

GAO

Report to the Ranking Member,
Committee on Financial Services,
House of Representatives

April 2007

TITLE INSURANCE

Actions Needed to Improve Oversight of the Title Industry and Better Protect Consumers





Highlights of GAO-07-401, a report to the Ranking Member, Committee on Financial Services, House of Representatives

Why GAO Did This Study

In a previous report and testimony, GAO identified issues related to title insurance markets, including questions about the extent to which premium rates reflect underlying costs, oversight of title agent practices, and the implications of recent state and federal investigations. This report addresses those issues by examining (1) the characteristics of title insurance markets across states, (2) factors influencing competition and prices within those markets, and (3) the current regulatory environment and planned regulatory changes. To conduct this review, GAO analyzed available industry data and studies, and interviewed industry and regulatory officials in a sample of six states selected on the basis of differences in size, industry practices, regulatory environments, and number of investigations.

What GAO Recommends

GAO recommends that HUD and state insurance regulators take actions to improve consumers' ability to comparison shop for title insurance and strengthen the regulation and oversight of the title insurance market, including the collection of data on title agents' operations. Further, Congress may want to consider, as part of its oversight of HUD, exploring the need for modifications to RESPA, including increasing HUD's enforcement authority. HUD generally agreed with these recommendations, and NAIC agreed they should be explored.

www.gao.gov/cgi-bin/getrpt?GAO-07-401.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Orice M. Williams at (202) 512-8678 or williamsom@gao.gov.

TITLE INSURANCE

Actions Needed to Improve Oversight of the Title Industry and Better Protect Consumers

What GAO Found

The U.S. title insurance market is highly concentrated at the insurer level, but market characteristics varied across states. In 2005, for example, five insurers accounted for 92 percent of the national market, with most states dominated by two or three large insurers. Variations across states included the way title agents conducted their searches as well as the number of affiliated business arrangements (ABA) in which real estate agents, brokers, and others have a stake in a title agency. Finally, premiums varied across states due to cost and market variations that can also make understanding and overseeing title insurance markets a challenge on the national level.

Certain factors raise questions about the extent of competition and the reasonableness of prices that consumers pay for title insurance. Consumers find it difficult to comparison shop for title insurance because it is an unfamiliar and small part of a larger transaction that most consumers do not want to disrupt or delay for comparatively small potential savings. In addition, because consumers generally do not pick their title agent or insurer, title agents do not market to them but to the real estate and mortgage professionals who generally make the decision. This can create conflicts of interest if those making the referrals have a financial interest in the agent. These and other factors put consumers in a potentially vulnerable situation where, to a great extent, they have little or no influence over the price of title insurance but have little choice but to purchase it. Furthermore, recent investigations by the Department of Housing and Urban Development (HUD) and state insurance regulators have identified instances of alleged illegal activities within the title industry that appeared to take advantage of consumers' vulnerability by compensating realtors, builders, and others for consumer referrals. Combined, these factors raise questions about whether consumers are overpaying for title insurance.

Given consumers' weak position in the title insurance market, regulatory efforts to ensure reasonable prices and deter illegal marketing activities are critical. However, state regulators have not collected the type of data, primarily on title agents' costs and operations, needed to analyze premium prices and underlying costs. In addition, the efforts of HUD and state insurance regulators to identify inappropriate marketing and sales activities under the Real Estate Settlement Procedures Act (RESPA), have faced obstacles, including constrained resources, HUD's lack of statutory civil money penalty authority, some state regulators' minimal oversight of title agents, and the increasing number of complicated ABAs. Finally, given the variety of professionals involved in a real estate transaction, a lack of coordination among different regulators within states, and between HUD and the states, could potentially hinder enforcement efforts against compensation for consumer referrals. Because of the involvement of both federal and state regulators, including multiple regulators at the state level, effective regulatory improvements will be a challenge and will require a coordinated effort among all involved.

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Abbreviations

ABA	affiliated business arrangement
ALTA	American Land Title Association
Fannie Mae	Federal National Mortgage Association
Freddie Mac	Federal Home Loan and Mortgage Corporation
HUD	Department of Housing and Urban Development
NAIC	National Association of Insurance Commissioners
RESPA	Real Estate Settlement Procedures Act
RESPRO	Real Estate Services Providers Council
SEC	Securities and Exchange Commission

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United States Government Accountability Office
Washington, DC 20548

April 13, 2007

The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
House of Representatives

Dear Mr. Bachus:

Title insurance is designed to guarantee clear ownership of a property that is being sold and is a required part of most real estate transactions across the United States. Although home buyers pay for title insurance premiums, they often know little about the insurers themselves or the title insurance industry. Recent state and federal investigations into the sale of title insurance have identified practices by some title insurers, their agents, and others involved in the sale of title insurance, that allegedly allowed these entities to make undue profits at consumers' expense. At the same time, insurance regulators in at least four states have concluded that consumers are being overcharged for title insurance, and the California insurance regulator has recommended rate rollbacks—an action that some in the title industry have strongly criticized. Because virtually everyone who buys a home or refinances a home mortgage in the United States typically must purchase title insurance, the potential effects of such practices are enormous.

We previously provided a report and testimony identifying issues in the title insurance market that merited further study because they could shed light on competition and the prices consumers pay.¹ In response to the former Chairman's request, we prepared this report to address and elaborate on those issues. Specifically, we address (1) the characteristics of title insurance markets and differences across states, (2) prices and competition in the industry, and (3) the current regulatory environment and planned regulatory changes.

¹GAO, *Title Insurance: Preliminary Views and Issues for Further Study*, GAO-06-568 (Washington, D.C.: Apr. 24, 2006); and *Title Insurance: Preliminary Views and Issues for Further Study*, GAO-06-569T (Washington, D.C.: Apr. 26, 2006).

To do this work, we performed a detailed review of the laws, regulations, and market practices in California, Colorado, Illinois, Iowa, New York, and Texas.² We chose these six states on the basis of differences in the size of their markets, title insurance practices and customs, the rate-setting and regulatory environments, and the number of federal and state investigative actions. In some of these states, we were able to tour title plant facilities and observe the title search and examination process. We reviewed available studies of the title insurance industry and discussed their results with the authors.³ We also gathered the views of officials from a variety of national organizations whose members are involved in the marketing or sale of title insurance or related activities, and we spoke with insurers, agents, and title industry associations. We asked for, but did not receive, cost data from agents and insurers that would allow us to analyze agents' costs. We obtained and analyzed data collected by the National Association of Insurance Commissioners (NAIC), the Texas Department of Insurance, the California Department of Insurance, and the American Land Title Association (ALTA).⁴ We also consulted other publicly available financial information on title insurers and agents and spoke with agents about costs, examined financial data filed with the Securities and Exchange Commission (SEC), and spoke with officials from three of the largest title insurance underwriters. We interviewed key insurance, banking, mortgage, and real estate regulators in each state about the regulatory environments, spoke to officials from the Department of Housing and Urban Development (HUD), and reviewed relevant federal laws and regulations. We also discussed these issues with officials from the Federal National Mortgage Association and the Federal Home Loan and Mortgage Corporation to better understand the relationship between the secondary mortgage market and title insurance. Lastly, we interviewed

²Except where noted, our analysis is limited to these states.

³Birny Birnbaum, *Report to the California Insurance Commissioner: An Analysis of Competition in the California Title Insurance and Escrow Industry* (Austin, TX: December 2005); Donald Martin, PhD, and Richard Ludwick, Jr., PhD, *Affiliated Business Arrangements and Their Effects on Residential Real Estate Settlement Costs: An Economic Analysis* (Washington, D.C.: October 2006); and Gregory Vistnes, *An Economic Analysis of Competition in the Title Insurance Industry* (Washington, D.C.: March 2006).

⁴NAIC is a voluntary organization of the chief insurance regulatory officials of the 50 states, the District of Columbia, and the four U.S. territories. NAIC assists state insurance regulators by providing guidance, model (or recommended) laws and guidelines, and information-sharing tools. ALTA is a national trade association for title insurers and agents, but its members may also include attorneys, builders, developers, lenders, and real estate brokers.

staff and state regulators working with NAIC to get their views on the industry and to obtain information on the activities of their Title Insurance Working Group.

We performed our work in Washington, D.C.; Chicago, Illinois; and six sample states between February 2006 and March 2007 in accordance with generally accepted government auditing standards. Appendix I contains a more detailed description of our objectives, scope, and methodology.

Results in Brief

In the United States, the title insurance market is highly concentrated at the insurer (or underwriter) level, but market characteristics varied across the states. In 2005, for example, five insurers accounted for 92 percent of the national market, and most states were dominated by two or three large insurers. However, state markets differed in several ways. For example, large insurers tended to use local or regional title agents to conduct their business, and the mix of affiliated agents (those in which the insurer has an ownership interest) and independent agents varied across states. The extent of affiliated business arrangements (ABA)—situations in which real estate or other professionals are part or full owners of title agencies—also varied. In some states the number of ABAs, which have been cited in many of the regulatory investigations into industry practices, has grown substantially. Furthermore, title agents use different processes to carry out title searches and examinations, largely because of variations in the way the industry has developed across states. Title agents in some states have automated “title plants” containing most public records, while, in other states, title agents rely on the less-efficient process of hiring people to search physical records. The extent of agents’ activities also varied widely across states, including how they set prices for their services, the portion of claims they paid, and the extent of their participation in the escrow and closing processes. Finally, we found that premiums varied across states, due to cost and market variations that can make understanding and overseeing title insurance markets a challenge on the national level.

