the captive reinsurer. In theory, the reinsurance premium should reflect the likelihood of losses on the policies reinsured. In the case of the title captive reinsurance, the title insurers paid almost half of the title premium as reinsurance premium, while the captive reinsurers paid little or nothing in claims. In essence, the captive reinsurance agreements were a kickback to the homebuilders of almost 50 percent of the premium. The size of the kickbacks is a further indication of how title premiums are excessive in relation to the costs of providing the product.²⁵

Operating costs for title insurers include any direct title searching, examining and clearing of titles that is not performed by affiliated title agents as well as maintaining the title plant. Updating the plants requires constant and detailed attention, and the intellectual property of the title plants is carried on the books of title insurers as non-depreciating assets. Operating the title plants is a small portion of the operating expense. Industry consultant Demotech reported that title plant updating and maintenance consumed less than 1 percent (0.67 percent) of annual

²⁴ “Iowa’s title alternative lifts its game,” *The Title Report*, February 20, 2006 at www.thetitulereport.com.

²⁵ “Insurance Commissioner John Garamendi Announces Major Settlement Agreements With Title Insurers—More Than \$37 Million To Be Paid For Illegal Kickback Schemes,” California Department of Insurance press release, July 20, 2005. See also charts prepared by Erin Toll, Colorado Department of Insurance for presentation at June, 2005 NAIC Title Insurance Working Group meeting.

industry revenue.²⁶ Title production services consumed about 5 percent (4.73 percent) of annual revenue.

Title insurers' operating expenses can also include the costs associated with acquisitions and litigation. For example, First American Corporation, the nation's largest title insurer, included \$87.7 million in acquisition related expenses and \$12.5 million in regulatory and litigation costs as operating expenses in 2005, more than ten percent of its total other (non-labor related) operating expenses.²⁷ In 2004, First American recorded \$37.3 million in litigation and regulatory settlements resulting from the state captive reinsurance agreements as operating expenses and \$79.9 million related to acquisition costs, about one seventh (13.9 percent) of that year's operating expenses.²⁸

The loss ratio for title insurance is among the very lowest in the insurance industry. Title insurance differs from other forms of insurance because it insures against risks in the past (such as incorrect deed recordings), not against future risks. As a consequence, title insurance companies' underwriting is not based on future actuarial risk balancing but on avoiding losses which can be greatly mitigated through due diligence by screening the pre-existing risks on the title.²⁹ Title insurers pay about 5 percent of premium dollars on claims, compared to about 80 percent for auto and home insurers.³⁰ Between 1995 and 2004, title insurance loss ratios averaged 4.6 percent and the loss ratio was below five percent eight out of ten years.³¹ For example, First American Title received \$3.4 billion in premiums in 2003 but paid only \$41.7 million in claims – or a 1.2 percent loss ratio.³²

Most title insurance is sold for title insurers through title agents. Title agents can be affiliated with the title insurer or non-affiliated independent title agents. The bulk of the title insurance

²⁶ Demotech, "Title Insurance Industry Information and Economic Data," 2005 at 65.

²⁷ The First American Corporation, Securities and Exchange Commission 10-K filing, Fiscal Year December 31, 2005 at 26.

²⁸ *Ibid.*

²⁹ Arrunada, Benito, "A Transaction-Cost View of Title Insurance and its Role in Different Legal Systems," *The Geneva Papers of Risk and Insurance*, Vol. 27, No. 4, October 2002.

³⁰ Treaster, Joseph B., "Iowa Cuts Added Costs in Title Insurance Policies," *New York Times*, July 6, 2005.

³¹ DasGupta, Neil and Richard McCarthy, "Clouds on Horizon After Title Industry's Bright Year," A.M. Best Special Report, October 2005 at 13.

³² Brown, Wendy, "Suit Calls for Reform, Refund," *The New Mexican*, March 30, 2006.

premium – 70 to 90 percent, depending on the state – goes to the title agent because the title agent is typically the one who does the search, examination and underwriting of the title insurance policy.