Several factors related to the way that title insurance is marketed and priced raise questions about the extent of price competition in the title insurance industry and the ability of consumers to affect market prices. First, consumers find it difficult to shop for title insurance based on price. Purchasing title insurance is a transaction that consumers are unfamiliar with, and it can be difficult for them to gather information on all title insurance-related costs. HUD provides educational information on title insurance. However, the benefit of this information is limited because consumers may receive it after a title agent and insurer have been

selected, and lenders are not required to provide it on mortgage refinance transactions. In addition, purchasing title insurance is generally a small part of a larger home purchase or mortgage refinancing process that most consumers do not want to disrupt or delay for relatively small potential savings. Second, consumers generally do not select their title agent or insurer, and title agents do not market to consumers but rather compete among themselves for referrals from those who do—that is, real estate and mortgage professionals. This arrangement can create conflicts of interest if professionals making the referrals have a financial interest in the agent recommended. HUD and state insurance regulators have recently identified instances of alleged illegal activities within the title industry that appeared to compensate real estate agents, builders, and others for referring consumers to particular title insurers or agents. These alleged activities, which include referral fees, captive reinsurance arrangements, and inappropriate ABAs, potentially reduce price competition and, according to some insurance regulators, could indicate excessive pricing by insurers.⁶ Third, as property values or loan amounts increase, prices that consumers paid for title insurance appeared to increase faster than insurers' and agents' costs. Insurers we spoke with argued that such a pricing structure reflected regulators' intent to subsidize consumers in low-value transactions, but they could not provide data to support the existence of such subsidization. Of the six regulators we spoke with, only one said that such subsidization was intentional. Finally, in states where agents' search and examination services are not included in the premium, it is not clear that the underlying costs justify the additional amounts consumers may pay to title agents. Insurers told us that they generally shared the same portion of premiums with their agents, regardless of whether agents' costs for search and examination services were to be included in the premium. Ultimately, disagreement exists between title industry officials and regulators over the actual extent of price competition within title insurance markets. Industry officials generally assert that price competition exists, while many regulators argue (1) that it does not exist and (2) that consumers may be paying too much for title insurance compared with the cost of providing the insurance.

⁶In captive reinsurance arrangements, a home builder, real estate broker, lender, title insurance company, or some combination of these entities forms a reinsurance company that works in conjunction with a title insurer. Sham ABA arrangements are those in which the affiliated entity performs little or no actual settlement services and is allegedly being used just to compensate ABA owners for consumer referrals. Other arrangements include the use of inducements and incentives by title companies to obtain title insurance business, especially when these inducements were used to influence referrals by real estate agents, banks, lenders, builders, developers, and others.

Data collection efforts and regulatory oversight, especially of title agents, were limited across the states we reviewed. Given consumers' apparently limited ability to exert pressure on title agents and insurers to compete on price, the critical question is whether amounts paid by consumers for title insurance reflect the actual underlying costs of producing title insurance policies. Potentially understanding the relationship between costs and the amounts consumers pay could help regulators improve their ability to protect consumers. Yet, states rarely audit agents; few require strong insurer oversight of agents; and, until recently, state regulators had done little to oversee ABAs or enforce laws intended to restrict business from affiliated sources. Also, because title insurance is a relatively small line of insurance, title insurers and agents get less than the usual limited market conduct scrutiny given other types of insurers by state insurance regulators.⁶ All of the regulators, both state and federal, face a number of challenges. For example, varying levels of cooperation exist within each state among the regulators who oversee entities involved in the sale and marketing of title insurance, with some states demonstrating little or no cooperation and others having somewhat more structured arrangements. HUD—the primary federal agency responsible for enforcing the Real Estate Settlement Procedures Act (RESPA)—has taken a number of enforcement actions under RESPA recently, but HUD officials told us that they face resource limitations and difficulties in investigating increasingly complex ABA arrangements. Furthermore, HUD is authorized to seek injunctions against alleged violations of section 8 of RESPA's provisions on referral fees and affiliated businesses, but HUD is not authorized to levy civil money penalties. Moreover, a lack of formal coordination between HUD and state regulators on referral fee cases may have hindered enforcement efforts. In response to these and other concerns, several state regulators and HUD are either planning or making changes to their regulatory regimes for the marketing and sale of title insurance. These changes include potentially reducing premium rates; collecting detailed cost data from title agents; and seeking changes to RESPA, including enhancing HUD's enforcement authority. Some industry stakeholders see the current model of selling and marketing title insurance as irretrievably broken and have put forth the following two alternatives: (1) requiring

⁶Market conduct examinations are performed by state insurance commissioners, and they review agent-licensing issues, complaints, types of products sold by the company and agents, agent sales practices, proper rating, claims handling, and other market-related aspects of an insurer's operation. See GAO, *Insurance Regulation: Common Standards and Improved Coordination Needed to Strengthen Market Regulation*, GAO-03-433 (Washington, D.C.: Sept. 30, 2003).

lenders to pay for title insurance and (2) following the Iowa model of a state-run title insurer.

We are recommending that HUD take two actions to improve the functioning of the title insurance market. Specifically, we are recommending that HUD (1) improve consumers' ability to shop for title insurance based on price and (2) improve its ability to detect and deter violations of section 8 of RESPA. In taking these actions, we recommend that HUD consider expanding the information in its home-buyer information booklet; evaluating the costs and benefits to consumers from ABAs; clarifying regulations related to referral fees and ABAs; and enhancing the agency's coordination with state regulators. Likewise, we are recommending that state insurance regulators, working through NAIC where appropriate, take two actions to improve the functioning of the title insurance market. Specifically, we are recommending that state regulators take action to (1) improve consumers' ability to shop for title insurance and (2) improve their oversight of title agents. As part of this process, we are recommending that these regulators consider evaluating the competitive benefits of publicizing complete title insurance cost information; strengthening their regulation of title agents and ABAs, including the collection of data on title agents' operations; and exploring ways to improve their cooperation with other state regulators and HUD. We also suggest, as a matter for congressional consideration, amending RESPA to give HUD increased enforcement authority for violations of RESPA's section 8 prohibitions on referral fees by granting the ability to levy civil money penalties and enhance the information required to be provided to consumers.

We provided a draft copy of this report to HUD and NAIC. The Assistant Secretary for Housing at HUD and the Executive Vice President of NAIC provided written comments on the draft. Their comments are included in appendixes III and IV, respectively, of this report. The Assistant Secretary for HUD generally agreed with the recommendations in the report, and also indicated that the report accurately assessed the issues that adversely affect consumers in the title insurance market. In response to our recommendation to better protect consumers and improve their ability to shop for title insurance, he acknowledged the importance of these goals and noted that HUD is taking several actions in these areas. Specifically, he said that HUD is (1) considering ways to improve its home-buyer information booklet; (2) evaluating whether various ABA structures, even though they may be legal, are operating as Congress intended; and (3) continuing its efforts to develop and clarify guidelines regarding practices that negatively effect consumers. With respect to our

recommendation to consider improving regulatory coordination with state regulator agencies, the Assistant Secretary agreed that such coordination is necessary and pointed out past instances of successful cooperation between HUD and state insurance regulators. Lastly, he emphasized the ongoing challenge of RESPA enforcement without civil money penalty authority, stating that consumers would benefit if such authority were granted to HUD. The Executive Vice President of NAIC stated that the recommendations in the report were worthy of exploration, and she noted that the report recognizes that shortcomings exist in the area of consumer protection. Both HUD and NAIC also offered clarifying remarks.

Background

In any real estate transaction, the lender providing the mortgage needs a guarantee that the buyer will have clear ownership of the property. Title insurance is designed to provide that guarantee by generally agreeing to compensate the lender (through a lender's policy) or the buyer (through an owner's policy) up to the amount of the loan or the purchase price, respectively. Lenders also need title insurance if they want to sell mortgages on the secondary market, since they are required to provide a guarantee of ownership on the home used to secure the mortgage.⁷ As a result, lenders require borrowers to obtain title insurance for the lender as a condition of granting the loan (although the buyer, the seller, or some combination of both may actually pay for the lender's policy). *Lenders'* policies are in force for as long as the loan is outstanding, but end when the loan is paid off (e.g., through a refinancing transaction); however, *owners'* policies remain in effect as long as the purchaser of the policy owns the property.

Title insurance is sold primarily through title agents, although insurers may also sell policies themselves. Before issuing a policy, a title agent checks the history of a title by examining public records, such as deeds, mortgages, wills, divorce decrees, court judgments, and tax records. If the title search reveals a problem, such as a tax lien that has not been paid, the agent arranges to resolve the problem, decides to provide coverage despite the problem, or excludes it from coverage. The title policy insures the policyholder against any claims that might have existed at the time of the purchase but were not identified in the public record. The title policy does

⁷Both the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation require a guarantee of title as a condition of purchasing loans from mortgage lenders.

not require that title problems be fixed, but compensates policyholders if a covered problem arises. Except in very limited instances, title insurance does not generally insure against title defects that arise after the date of sale.

Title searches are generally carried out locally because the public records to be searched are usually only available locally. Title agents or their employees conduct the searches. The variety of sources that agents must check during a title search has fostered the development of privately owned, indexed databases called "title plants." These plants contain copies of the documents obtained through searches of public records, and they index the copies by property address and update them regularly. Insurers, title agents, or a combination of entities may own a title plant. In some cases, owners allow other insurers and agents access to their plants for a fee.

Title insurance premiums are paid only once, at the time of sale or refinancing, to the title agent. In what is called a premium split, agents retain or are paid a portion of the premium amount as a fee for conducting the title search and related work and for their commission. Agents have a fiduciary duty to account for premiums paid to them, and insurers generally have the right to audit the agents' relevant financial records. The party responsible for paying for the title policies varies by state and even by areas within states. In many cases, the seller pays for the owner's policy and the buyer pays for the lender's policy, but the buyer may also pay for both policies or split some or all of the costs with the seller. In most cases, the owner's and lender's policies are issued simultaneously by the same insurer, so that the same title search can be used for both policies. The price that the consumer pays for title insurance is determined by applying a rate set by the underwriter or state to the loan value (for the lender's policy) and home price (for the owner's policy). In a recent nationwide survey, the average cost for simultaneously issuing lender's and owner's policies on a \$200,000 loan, plus other associated title costs, was approximately \$859, or approximately 28 percent of the average total loan origination and closing fees.⁸

⁸Bankrate.com, *Closing Costs Survey*, <http://www.bankrate.com/brm/news/mortgages/ccmain2006a1.asp> (North Palm Beach, FL: August 2006). The survey was conducted by Bankrate.com in 2006 by obtaining online information where available. We did not assess the validity of the data collected in the survey.

Title insurance differs from other types of insurance in key ways. First, in most property and casualty lines, losses incurred by the underwriter account for most of the premium. For example, property-casualty insurers' losses and loss adjustment expenses accounted for approximately 73 percent of written premiums in 2005.⁹ In contrast, losses and loss adjustment expenses incurred by title insurers as a whole were approximately 5 percent of the total premiums written, while the amount paid to or retained by agents (primarily for work related to title searches and examinations and for commissions) was approximately 70 percent.

Second, title agents' roles and responsibilities differ from those of agents for other lines of insurance. Agents in lines of insurance other than title insurance primarily serve as salespeople, while title agents' work can be a labor-intensive process of searching, examining, and clearing property titles as well as underwriting and traditional sales and marketing. Title agents access and examine numerous public documents, among them tax records, liens, judgments, property records, deeds, encumbrances, and government documents, and then clear or exclude from coverage any title problems that emerge. Depending on the level of technology used, the accessibility of public documents, the relative efficiency of local government recorders' offices, and other factors, this process can take from a few minutes up to a few weeks or more. In some states, title agents also are responsible for claims up to a specific dollar amount. Most title agents also handle the escrow and closing processes and document recordation after the closing. In general, title agents issue the actual insurance policy and, after deducting expenses, remit the title insurer's portion of the premium.

Third, unlike premiums for other types of insurance, title insurance premiums are nonrecurring. That is, title insurers have only one chance to capture the cost of the product from the consumer, unlike other types of insurers that collect premiums at regular intervals for providing ongoing coverage. The title insurance premium amount must cover losses for any future problems that were either not uncovered in the title agent's search or, for a small number of policies, problems that emerge after the day of closing.

⁹According to industry experts and analysts, the different loss and expense structure of the title insurance industry reflects the fact that title insurance is primarily focused on preventing losses through title searches and examinations, and that most property-casualty insurance is focused on compensating policyholders for losses.

Fourth, title insurance has a different coverage period than other types of insurance. With title insurance, coverage begins on the day of closing and goes back in time. Most policies cover events that occurred in the past, including unpaid tax liens, judgments, issues with missing heirs, and forgeries in the document chain of title. The purpose of the title agent's search is to turn up these problems before closing so that they can be cleared or excluded from coverage. However, if a problem occurred in the past but only emerged after the day of closing and was not excluded from coverage, then the policy would offer protection to the lender and home owner. The comprehensiveness of the agent's search can be a factor in minimizing such losses. For this reason, title insurance is often referred to as loss prevention insurance, in contrast to other types of insurance that attempt to prospectively minimize exposure to claims.

Finally, the title insurance market's business cycle is more closely related to the real estate market and to interest rates than the business cycle for other types of insurance. Typically, this relationship is inverse, so that the revenues of title companies rise when interest rates fall, largely because lower interest rates usually lead to a surge in home buying and refinancing and thus increase demand for title services and products.

Under current federal law, the regulation of insurance, including title insurance, is primarily the responsibility of the states. However, title insurance entities are also subject to RESPA, a federal law intended to improve the settlement process for residential real estate. Section 8 of RESPA generally prohibits the giving or accepting of kickbacks and referral fees among persons involved in the real estate settlement process. Section 8 also lays out the conditions under which ABAs are permissible. First, the affiliation must be disclosed to the consumer, along with a written estimate of charges. Second, ABA representatives may not require consumers to use a particular settlement service provider. Third, the only thing of value that ABA owners may receive, other than payment for services rendered, is a return on their ownership interest. In addition, HUD has issued policy statements that describe multiple factors, including what it considers to be core title services, that HUD will use in determining if an entity is a bona fide provider of settlement services. HUD is responsible for administering section 8 of RESPA, but its enforcement authority is limited to seeking injunctions against potential violations. Unlike other sections of RESPA (e.g., section 10, which authorizes HUD to assess civil money penalties for certain violations by entities that fail to provide escrow account statements), section 8 of RESPA does not authorize HUD to levy civil money penalties for violations.

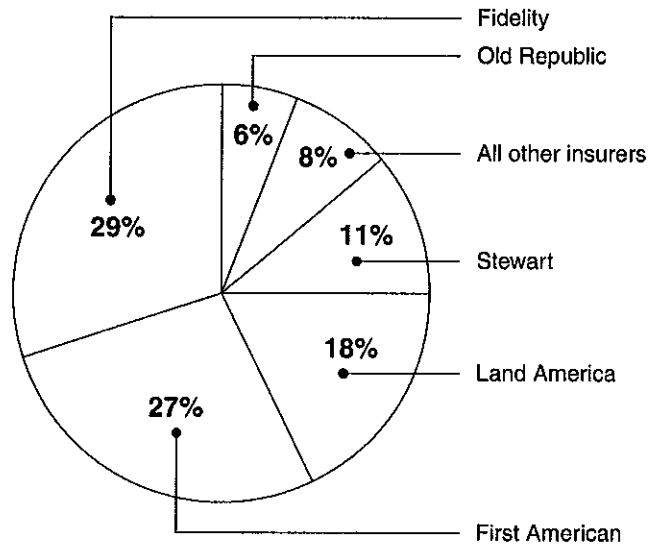
Title Insurance Market Is Highly Concentrated at the Insurer Level, but Otherwise Differs across States

Title insurance markets can be described by various characteristics, such as the following:

- While high market concentration exists among national title insurers, they market insurance through large numbers of independent and affiliated agents, with the mix varying across states.
- The use of ABAs—in which a real estate professional, such as a real estate agent, owned a share of a title agency—varied.
- Processes used by agents to conduct searches and examinations in some states were more efficient than others, and the responsibilities of title agents also varied.
- Premiums across states are difficult to compare, but they appeared to vary significantly.

Nationally, five title insurers, or underwriters, captured about 92 percent of the market in 2005 (see fig. 1). Most states were dominated by a group of two or three insurers, sometimes including a regional insurer. For example, in California, about 66 percent of the market share in 2005 was split nearly evenly between the largest two insurers—First American and Fidelity. The remaining approximately 33 percent of the market was predominantly split among the other three national insurers (25 percent) and five regional independent insurers (8 percent). Although they are national insurers, these five major underwriters sell and market title insurance in local markets through networks of direct operations, partial or full ownership of affiliates, and contracts with independent agents. According to the annual reports of the four largest title insurers, they each use between 8,000 and 11,000 agencies to sell their insurance nationwide.

Figure 1: Title Insurer National Market Share as a Percentage of Direct Premiums Written, 2005



Source: GAO analysis of industry data.

Note: Total may not add up to 100 percent due to rounding.

Mix of Affiliated and Independent Agents Differs by State

Most state markets have two types of title agents: affiliated and independent. Title insurers use both types of agents, depending on conditions in the local market, including local tax policies and established market practices, as well as the level of service the underwriter provides to the agents. Affiliated agents carry higher fixed costs to the insurer as owner, and underwriters told us that these costs were especially challenging when the market softened and the insurer's tax liability for affiliated agents rose. However, insurers also said that with affiliated agents they had more control over the premium split and, because the agents were closely aligned with the underwriter, did not have to provide as much in services, such as training. Underwriters noted that they also benefited from contracting with independent agents because doing so kept their fixed costs low and allowed them to benefit from some tax advantages. However, according to the insurers, contracting has its disadvantages, by obliging the insurers to negotiate a competitive premium split (in nonpromulgated states) or risk having the agent establish a

relationship with another underwriter.¹⁰ Independent agents, who work with several underwriters, also may not provide the guaranteed flow of business, and thus the same revenue stream, as affiliated agents.