The real costs to insurers are the amounts title insurance carriers and title agents pay to real estate intermediaries to capture homeowners' policy dollars. Title insurance companies pay commissions to title agents, not to real estate professionals. It is illegal to pay someone for a referral, which is why they either do it illegally or via affiliated business arrangements. The expenses of title insurers and title agents are often inflated because of considerations provided to the referrers, which may include money or a variety of free services, such as printing and distributing marketing materials for real estate agents. To secure these referrals, title insurers and title agents offer considerations to the real estate professionals (real estate brokers, mortgage brokers, lenders and developers) and these considerations increase the cost of the insurance premium for the home buyer.³³ Some considerations are legal in some states, including paying for marketing costs, market analyses and mailing lists, while most forms of considerations and gifts are illegal kickbacks.³⁴

On a countrywide basis, the top four title insurers paid an average of about 80 percent of the title insurance premiums to their title agents in the form of commissions.³⁵ An analysis of commission splits in California found that between 8 percent and 12 percent of the premium was paid to the title underwriter and between 88 percent and 92 percent of the premium was paid to the title agent.³⁶ It should be noted that the commission split is not disclosed to borrowers. The HUD-1 form that discloses the costs of title insurance to borrowers

Commission Split of Top Four Title Companies			
	2003	2004	2005
Fidelity	78.4%	78.0%	77.5%
First American	80.9%	81.3%	80.5%
LandAmerica	80.2%	80.1%	78.2%
Stewart	82.0%	81.6%	81.2%
Average	80.4%	80.3%	79.3%
Source: 2005 SEC 10-K Filings			

³³ Birnbaum at 27.

³⁴ Gandel, Stephen, "Congressman Calls for Title-Insurance Investigation," *Money*, February 24, 2006.

³⁵ Consumer Federation of America analysis of Securities and Exchange Commission 10-K filings for Fidelity National Title, First American Corporation, LandAmerica Financial Group and Stewart Information Services Corporation, fiscal year 2005.

³⁶ Birnbaum, Birny, Report to the California Insurance Commissioner, *An Analysis of Competition in the California Title Insurance and Escrow Industry*, December 2005 at 17.

at line 1108 merely shows the total premium amount the buyer pays for title insurance, but homebuyers assume that the entirety of the premium goes toward underwriting, not the real estate intermediary in the room with them at the time of closing.

The real costs for creating the title insurance policy are very low, a few hundred dollars for the title search and taxes and 5 percent of the premium price for losses, but consumers are being charged considerably more than the cost of the product plus a reasonable amount for profits. For a \$500,000 home in the Washington, D.C. metropolitan area, title insurers are charging about \$1,775.³⁷ The direct cost of the policy to the underwriter is about \$200 to perform the associated administrative title services and 5 percent of the “market” premium, about \$90, for a total of under \$300 – about a sixth of the price being charged by title carriers. The remainder may be the split the underwriter pays the real estate agent, mortgage broker or title agent. The title industry maintains that title insurance can’t be compared to other insurance products because of much higher operating expenses (i.e., maintenance and records search expenses) than other lines of insurance, but the overwhelming majority of these costs are related to the commission split that is paid to the title agents.

III. Factors Contributing to Excessive Cost

Although consumers know little about it, title insurance is big business. Title insurance premiums written exceed most property and casualty lines including medical malpractice, fire, farm owner’s, mortgage, ocean marine, inland marine, commercial auto physical damage and several other lines of property/casualty insurance.³⁸ The real estate boom has been very profitable for title insurers; since premiums are based on a percentage of the home sales price, rising home prices increase the cost of title insurance premiums. Between 1995 and 2004, total operating revenue for the title insurance industry grew more than three-fold from \$4.8 billion to

³⁷ First American Title Fee Calculator, Basic ALTA Coverage Premium Quote, accessed April 18, 2006, www.titlefees.firstam.com/titlefees.asp.

Calculation based on previously having title insurance valued at \$250,000.

³⁸ Boyer, M. Martin and Charles M. Nyce, “Banks as Insurance Referral Agents? The Convergence of Financial Services: Evidence from the Title Insurance Industry,” *Scientific Series*, Centre Interuniversitaire de Recherche en Analyse des Organisations, 2002s-78, September 2002, at 3; A.M. Best Aggregates and Averages, 2005 edition, 2004 data.