Underwriters balance these benefits and risks when determining which agents they will use in each state. Two underwriters told us that they strive to maintain about an equal balance between affiliated agents and independent agents. Other insurers told us that, because their expenses can be higher by virtue of their ownership interest in affiliated agents, they were reluctant to take on too many affiliated agents and preferred to contract with independent agents, especially when market conditions declined. However, several industry participants told us that underwriters' purchase and use of affiliated agents in some states had increased significantly over the last 5 years. As shown in figure 2, affiliated agents dominated the market in California, the state with the largest total of premiums written, while independent agents capture the majority of the markets in Colorado, Illinois, and New York. Conversely, the Texas market was relatively more evenly balanced, with insurers, affiliated agents, and independent agents sharing the number of premiums written. In Iowa, the state-run Title Guarantee Division of the Iowa Finance Authority has a slight majority of the market and independent agents have most of the remainder.

¹⁰The term "nonpromulgated states" refers to those states where the title rate is determined by a method other than a state regulatory body setting it.

Figure 2: Title Insurance Premiums Written, by Source, 2005

Dollars in millions

	Premiums				Percentage of premiums for the state, by writer
	Written directly by insurer	Written by affiliated agents	Written by independent agents	Total	
California	\$108.4	\$2,370.7	\$719.1	\$3,198.3	3 74 23
Texas	459.2	410.6	617.7	1,487.5	31 28 42
New York	301.9	25.6	893.1	1,220.6	25 2 73
Illinois	71.5	45.4	233.8	350.7	20 13 67
Colorado	35.5	75.4	232.3	343.2	10 22 68
Iowa ^a	4.5	0.8	3.2	8.5	53 9 38
Total	\$980.9	\$2,928.4	\$2,699.3	\$6,608.7	15 44 41

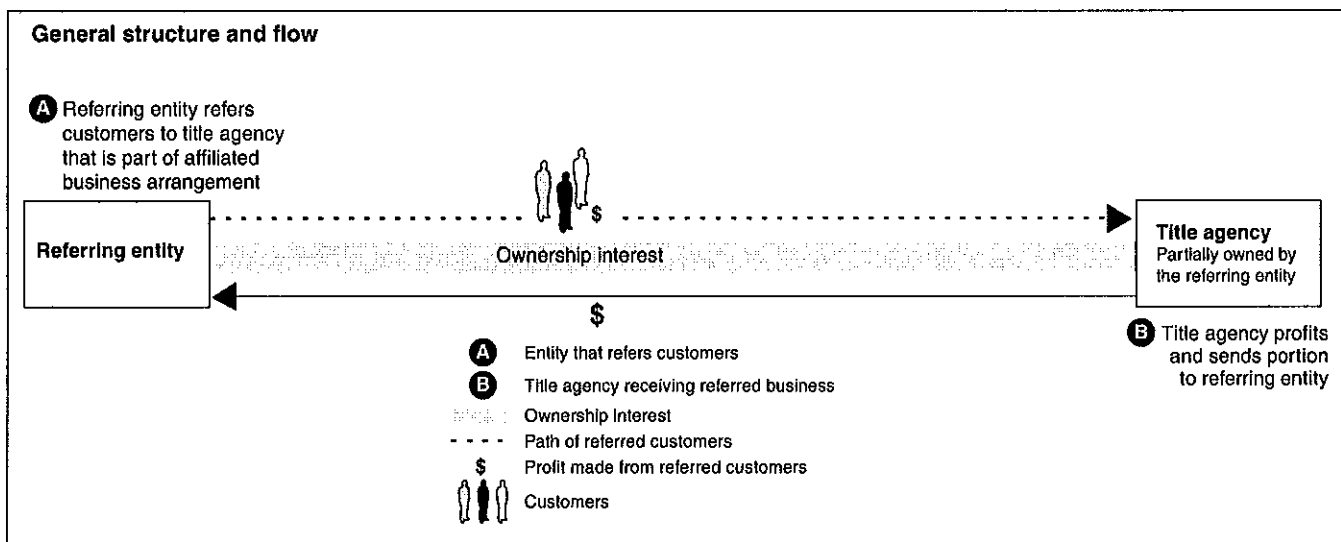
Source: GAO analysis of title industry data.

^aPremiums listed as being written directly by insurer are those written by the state-run Title Guarantee Division of the Iowa Finance Authority. Premiums written by affiliated or independent agents are premiums written by out-of-state title insurers on properties in Iowa.

Use of Affiliated Business Arrangements Appears to Be Increasing

We found that the use of ABAs varied by insurer and location. ABAs generally involved a referring entity, such as a real estate or mortgage professional, or builder, having full or partial ownership of an agency (see fig. 3). For example, a mortgage lender and a title agent might form a new jointly owned title agency, or a builder might buy a portion of a title agency. The owners of ABAs are to split the revenues in proportion to their ownership shares to satisfy antirebating laws.

Figure 3: Example of an Affiliated Business Arrangement



Source: GAO analysis of interviews with industry officials.

Nationally, the use of ABAs appears to be growing. For example, according to a study done for the Real Estate Services Providers Council (RESPRO), affiliated title agents accounted for approximately 26 percent of title-related closing costs in 2005, up from about 22 percent in 2003.¹¹ Although precise data showing state-by-state growth were not available, industry participants in some states—especially Colorado, Illinois, Minnesota, and Texas—told us that the number of ABAs in their states had grown significantly.¹²

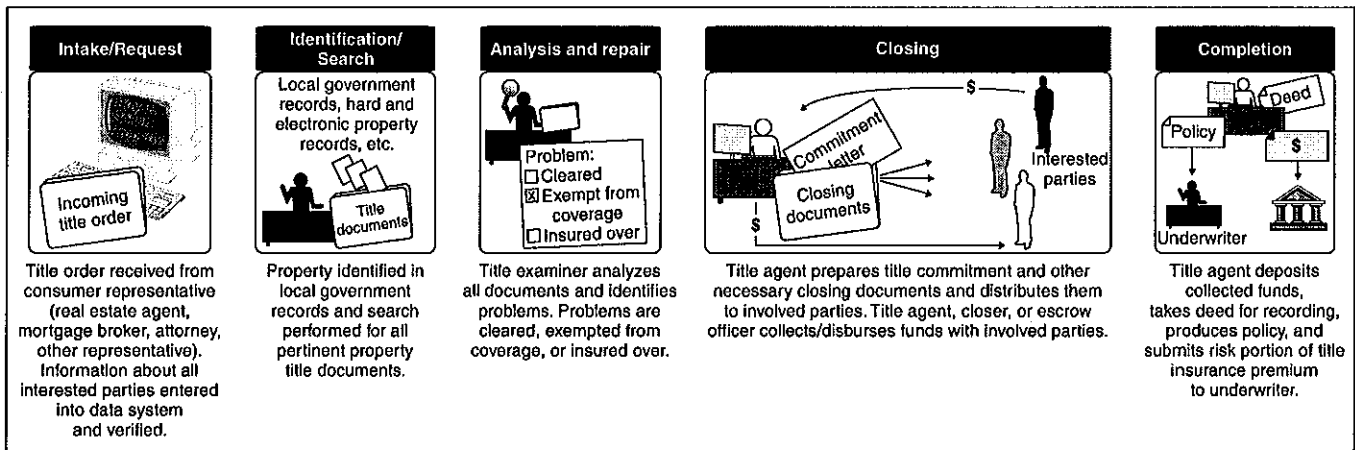
¹¹RESPRO is a national nonprofit trade association of settlement service providers, including real estate broker-owners, real estate franchisers, mortgage lenders/brokers, title insurers/agents, home builders, and home warranty companies. Many of its members offer affiliated services through subsidiaries, joint ventures, and partnerships.

¹²Although Minnesota was not in our sample, we spoke to state insurance regulators in the state.

Agents Conduct the Title Search and Examination Process Differently across States

We found that while the basic title search and examination process shared certain elements across states, the process was more efficient in some states than in others. Figure 4 describes the common elements of the title search and examination process, which begins with a request from the consumer's representative and intake by the title agent. The agent then performs the search, and a title examiner hired by the title agent analyzes the collected documents to identify any potential problems to be cleared. Once any identified problems are cleared, exempted from coverage, or insured over, the title agent prepares the closing documents and collects and disburses checks at the closing. Finally, the agent deposits collected funds in escrow accounts, records the deed or title with the relevant local government offices, and submits the title commitment to the insurer for policy issuance.

Figure 4: Common Elements of the Title Search and Examination Process



Sources: GAO observation of title plant operations and analysis of comments made by title industry officials; Art Explosion (images).

Agents in some states use primarily automated processes, either owning or purchasing access to a title plant.¹³ Because of these plants, the title search process in these states can be very efficient, which can decrease the amount of time required to issue a title insurance policy. Some of the most advanced of these title plants have documents scanned from local government sources, indexed and cross-referenced by various types of

¹³Some state laws, such as those in Iowa and Texas, require title agents or abstractors to have access to a title plant.

identifying information. Four of the title data centers we visited had electronic records going back 20 years or more. During a tour of one title plant in Texas, we observed a title examiner obtain nearly all documents pertinent to the title search and examination in electronic format within seconds. If the title examiner did not have immediate access to a necessary document, she would e-mail the owner of that information and have it sent electronically or through the mail from one of the search services to which the plant subscribed, usually within 1 day or less. For this plant, typical turnaround time for a completed title search, examination, and commitment for a title examiner simultaneously working on several titles was 2 to 3 days. In another highly automated plant located in a large urban center, we were told that the typical title search and examination took about 25 minutes. One of the nation's largest title insurers, First American, recently announced that with new software developments, its agents could produce a fully insured title commitment in 60 seconds for many refinance transactions.

In contrast, in a less-efficient process, agents in some states must physically search public records, which can add to the time required to issue a policy. In New York, for example, title plants are rare, and title agents commonly employ abstractors and independent examiners who must go to various county offices and courthouses to manually conduct searches. Including the process of clearing title problems and attorney review, one underwriter told us that in New York, the typical title insurance issuance took 90 to 120 days for a purchase and 30 to 45 days for a refinance. Most historical data are proprietary to each underwriter and are based on previously insured titles. At an underwriter-owned title plant in an East Coast city, described as typical for the region, we saw that although the plant held approximately 1.5 million records of previously insured titles, few records were updated when a new search came in on that same property. Personnel at the plant said that it was too labor-intensive to consolidate all of the files, although not updating the files resulted in a large number of redundancies in records across the plant. Also, in some states, industry participants told us that delays in recording and processing at local government offices contributed greatly to inefficiencies in the issuance process.

Title Agents' Responsibilities Also Differ across States

We found that the extent of title agents' responsibility for claims losses, involvement in the closing process, and ability to set premiums varied widely across states. For example, in some states, agents are responsible for a specific portion of losses on claims. In California and Colorado, the underwriter-agent agreement stipulates that title agents are responsible for

up to the first \$5,000 of a title claim.¹⁴ Underwriters said that this deductible gave agents an incentive to conduct more diligent searches and examinations. In other states, agents are not responsible for a specific portion of a claim but may take responsibility for some part or all of it, especially if the claim is small. According to agents in New York and Minnesota, it is faster, more efficient, and more customer-friendly for the agent to handle smaller claims rather than passing them on to the underwriter. An industry organization said that current, informal agent claims practices show that agents generally take responsibility for claims under \$2,500. Independent agents told us that the industry is moving toward more risk borne by the agents. In fact, agent application and review documents that we obtained from underwriters showed that the number and amount of claims the agent was responsible for were criteria insurers used when deciding whether to retain independent agents. One underwriter told us that although their agents did not have deductibles, the insurer was able to recover about \$10 million in funds from agents on claims the underwriter had already paid through aggressive follow-up on and investigation into possible errors on previously paid claims.

Some agents are also involved in more aspects of the closing process. We found that some agents handled the entire closing process, including the escrow, while others did not handle the escrow portion. These practices varied within as well as across states. In California, for example, title agencies have both underwriter and agent-controlled escrow companies that handle the full escrow process and actively market those services. These agencies offer a full package of closing services, from title search, examination, and clearance to document preparation and disbursement of funds at the closing. Other title agents were independent from escrow companies. In some states, such as New York, where it is customary for the home buyer and seller to have a lawyer present at the closing, title agents employ closers, whose chief duty is to handle the checks for taxes and escrow and to record the deed. Similarly, in Illinois, the lawyers actually serve as attorney-agents and are prohibited by the underwriter from handling the escrow.

Finally, in some states, title agents determine the amount to charge consumers for the search and examination portion of the premium, while in other states, they do not. The states where they do are referred to as

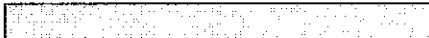
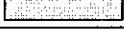
¹⁴California insurance department guidelines say that title agents cannot pay more than \$5,000 of a claim.

“risk-rate” states because only the insurance, or risk-based, portion of the premium is regulated. In these states, state regulators review underwriters’ rates for the risk-based portion of the premium, but the agents set the fees for search and examination services (generally the larger part of the cost to consumers) without regulatory review. According to ALTA, 30 states plus the District of Columbia are considered risk-rate states. The rest of the states, excluding Iowa, are considered to be all-inclusive because they incorporate charges for the risk-based portion of title insurance and other fees, such as those for the search and examination, in the regulated premium. The premium may or may not include settlement and closing costs. In these all-inclusive states, agents are not able to determine the price they will charge for searches and examinations, because they are required to charge the rates set by the state or the underwriter. Insurers set their premium rates based on their own expected costs and how much of the premium they have agreed to split with the agent.

Premiums Are Difficult to Compare across Markets, but Appear to Vary Significantly

Because title insurance premium rates depend on the amount of the loan or value of the home being insured, premiums differ widely across states. Figure 5 shows the premium rates for median-priced homes in major cities in our sample states.

Figure 5: Title Insurance Premium Rates for a Basic Owner’s Policy on Median-Priced Homes in Selected Areas, 2005

	Median-priced home loan or value		Owner’s policy rate	
Los Angeles, CA		\$529,000		\$1,587
New York, NY		445,200		2,190
Chicago, IL		264,200		1,025
Denver, CO		247,100		1,216
Dallas, TX		147,600		871
Des Moines, IA		145,500		700 ^a

Source: GAO analysis of National Association of Realtors’ and title industry data.

Note: Rates are either from the largest underwriter or are promulgated rates.

^aLender’s policy rate used in the Iowa data because a rate was not given for the owner’s policy. Although the premium would be \$146, according to Iowa Title Guaranty officials, additional required services would add approximately another \$550, for a total of approximately \$700.

One reason title insurance premium rate comparisons are difficult is because, as we previously mentioned, items included in the premium varied by state. A study from insurance regulators in Florida, where rates are promulgated and include the risk portion only, noted that what all-inclusive rates include varies even among the all-inclusive states.¹⁶ According to the study, in Texas and Pennsylvania, the premium includes the risk portion, search and examination costs, and settlement fees, while in California, the all-inclusive rate does not include settlement and closing costs. The Florida study also noted that one state (Utah) includes closing costs but not searches and examinations, and another state (Illinois) allows the entire rate to be determined competitively as either risk-based or all-inclusive.

A national survey conducted by Bankrate.com in 2006 also showed significant differences in title premiums across states.¹⁶ This survey of the 50 states and the District of Columbia compiled average mortgage closing costs, including title insurance, search and examination and settlement costs, and origination fees, using data obtained from as many as 15 of the largest national lenders' online quote systems. The survey calculated costs for a standard \$200,000 loan in one Zip Code of the largest urban center in each state. The data showed costs ranging from a high of \$3,887 to a low of \$2,713, with a national average of \$3,024. Bankrate.com representatives attributed most of the difference across states to wide disparities in the cost of title insurance, which they found varied almost 64 percent, from a high of \$1,164 to a low of \$418. The average was \$663. However, these data must be viewed with caution because they do not account for differences in what could be included in the premium. Moreover, since these data came from only one Zip Code per state, they may not be representative of other localities.

Industry officials said that rates vary because of differences in what was included in the rate and in standard business costs in each area. Nearly all of the industry participants we spoke with emphasized that title insurance is a local business, varying both within and across states. They said that state property, trustee, probate, and estate laws could partially explain the rate differences. In some states, these requirements make it much more

¹⁶Florida Office of Insurance Regulation, *An Analysis of Florida's Title Insurance Market: Three Studies That Provide a Comprehensive, Multi-Faceted Review of the Florida Title Insurance Industry* (Tallahassee, FL: July 2006).

¹⁶*Closing Costs Survey*, <http://www.bankrate.com/brm/news/mortgages/ccmain2006a1.asp>.

expensive to do the search and examination work and clear all of the risks through the examination process. Experts told us that trying to compare rates across states would not be meaningful because of the differences in the components of the premium.

Multiple Factors Raise Questions about the Extent of Competition and the Reasonableness of Prices in the Title Insurance Industry

Among the factors raising questions about the existence of price competition and the resulting prices paid by consumers within the title insurance industry are the following:

- consumers find it difficult to shop for title insurance, therefore, they put little pressure on insurers and agents to compete based on price;
- title agents do not market to consumers, who pay for title insurance, but to those in the position to refer consumers to particular title agents, thus creating potential conflicts of interest;
- a number of recent investigations by HUD and state regulatory officials have identified instances of alleged illegal activities within the title industry that appear to reduce price competition and could indicate excessive prices;
- as property values or loan amounts increase, prices paid for title insurance by consumers appear to increase faster than insurers' and agents' costs; and
- in states where agents' search and examination services are not included in the premium paid by consumers, it is not clear that additional amounts paid to title agents are fully supported by underlying costs.

Disagreement exists between title industry officials and regulators over the actual extent of price competition within title insurance markets, with industry officials asserting that such competition exists and a number of regulators stating that a lack of competition ultimately results in excessive prices paid by consumers.

Lack of Consumer Knowledge about Title Insurance Results in Little Pressure on Insurers to Compete on Price

For several reasons, consumers find it difficult to shop for title insurance based on price, raising questions about the existence of price competition in title insurance markets. First, most consumers buy real estate—and with it, title insurance—infrequently. As a result, they are not familiar with what title insurance is, what reasonable prices might be, or which title agents might provide the best service. According to a study commissioned

by the Fidelity National Title Group, Inc., in response to proposed regulatory changes in California, it is typically not worth an individual's time to become more educated about title insurance, because any resulting savings would likely be relatively small.¹⁷ That is, the cost to consumers of becoming sufficiently educated to make an informed decision is potentially higher than the risk of paying more to a title agent suggested by a real estate or mortgage professional. However, one potential consequence of a failure to shop around was noted by several of the state insurance regulatory officials that we spoke with, who expressed concern that consumers may not be getting the discounts for which they are eligible. For instance, insurers may give (1) discounts on mortgage refinance transactions because the previous search and examination were fairly recent and (2) discounts to first-time home buyers or senior citizens. Several title industry officials agreed that consumers might not be aware of such discounts and may, in some cases, not be receiving discounts to which they are entitled.