\$15.5, according to data from Demotech.³⁹ Operating revenue, including premium as well as escrow and other services, was \$16.4 billion in 2004, of which \$15.1 billion was premium, according to A.M. Best and Co. The revenue was used to pay claims, operating expenses and profits. This broke down as follows over the past decade:

TITLE INSURANCE REVENUE BREAKDOWN

Year	Operating Revenue	Profit	Loss and Adjustment	Operating Expenses
1995	\$4.8	\$0.0	\$0.3	\$4.6
1996	\$5.6	\$0.1	\$0.3	\$5.2
1997	\$6.2	\$0.1	\$0.3	\$5.8
1998	\$8.3	\$0.3	\$0.3	\$7.7
1999	\$8.5	\$0.3	\$0.4	\$7.9
2000	\$7.9	\$0.0	\$0.4	\$7.4
2001	\$9.8	\$0.2	\$0.5	\$9.0
2002	\$12.6	\$0.5	\$0.6	\$11.6
2003	\$16.5	\$1.0	\$0.7	\$14.8
2004	\$16.4	\$0.8	\$0.7	\$14.9
Total	\$96.6	\$3.3	\$4.5	\$88.9
% of premium	1.00	0.03	0.05	0.92
Growth 04/95	3.42	24.24	2.33	3.24

Figures in Billions of Dollars

Source: A.M. Best and Co., Special Report, October 2005

These data reveal that the huge jump in premium did not result in a similar jump in profits, likely because reverse competition forced insurers to pay ever greater amounts to referrers of business.

Additionally, the wave of refinancing as interest rates remained at historic lows meant that title insurers could be receiving premiums to insure the same property multiple times in relatively short periods.⁴⁰ Although refinancing activity has slowed as interest rates have risen over the past 18 months, during the previous years, many homeowners refinanced their homes repeatedly. There is concern that consumers could be charged unnecessarily high rates for renewing title insurance policies for which the risk or cost has not appreciably changed but the price remains

³⁹ Fidelity National Title Group, Inc., Securities and Exchange Commission 10-K filing, Fiscal Year, December 31, 2005 at 4.

⁴⁰ Mara, Janis, "The Real Estate Boom Pumps Up Title Insurance," *Inman News*, August 26, 2005.

unnecessarily high. Although most title insurance claims are filed within the first six years of the policy, the modest price reductions in refinance title policies may not accurately reflect the risk of the policy. Despite expectations that the real estate market will cool, Fitch Ratings has predicted that 2006 “will likely be another good year for title insurer earnings” by historical standards.⁴¹

Title insurance is a highly concentrated industry with the overwhelming majority of the market controlled by only five firms. Five title insurance firms control 92 percent of the national market. Between 1988 and 1996, the number of title insurance firms declined by about a fifth (18.4 percent) while the volume of premiums increased by nearly half (47.3 percent).⁴² Since 1996, the

Market Share			
	2003	2004	2005P
Fidelity	31.5%	30.5%	28.8%
First American	22.9%	25.9%	27.8%
LandAmerica	18.1%	18.2%	18.1%
Stewart	11.4%	11.2%	11.5%
Old Republic	6.3%	6.0%	5.7%
Top 3	72.5%	74.6%	74.7%
Top 4	83.9%	85.8%	86.2%
Top 5	90.2%	91.8%	91.9%
Source: ALTA's Market Share Family-Company Reports 2003-2005			

industry has consolidated further. In 1998, LandAmerica was created from a merger between Lawyers Title Insurance and Commonwealth Land Title Insurance. In 2000, Fidelity National Financial (parent of Fidelity National Title) acquired Chicago Title.⁴³

According to the American Land Title Association, the primary title insurance trade association, the top five title insurance firms (affiliated companies known as “families”) have increased their market share from 90.2 percent in 2003 to 91.9 percent in 2005.⁴⁴ Although the increase is slight, the current title insurance market concentration precludes large increases because there is only 8.1 percent of the market that is not controlled by the five largest firms. Moreover, the five

⁴¹ Fitch Ratings, “Review and Outlook 2005-2006: U.S. Title Insurance,” December 7, 2005 at 3.

⁴² Walker, Teresa, “Title Insurance: An Overview,” *NAIC Research Quarterly*, October 1997, Vol. III, Iss. 4 at 5.

⁴³ Fidelity National Title Group, Inc., Securities and Exchange Commission 10-K filing, Fiscal Year, December 31, 2005 at 4.