Second, consumers may have difficulty comparing price information from different title agents because many title agents also charge for services that are not included in the premium rate, such as fees related to real estate closing and other administrative fees. In states where title agents charge separately for search and examination services, such charges can be as large as the title insurance premium itself. Thus, even if consumers collected and compared premium rates, which are posted on some states' Web sites, they might not get an accurate picture of all the title-related costs they might pay when using a particular agent.

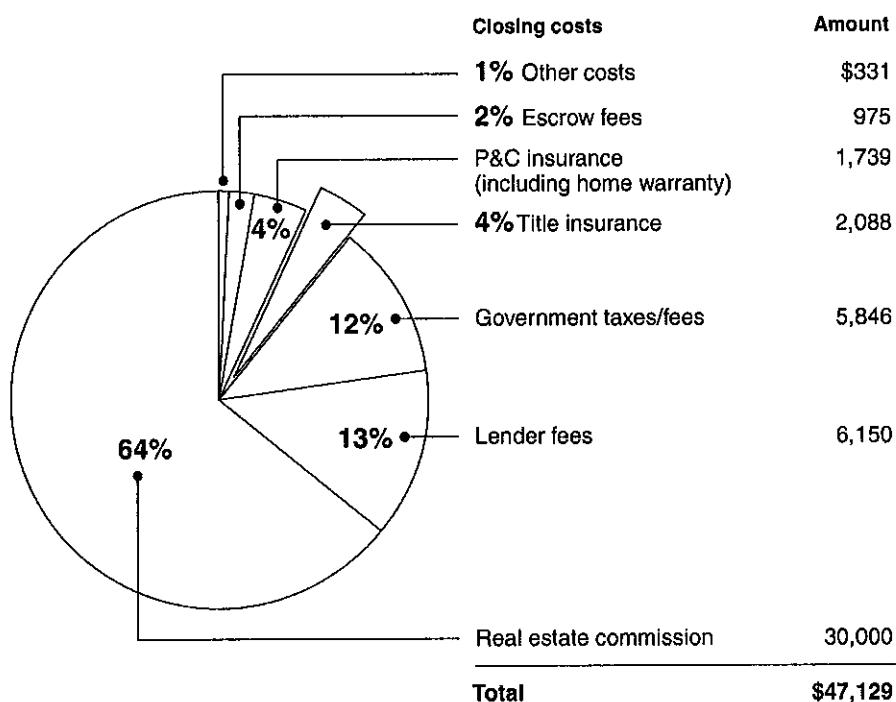
Third, title insurance is a smaller but required part of a larger transaction that consumers are generally unwilling to disrupt or delay. As we have seen, lenders generally require home buyers to purchase title insurance as part of any real estate purchase or mortgage refinancing transaction. However, purchasing title insurance is a relatively small part of such transactions. For example, according to an analysis by the Fidelity National Title Group, Inc., in 2005 in California, on a transaction with a sales price of \$500,000 and a loan amount of \$450,000, title insurance costs, on average, amounted to only 4 percent of total closing costs, including the real estate agent's commission (see fig. 6). Even when the

¹⁷Gregory Vistnes, *An Economic Analysis of the California Department of Insurance Proposal to Impose Rate Regulation in the California Title Insurance Industry* (Washington, D.C.: August 2006).

seller pays the real estate agent's commission, title insurance costs are still small compared with the size of the buyer's transaction. In addition, it appears that by the time consumers receive an estimate from the lender of their title insurance costs as part of the Good Faith Estimate, a title agent has already been selected, and the title search has already been requested or completed.¹⁸ To shop around for another title insurer at that point in the process could also threaten to delay the scheduled closing. According to a number of title industry officials and state insurance regulators we spoke with, most consumers place a higher priority on completing their real estate transaction than on disrupting or delaying that transaction to shop around for potentially small savings.

¹⁸RESPA requires lenders to provide consumers with an estimate of the costs a consumer will likely have to pay, called a Good Faith Estimate, prior to the closing of a mortgage transaction.

Figure 6: Average Allocation of Closing Costs in California, 2005



Source: Fidelity National Title Group, Inc.

Note: Calculations done using a \$500,000 sales price and a \$450,000 loan amount. We did not verify the data supporting this analysis.

HUD publishes an informational booklet designed to help fulfill RESPA's goal of helping consumers become better shoppers for mortgage settlement services, including title insurance. Although this document provides much useful information, it is generally distributed too late in the home-buying process to help consumers with respect to title insurance, and it lacks some potentially useful information. RESPA currently requires lenders to provide the booklet to consumers within 3 days of the loan application. HUD officials recognize the need to get this information to consumers earlier and recommended in a 1998 study that real estate agents, as well as lenders, provide the information at first contact.¹⁹

¹⁹Board of Governors of the Federal Reserve System, Department of Housing and Urban Development, *Joint Report to the Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act* (Washington, D.C.: July 1998).

Furthermore, RESPA only requires the information to be distributed in a transaction involving a real estate purchase, and not in other transactions, such as mortgage refinances, where title insurance is also required by lenders. The usefulness of the informational booklet is further limited by the absence of information on the discounts most title insurers provide and on potentially illegal ABAs.

Because consumers may not have access to potentially useful information when purchasing title insurance, they may not be able to make well-informed decisions on the purchase of title insurance. Specifically, consumers may face difficulty in independently collecting information on all amounts charged by title agents in order to comparison shop. In addition, the limitations in the content of HUD's information booklet and when consumers receive it can result in consumers' getting information too late in the process, thereby hindering their ability to influence the selection of a title agent or insurer. Moreover, several state insurance regulators expressed concern that consumers might not be getting all available discounts because they do not know they are available or that they are entitled to the discounts. In addition, HUD officials said that the use and complexity of ABAs in the title industry has increased, and consumers could benefit from additional information in this area.

Title Agents Market Not to Consumers, but to Those in a Position to Make Referrals, Creating Potential Conflicts of Interest

Another factor that raises questions about the existence of price competition is that title agents market to those from whom they get consumer referrals, and not to consumers themselves, creating potential conflicts of interest where the referrals could be made in the best interest of the referrer and not the consumer. Because of the difficulties faced by consumers in shopping for title insurance, consumers almost always rely on a referral from a real estate or mortgage professional. In fact, some insurance regulatory officials we spoke with said they are concerned that consumers may not even be aware they are able to choose their own title agent and insurer. According to title industry officials, because of consumers' unfamiliarity with and infrequent purchases of title insurance, it is not cost-effective to market to them. Rather, title agents market to and compete for referrals from real estate and mortgage professionals.

According to title industry officials, competition among title agents for consumer referrals is very intense and motivates them to provide excellent service to real estate and mortgage professionals. This is because if they do not provide good service, those professionals will send their future referrals elsewhere. Both title and real estate industry officials told us that such professionals have a strong interest in customers' having a good

experience with respect to the portion of a closing conducted by a title agent, because customers' experiences there will reflect back on the professional. As a result, they said, such competition on the basis of service benefits consumers.

However, this competition among title agents for consumer referrals is also characterized by potential conflicts of interest, since those making the referrals may have the motivation to do so based on their own best interests rather than consumers' best interests. Real estate and mortgage professionals interact more regularly with title agents and insurers than do consumers and, thus, are likely to have better information than consumers on the prices and quality of work of particular title agents and insurers. To the extent the interests of those professionals are aligned with those of the consumers they are referring, the knowledge and expertise of those professionals can benefit consumers. However, conflicts of interest may arise when the professional making the referral has a financial interest in directing the consumer to a particular title agent. Under such circumstances, the real estate or mortgage professional may be motivated to make a consumer referral not based on the customer's best interests but on the professional's best interests. For example, a real estate professional may be a partial or full owner of a title agency, such as through an ABA, and therefore receive a share of the profits earned by that agency. As such, the professional may have an incentive to refer customers to that title agency.

Alleged Illegal Activities Appear to Reduce Competition and Could Indicate Excessive Prices Paid by Consumers

Examples of Allegedly Illegal Referral Fees Described in Investigations by HUD and State Insurance Regulators

- A title agent paid real estate agents' business training and printing expenses.
- A title agent provided trips, entertainment, and catering for entities involved in real estate transactions.
- A title agent contributed to a pool of funds that was given away in a drawing among real estate agents.
- A title agent paid an excessive rate to rent a conference room from a real estate company.
- Title agents provided free or below-cost marketing services to real estate agents.

In recent years, HUD and state insurance regulators have identified a number of allegedly illegal activities related to the marketing and sale of title insurance that appear to be designed to obtain consumer referrals and, thus, raise questions about competition and, in some cases, the prices paid by consumers (see sidebar). In addition, several title insurers and agents told us that they lost market share because they did not provide some compensation for consumer referrals. The payment or receipt of compensation for consumer referrals potentially reduces competition because the selection of title insurer or agent might not be based on the price or quality of service provided, but on the benefit provided to the one making the referral. The giving or receiving of anything of value in return for referral of consumers' title insurance business is a potential violation of RESPA and many state laws. For example, it might be illegal for a title insurer to provide free business services to a realtor in exchange for that realtor's referring consumers to the title agent. It might also be illegal for the realtor to accept those services.