⁴⁴ American Land Title Association, Market Share Family-Company Reports 2003, 2004 and 2005. Available at www.alta.org.

large national firms have continued to purchase the regional independent companies and are expected to continue consolidation in the future.⁴⁵

Title insurance markets are heavily concentrated, meaning that a few firms control most of the sales. As mentioned above, only five insurer groups are responsible for 92 percent of the sales on a countrywide basis. In some states and in some counties, the concentration is even greater, with one or two title insurers controlling the entire market. Another measure of concentration is the Herfindahl-Hirschman Index (which is the sum of the squares of the seller market shares). The Federal Trade Commission and the Department of Justice have published guidelines for HHIs as part of their consideration of potential anti-competitive consequences of horizontal mergers. According to the guidelines, a market with an HHI over 1,800 is “highly concentrated.”⁴⁶ The countrywide title insurance HHI is over 2,100. But even this high figure understates the concentration of title insurance. States or even counties within a state better define title insurance markets because title insurance regulation varies by state and because the raw material for title insurance comes from county courthouses. The HHI for California is over 2,400 and in several counties within California, the HHI is over 7,500.

Three states – Florida, Texas and New Mexico – set rate caps while some other states require the prior approval of rates before policies are offered. Other states have file-and-use (permitting state regulators to block the implementation of insurance rates within a short period after they were filed with the state), and some states have no rate regulation. Weak price regulation in a reverse competition market is a prescription for excessively high prices for consumers. Reliance on market forces to protect consumers where reverse competition dominates does not work. Real and effective price regulation is required. Consumers don’t have the market power to discipline title insurance prices and those that do have the power – referrers of business – have an incentive for higher prices that include funds to pay for considerations for the referral.

Recent State and Federal Enforcement Actions Suggest Title Costs are Inflated

⁴⁵ Fitch Ratings, “Review and Outlook 2005-2006: U.S. Title Insurance,” December 7, 2005 at 6.

⁴⁶ See U.S. Department of Justice, Antitrust Division Manual, Chapter 2: Statutory Provisions and Guidelines of the Antitrust Division, 1.5 Concentration and Market Shares; U.S. Department of Justice and Federal Trade Commission, “Commentary on the Horizontal Merger Guidelines,” March 2006 at 15.

There have been a widening number of recent state investigations into allegations of title insurers paying kickbacks, which have increased the costs of title insurance premiums for home buyers. The Federal Real Estate Settlement Procedures Act (RESPA) prohibits paying title agents kickbacks, defined as giving or accepting money or other items or services of value, and many state laws have anti-kickback provisions.⁴⁷ However, RESPA does not prohibit making payments to partner or affiliated firms, so title agents have an incentive to become affiliated with insurers to receive these benefits. Title agencies may create captive firms which can receive premium rebates for illusory services to maintain their cut of the title insurance business; for example, creating reinsurance firms that are not true reinsurance firms but are created to siphon profits into the title agents' pockets. These agents own these captive reinsurance operations. In these sham reinsurance operations, the title insurance company "fronts" for the reinsurer and establishes arrangements removing most of the risk from the reinsurer, often guaranteeing profits for the reinsurer. Several major title insurance firms pay up to half of their premiums to captive reinsurance firms operated by homebuilders or developers. Captive reinsurance products are troubling because there is little evidence low-risk insurance such as title insurance needs reinsurance, the premiums paid by the title companies greatly exceed the transferred risk and rebating premiums can run afoul of federal and state laws barring anti-competitive practices.⁴⁸ Examples of recent state actions in reaction to kickback schemes in title insurance are attached at Appendix A.

The Department of Housing and Urban Development is investigating whether the affiliated business arrangements established by title insurers are truly distinct businesses or whether they are shell companies which provide payments to homebuilders or real estate agents.⁴⁹ In 2005 alone, HUD settled 10 investigations for a total of \$1.5 million against real estate, homebuilding, closing agencies, title agencies and title insurers related to RESPA's Section 8 anti-kickback provisions. Some of the HUD actions are shown in Appendix B.

⁴⁷ Johansen, Erin, "Insurance Division Alleges Kickbacks," *Denver Business Journal*, January 14, 2005.

⁴⁸ McIntyre Law Firm, PLLC, "Summary of NAIC Spring 2005 Meeting," April 4, 2005.