Nonetheless, state and federal regulators have identified a number of alleged instances of such payments, resulting in those involved paying over \$100 million in fines, penalties, or settlement agreements. Table 1 summarizes these investigations. From 2003 to 2006, insurance regulators in three of our six sample states had concluded at least 20 investigations related to the alleged payment of referral fees, involving over 52 entities, including title insurers, title agents, and builders.²⁰ As a result of these investigations, the entities involved were ordered to pay or agreed to pay approximately \$90.6 million in the form of consumer refunds, fines, and settlements. Over the same period, HUD concluded at least 38 enforcement actions resulting in settlements related to alleged referral fee violations. These actions involved at least 62 entities and resulted in those entities' being ordered to pay or agreeing to pay approximately \$10.7 million.

²⁰Entities involved in multiple cases and settlements were counted once for each case and settlement in which they were involved.

Table 1: Information on Closed Cases and Settlements Involving Referral Fees Resulting from Investigations by Insurance Regulators in Six Sample States and HUD, 2003-2006

Dollars in millions

Investigating organization ^a	Closed cases and settlements involving referral fees	Entities involved ^b	Amount that entities were ordered to pay or agreed to pay ^c	Portion of total payments involving captive reinsurance ^d
State insurance regulators				
California Department of Insurance	12	26	\$61.3	\$37.9
Colorado Department of Regulatory Agencies, Division of Insurance	6	24	25.3	25.3
New York State Insurance Department	2	2	4.0	-
Subtotal	20	52	\$90.6	\$63.2
HUD ^e	38	62	10.7	3.6
Subtotal	38	62	\$10.7	\$3.6
Total	58	114	\$101.3	\$66.8

Source: GAO analysis of state and HUD data.

^aInsurance regulators in Illinois, Iowa, and Texas, our other sample states, did not have any such closed cases or settlements.

^bEntities involved in multiple cases and settlements were counted once for each case in which they were involved.

^cAmounts paid included any refunds to consumers, fines, or settlement amounts.

^dIn captive reinsurance arrangements, a home builder, real estate broker, lender, title insurance company, or some combination of these entities forms a reinsurance company that works in conjunction with a title insurer. Some investigations alleged that these arrangements were used as a means of paying referral fees.

^eAmounts paid to HUD reflect only negotiated settlements, because HUD cannot levy civil money penalties.

Several insurance regulators in states outside of our sample states, while not completing enforcement actions or reaching settlement agreements, expressed concerns over activities related to referral fees. For example, in October 2006, the Washington State Office of the Insurance Commissioner published the results of its investigations into referral practices in the title industry in Washington.²¹ According to the report, the use of inducements and incentives by title companies to obtain title insurance business appeared to be “widespread and pervasive,” and these inducements were used to influence referrals by real estate agents, banks, lenders, builders,

²¹Washington State Office of the Insurance Commissioner, *An Investigation into the Use of Incentives and Inducements by Title Insurance Companies* (Olympia, WA: October 2006).

developers, and others. The inducements included, among other things, the provision of advertising services, open houses, entertainment, and educational classes. According to the report, the regulator decided not to take any enforcement actions on the basis of the activities they identified because of the expense of doing so and because the regulator accepted some responsibility for allowing such a situation to develop. However, the report also stated that the regulator would put the industry on notice that there would be consequences for any future violations.

In Illinois, the state title insurance regulator issued a series of bulletins and informational handouts in 2005 and 2006 that expressed concerns over potentially illegal referral fees and inappropriate ABAs.²² The regulator had found that some title agents were using title service companies (owned by title insurers) that in some cases performed almost all title-related work, such that all the title agent had to do was sign and return some documents in exchange for receiving part of the premium. According to the regulator, such arrangements would violate state law requiring title agents to perform certain minimal activities in return for fees received from consumers. The regulator told us that the companies involved in these activities were cooperative in ceasing such activities and, as a result, the regulator was not pursuing any enforcement actions. Such arrangements, however, (1) may constitute an illegal referral fee under RESPA and (2) appear to be very similar to activities that were the subject in Illinois of state and HUD investigations in 1990 and 1991, resulting in a \$1 million settlement between HUD and the title insurer involved.

Finally, in April 2006, the state title insurance regulator in Alaska published a summary of title insurance examinations in which they expressed concern that title agents and real estate service providers were entering into business arrangements that blurred the line between legitimate transactions and illegal kickbacks.²³ Such arrangements, the report noted, may undermine competition and be an indication that premium rates are excessively high. The report stated that the insurance

²²Title Insurance Section, Division of Financial Institutions, Illinois Department of Financial and Professional Regulation, *Bulletin 1-05: Title Insurance Agent Requirements* (Springfield, IL: July 2005); *Title Insurance Industry Meeting Informational Handout 1-06* (Springfield, IL: February 2006); and *Title Insurance Industry Meeting Informational Handout 2-06* (Springfield, IL: February 2006).

²³Division of Insurance, Alaska Department of Commerce, Community, and Economic Development, *Summary of Title Insurance Examinations: Division of Insurance* (Juneau, AK: April 2006).

Allegedly Illegal Captive Reinsurance Arrangements Could Indicate Consumers Were Paying Excessive Prices for Title Insurance

Example of a Captive Reinsurance Arrangement

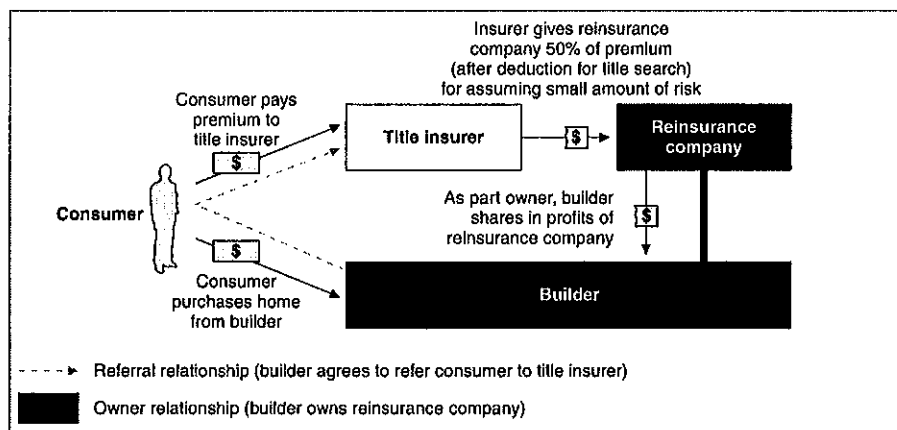
In one multistate settlement that involved 26 state insurance regulators, regulators alleged that title insurers and home builders created captive reinsurance arrangements. Under these arrangements, the insurers deducted a processing fee of \$350 from the premium, then paid 50 percent of the remainder to a reinsurer for assuming 50 percent of the policy risk. The reinsurers, in turn, provided referrals to the title insurers. For example, in Colorado, a party to the settlement, the premium charged by one of the companies involved for an owner's and lender's policy on a \$250,000 loan and purchase price was \$1,614. In 2005, the combined loss ratio for all insurers in Colorado was approximately 4.5 percent. Under the arrangement described by regulators, on a hypothetical \$250,000 transaction, the reinsurer would collect approximately \$632 for assuming expected losses of about \$36 (4.5 percent of the \$1,614 premium), for a net profit of about \$596. In other words, about 37 percent of the \$1,614 paid by the consumer would allegedly go to the reinsurer as compensation for its builder, lender, or real estate broker-owner allegedly referring business to the insurer.

regulator is contemplating new regulations regarding the legality of these arrangements, but the regulator will first obtain industry input through public hearings. Overall, the alleged referral fee arrangements identified in the state and HUD investigations could potentially indicate that those making consumer referrals did so based on their own interests, and may not have resulted in obtaining the best prices for consumers.

From 2003 through 2006, state and HUD investigations of captive reinsurance arrangements, a potential form of referral fees, resulted in payments by insurers and other entities of approximately \$66.8 million, as previously shown in table 1.²⁴ Specifically, we identified 13 investigations involving 37 entities that were related to captive reinsurance arrangements, with 1 multistate settlement agreement involving activities in 26 states. In such arrangements, a home builder, real estate broker, lender, title insurance company, or some combination of these entities forms a reinsurance company that works in conjunction with a title insurer (see sidebar). The insurer agrees to "reinsure" all or part of the business it receives from the reinsurer's owners with the reinsurer by paying the company a portion of the premium (and allegedly transferring a portion of the risk) for each title transaction. Investigators alleged that the amounts received by these reinsurers exceeded the risk they assumed—particularly because virtually no claims were filed with either the insurer or the reinsurer—and considered these arrangements as a way to pay for referrals, allegedly violating RESPA's prohibitions on such payments. In settlement agreements with a lender and several home builders in 2006, HUD stated that there is almost never a bona fide need or business purpose for title reinsurance on a single family residence, especially from an entity or an affiliate of an entity that is in a position to refer business to the title insurer. In addition, HUD stated that when the payments to the captive reinsurer far exceed the risk borne by the builders, lenders, or real estate brokers, there is strong evidence that such an arrangement was created to pay referral fees and, therefore, is illegal. Figure 7 provides an example of a captive reinsurance arrangement described in a multistate settlement administered by the Colorado Division of Insurance in 2005.

²⁴Reinsurance is a mechanism that insurance companies routinely use to spread risk associated with insurance policies. Simply put, it is insurance for insurance companies.