⁴⁹ DasGupta, Neil and Richard McCarthy, "Clouds on Horizon After Title Industry's Bright Year," A.M. Best Special Report, October 2005 at 2.

These actions are helpful for the consumer but for the vast majority of American home buyers they are “too little – too late.” Congress must do something to remove or sharply reduce the financial incentives for title insurance companies, title agents and other intermediaries to engage in reverse competition through kickbacks. Just making these payouts illegal did not work. The incentive must be eliminated completely.

IV. What Can Be Done to Remove the Financial Incentive for Title Insurance Reverse Competition Kickbacks?

1. Replace Title Insurance with a Torrens-type Title System Like the Iowa Title Guaranty Program

“Torrens Title” is another method for protecting a buyer when a property is transferred. Starting in Australia in 1858, Torrens has replaced the old English land law, which was based on medieval concepts and made conveyancing, or the transfer of properties, cumbersome, time consuming and expensive (i.e., the title insurance system). Torrens is now widely used in many parts of the world.

The system is one where your title or ownership right to the property is actually created by the very act of registration, or recording in a central (usually governmental) register or record. The main object of the system is to make the register conclusive (in most cases) without a transferee or purchaser having to look behind the register. Once your name is registered or recorded on the title register under Torrens title you become the owner of the property to the exclusion of all others, by the very fact of registration. You therefore obtain “title by registration,” which is the pivotal concept of Torrens title. Under this system, no document such as a transfer or a mortgage is effective to pass the title or give rise to an interest in a property unless and until it is recorded at the centralized registry. Normally, the person who is recorded as the owner of a parcel of land cannot have his title challenged or overturned. This concept is known as ‘indefeasibility’ of title.

The state of Iowa uses a form of Torrens title system. This system provides a useful benchmark for examination by Congress of just how much homeowners might save through a more pro-

consumer approach. Iowa does not permit private title insurance; instead, the state operates a guaranty fund, which insures property titles essentially identically to private title insurers.⁵⁰ In 1947, Iowa banned title insurance after a spate of insurance bankruptcies in Sioux City and created a statewide title guaranty program. In 1985, Iowa developed Title Guaranty, the state sponsored title guaranty, to ensure that mortgages could be sold on the secondary market.⁵¹

The Iowa Title Guaranty program saves money for home buyers. Iowa's title insurance savings are the result of the elimination of commission payments to title agents and other transaction service providers, such as real estate agents. Iowa homebuyers pay between 20 percent and 30 percent less for title insurance premiums than the average nationwide costs homebuyers pay in other states.⁵² Consumer Federation of America compared the current residential certificate premium rates offered by the Title Guaranty program and a national title insurer and found significant savings. The Title Guaranty premium rate is \$110 for mortgages up to \$500,000 and the basic premium quote for a \$150,000 mortgage at First American Title is \$175, which is 59 percent higher.⁵³ Similar coverage for a \$500,000 mortgage in Washington, D.C. would cost \$1,775, more than 16 times more expensive than the Iowa program.⁵⁴ The Iowa State Bar Association calculated that mandatory private title insurance would add \$26 million to \$52 million to state real estate transaction costs annually.⁵⁵

Another very important part of the Iowa system is that the title is fixed, so the homeowner isn't out his or her property if a defect is later discovered. In contrast, title insurance simply pays up to the limit of the policy and the buyer can lose the property. Thus consumers get a better product in Iowa than in the rest of the nation, at a much lower price.

⁵⁰ Lavelle, Karen, "Title Insurance: Is it Wanted Here?" *Law Society Journal*, New South Wales, Australia, November 2002.

⁵¹ Iowa Finance Authority, Title Guarantee, *On the Move*, Fall 2005.

⁵² Treaster, Joseph B., "Iowa Cuts Added Costs in Title Insurance Policies," *New York Times*, July 6, 2005.

⁵³ Iowa Finance Authority, Title Guarantee, Residential Certificate Premium Rates, March 1, 2006; First American Title Fee Calculator, Basic ALTA Coverage Premium Quote, accessed April 18, 2006, www.titlefees.firstam.com/titlefees.asp.

⁵⁴ *Ibid.* Calculation based on previously having title insurance valued at \$250,000.

⁵⁵ Iowa State Bar Association, "Title Insurance: A Fleecing of America," 2003 at 11.

Given that most of the world has moved to more efficient methods of protecting home buyers from defects in their deeds and we see real savings achieved with the Iowa model, it appears Congress should encourage more states to be examining this and other less expensive alternatives to traditional title insurance.

2. Make Lenders Pay for Title Insurance

Another alternative is to have the lenders purchase the title insurance policies and include the cost of the title insurance in their APR, which is clearly subject to positive competitive forces. This would help to limit or eliminate the current lack of incentive to hold down the cost of title insurance premium, since there no longer would be an ability to indirectly pass the cost through to the home buyer.⁵⁶ The direct pass-through as part of the APR will pressure the lenders to achieve low title insurance cost, squeezing out the excessive kickbacks from the title insurance product. Homeowners would be protected with lender purchased title insurance coverage for the borrower even after they pay off their mortgages. Title policies remain in force until the property is sold or the loan is repaid. When a consumer refinances, the old lender's policy expires and a new lender's policy is required. However, the owner's policy remains in force with a refinance.

The general approach would be to make those requiring the title insurance pay for it – the lender for lender's policies and the buyer for owner's policies. The lender would be prohibited from passing the cost of title insurance on as a separate charge, which would incentivize the lender to seek lower title insurance prices. Since the lender would be a regular purchaser of many policies, the lender would be in a position to discipline title insurers on price in a more direct market transaction that currently exists.

Conclusion

Mr. Chairman, we appreciate your undertaking this important effort to help consumers who have, for too long, been burdened with excessive title insurance charges. Congress should consider

⁵⁶ Guttentag, Jack, "Title Insurance Fees Paid by Borrowers Include Referral Costs," March 21, 2005.

strong measures to overcome the extreme financial incentives for those in the title insurance business to engage in reverse competition, including such price increasing activities as excessive commissions, lucrative “reinsurance” arrangements, free or below cost services and other kickbacks.

Congress must find ways to remove or substantially remove this perverse financial incentive. Two ways to do so are:

1. Move away from the old-fashioned and inefficient title insurance legal system toward a Torrens system similar to that used in many parts of the world. Take a good look at the Iowa system as one example of a more efficient system.
2. Make the lenders pay for their own title insurance, eliminating the opportunity for kickbacks on that title insurance sold in America. Lenders will seek to lower the cost and are sophisticated buyers of title insurance who have no incentive to drive costs down today (lenders do not pay the premium today). The incentive to get title insurance at reasonable cost will be there when lenders have to pay for it themselves and build it into their cost of doing business.

I will be pleased to answer your questions at the appropriate time.

RECENT STATE ACTIONS AGAINST KICKBACK SCHEMES

- **Colorado:** A 2005 investigation in Colorado closed 11 title insurance agencies that were created to receive kickbacks from title insurers.⁵⁷ In 2006, the Colorado Insurance Department pledged to close 180 “sham” affiliated real estate businesses that received kickbacks from title insurers.⁵⁸
- **California:** California settled claims of kickbacks to lenders, real estate agents and developers’ captive reinsurance firms in exchange for referring business to title insurers that would refund \$37.8 million to consumers.⁵⁹
- **Michigan:** In 2006, four title insurers refunded \$27.5 million to Michigan home buyers to settle a 2000 class action suit representing 60,000 households.⁶⁰
- **Arizona:** Arizona settled an anti-kickback case with one title insurer in exchange for a \$1 million donation to the state American Red Cross because the insurer insisted on litigating the case if any refunds were made to actual consumers.⁶¹
- **New York:** Attorney General Eliot Spitzer is investigating whether national title insurance firms have been illegally paying rebates and referrals to real estate intermediaries that have increased title insurance premiums for homeowners.⁶²

⁵⁷ Prerault, Michael, “State Probe Propels Federal Inquiry,” *Denver Business Journal*, March 5, 2006.

⁵⁸ “Colorado Targets 180 ‘Sham’ Affiliated Businesses,” *Insurance Journal*, April 6, 2006.

⁵⁹ California Department of Insurance press release, “Insurance Commissioner John Garamendi Announces Major Settlement Agreements with Title Insurers – More than \$37 Million to be Paid for Illegal Kickback Schemes,” July 20, 2005.

⁶⁰ Gandel, Stephen, “Congressman Calls for Title-Insurance Investigation,” *Money*, February 24, 2006.

⁶¹ Harris, Craig, “LandAmerica Title Insurance Firm Settles Kickback Case with \$1 Million Gift,” *Arizona Republic*, September 9, 2005.

⁶² “Spitzer Said to Eye Title Insurers,” *CNNMoney.com*, March 2, 2006.

RECENT HUD ACTIONS RELATED TO
RESPA'S SECTION 8 ANTI-KICKBACK PROVISIONS

- **Tennessee:** HUD reached a settlement with a builder in Tennessee that, along with 7 other builders, created an affiliate with a national title insurance company that provided “little or no title work” for the title company, was not an independent company according to RESPA requirements, and received “substantial financial benefits from the referral of business.”⁶³ The investigation was settled for \$225,000.⁶⁴
- **Michigan:** HUD investigated whether real estate firms in Michigan were being over-reimbursed for providing office and conference room services to title companies. Four firms settled the investigations for a combined total of \$80,000 in the fall of 2005. HUD reached a settlement with two affiliates of a national real estate chain for receiving conference room rental reimbursements from a title company that exceeded the market rental rates. The real estate affiliates settled the investigation for a combined \$20,000.⁶⁵ A second affiliate of a national real estate firm settled similar charges for \$45,000.⁶⁶ Another real estate brokerage firm settled a similar allegation in Michigan for \$15,000.⁶⁷ Earlier in the year, HUD settled a case against a regional title insurer for making above market conference room rent payments to real estate agents for \$150,000.⁶⁸
- **Georgia:** HUD investigated a national real estate firm operating in and around Atlanta for providing inducements for sales agents that made referrals to a title company including higher sales commission splits and prizes and other benefits. In some cases, it

⁶³ Downing Homes, LLC, U.S. Department of Housing and Urban Development, December 15, 2005; Title Group Builders, HUD, December 15, 2005.

⁶⁴ Title Group Builders, HUD, December 15, 2005 at 4.

⁶⁵ RE/MAX Masters, HUD, October 20, 2005; RE/MAX in the Hills, HUD, September 12, 2005.

⁶⁶ Schweitzer Real Estate, Inc., d/b/a Coldwell Banker Schweitzer Real Estate, HUD, September 12, 2005.

⁶⁷ Hometown One Associates, Inc., d/b/a Remerica, HUD, September 12, 2005.

⁶⁸ Metropolitan Title Company, HUD, May 27, 2005.

appears that sales agents would forgo their commissions if they did not refer homebuyers to the title company. The real estate firm settled the investigation for \$250,000.⁶⁹

- **Tennessee 2:** A national title insurance company's Memphis-based affiliate was investigated for providing two employees and office space for an allegedly independent group which was a partnership between real estate agents, builders and the title insurer. The real estate agencies and builders provided "little or no work" to the partnership which was basically provided by the title insurer. The partnership was determined to be a "sham controlled business arrangement" that provided substantial referral fees to the builders and real estate agents. The title insurer agreed to pay a \$680,000 settlement to HUD, which was the value of title business referred by the real estate agents and builders.⁷⁰
- **Oklahoma:** HUD investigated a limited liability real estate services firm which was established by 40 Tulsa-area residential construction firms to establish a separate title agency "solely for the purpose of [...] distributing funds" from the title agency to the builders.⁷¹ A series of real estate shell companies owned the title agency (including the real estate services firm formed by the builders, and another escrow firm and the closing firm which owned the escrow firm) received regular disbursements of profits from the title agency for referring clients to it. The related companies agreed to terminate their referral payment or allocation arrangements and pay HUD \$125,000.⁷²

⁶⁹ Prudential Locations, LLC, HUD, August 22, 2005.

⁷⁰ First American Title, HUD, July 8, 2005.

⁷¹ Closing and Escrow of Tulsa, Inc., Closings of Tulsa, LLC, 2003 Builders Services, LLC, and Builders Title and Escrow, LLC, HUD, March 21, 2005 at 3.

⁷² Closing and Escrow of Tulsa, Inc., Closings of Tulsa, LLC, 2003 Builders Services, LLC, and Builders Title and Escrow, LLC, HUD, March 21, 2005 at 6-7.