Figure 7: Example of an Alleged Captive Reinsurance Arrangement



Source: GAO.

According to several state insurance regulators, the activities involved in such captive reinsurance arrangements suggest that title insurance premiums paid by consumers may be substantially higher than the cost of providing that insurance. The arrangements generally involved a title insurer taking the premium from a consumer, subtracting a certain amount to cover the cost of a title search and examination, then splitting the remainder with the reinsurer. On the basis of details provided in a multistate settlement, insurers were allegedly giving away as much as one-third or more of the premiums consumers paid in order to obtain consumer referrals. In 2005, industrywide loss and loss adjustment expenses only totaled about 5 percent of the total premiums written. The regulators stated that insurers' willingness to pay such a large portion of the premium to obtain consumers' title insurance business suggested that insurers overcharged consumers for this insurance.

A Number of Investigations Found ABAs Allegedly Being Used to Pay Referral Fees, Raising Questions about the Cost and Benefits of ABAs to Consumers

A number of investigations found that ABAs were allegedly being used to compensate ABA owners—often real estate or mortgage professionals—for consumer referrals, raising additional questions about competition in the title insurance industry. RESPA allows ABAs, provided that (1) a disclosure is made to the consumer being referred that describes the nature of the relationship, including financial interests, between the real estate settlement service provider and the person making the referral; (2) compensation for the referral is limited to a return on the ownership interest; and (3) the consumer being referred is not required to use a particular title agent. HUD has also issued a policy statement setting forth factors it uses to determine whether an ABA is a sham under RESPA or a

bona fide provider of settlement services. These factors include whether the entity actually performs substantial services in return for fees received, the entity has its own employees to perform these services, and the entity has a separate office. Nonetheless, federal and state investigations identified a number of ABAs that were alleged to be "shell" title agencies that either had no physical location, employees, or assets or did not actually perform any title services. Regulators alleged their primary purpose was to serve as a pass-through for payments or preferential treatment given by the title agent to real estate agents and brokers, home builders, attorneys, or mortgage brokers for business referrals. Over the past 4 years, HUD has completed at least 9 investigations of ABAs, involving at least 17 entities and resulting in approximately \$1.8 million being paid by those entities in settlements and refunds. A Colorado investigation found that a single licensed title agent was owner or part owner of 13 sham title agencies that were allegedly used to pay referral fees to mortgage brokers.

A number of regulators and industry participants we spoke with expressed concerns about the growing use of ABAs in the title industry. For example, HUD officials have said that while properly structured ABAs may provide some consumer benefits, they also create an inherent conflict of interest as the owner of an ABA is in a position to refer a consumer to that same ABA. They expressed concern that ABAs could be used as a means to mask referral fees, which are generally illegal under RESPA, and that they were seeing more complex arrangements in which it was becoming increasingly difficult to trace the flow of money and to determine if the agents involved in ABAs were actually performing core title services. Several state insurance regulators we spoke with expressed similar concerns. For example, Colorado insurance regulatory officials were concerned over the extent of sham ABAs in Colorado that were potentially being used as a means to pay referral fees. Those officials also said that, on the basis of their work with NAIC's Title Insurance Working Group, other state insurance regulators that had begun to examine ABAs were also finding potentially illegal activities. For instance, in a September 2005 settlement in Florida, 60 sham title agencies affiliated with 1 underwriter were alleged to have been fronts for referral fees.

Some title industry participants expressed concern that ABAs might also restrict competition. They said that when a real estate or mortgage brokerage firm, for example, owns an ABA, other title agents are generally barred from marketing their services to individuals working for that firm. In addition, they said that most or all of the consumer referrals from a brokerage that is an owner of an ABA generally go to that ABA. As a result

of this guaranteed order flow, they said, the title agents at that ABA might not be as interested in competing on price or service.

In contrast, some title industry officials said ABAs can be beneficial because they provide consumers with better service and potential cost savings. According to an industry organization, ABAs can increase consumer satisfaction through the convenience of one-stop shopping. Furthermore, they benefit their owners and consumers by giving owners greater accountability and control over quality. Industry participants also stated that because of the ability to take advantage of efficiencies, ABAs can result in potential cost savings for the consumer. A recent study sponsored by RESPRO, an industry group that promotes ABAs, concluded that title agents that are part of an ABA do not charge consumers any more than title agents that are not part of an ABA.²⁵ ABA proponents, and others, also stated that ABA owners, such as real estate or mortgage brokers, often have little leverage in encouraging their real estate agents and brokers to refer consumers to the ABA title agent. They said that these individuals compete based on their reputation, and that recommending a title agent that provided poor service would damage that reputation. As a result, they will only refer consumers to an ABA title agent if it provides good service. Industry organizations we spoke with said that they did not collect data on the percentage of business ABA title agents get from their owners' businesses.

Overall, the concerns expressed by regulators and some industry participants over ABAs raise questions about the potential effects of some ABAs on consumers. Specifically, concerns about some ABAs being used as a means of paying illegal referral fees raise questions about whether referrals are always being made in consumers' best interests. In addition, concerns about some ABAs potentially restricting competition among title agents raise questions about the extent of competition that is beneficial to consumers.

²⁵Donald Martin and Richard Ludwick, *Affiliated Business Arrangements and Their Effects on Residential Real Estate Settlement Costs: An Economic Analysis* (October 2006).

As Coverage Amounts Increase, Premiums Paid by Consumers Appear to Increase Faster Than Insurer and Agent Costs

Another factor that raises questions about the prices consumers pay for title insurance is that as the purchase price or loan amount on which a policy is issued increases, the amount paid by consumers appears to increase faster than the costs incurred by insurers and agents in producing that policy. A number of title insurers and agents we spoke with said that they made more money on high-priced transactions than on low-priced transactions because, while premiums increased with price, insurers' losses rose only slightly and agents' search and examination costs generally either did not increase or, in many cases, fell. In fact, several title insurers and agents said that transactions involving less-expensive properties often cost agents more to complete because they required agents to correct more title defects than on more expensive transactions. As a result of this pricing structure, writing title insurance on higher-value purchases and mortgages can be quite profitable for title insurers and agents.

Industry Officials Said That the Current Price Structure Subsidizes Consumers in Lower-Value Transactions, but They Could Not Provide Supporting Data

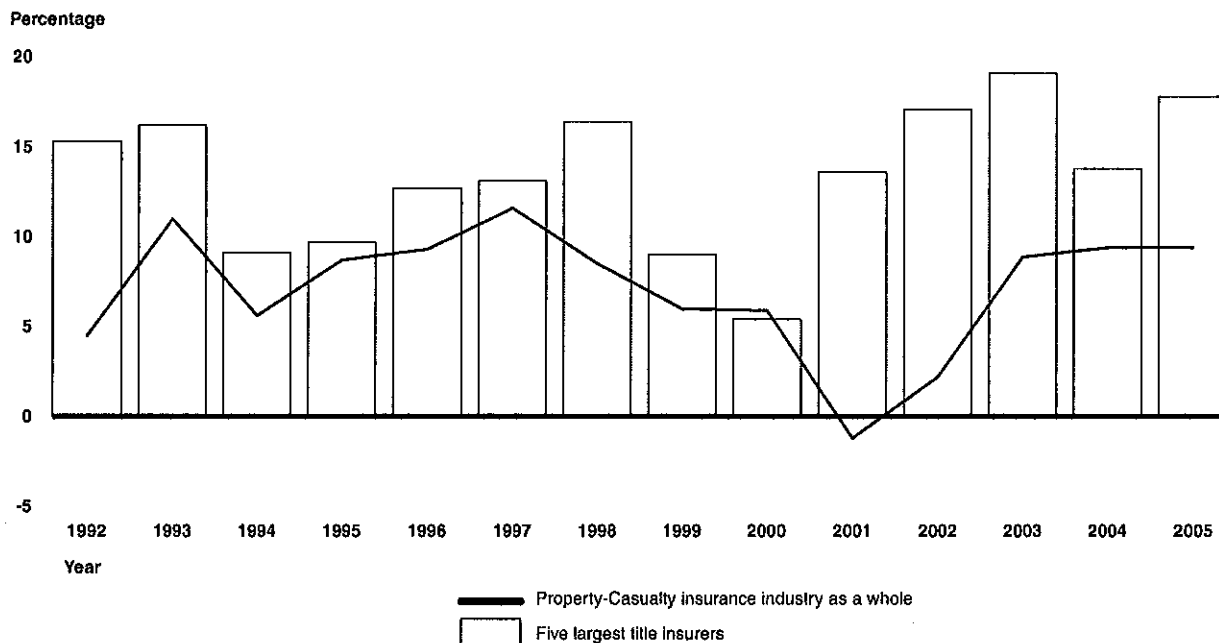
Title industry officials told us that while high-value transactions could be quite profitable for title insurers and agents, this profit was necessary to subsidize the lower profits or even losses from smaller transactions. These officials also told us that if insurers charged consumers on the basis of the cost of the actual work done, consumers buying relatively inexpensive properties would pay more than they currently did. However, while we asked title industry officials for data to support their assertion that they often lost money on low-priced transactions, they said that they did not collect financial information that would allow them to provide such data. Thus, we could not determine whether insurers or agents were actually losing money on any transactions.

According to industry officials, insurers and regulators purposely designed the current premium rate structures with an element of subsidization built in—that is, premiums for high-priced transactions were intended to subsidize the costs associated with lower-priced transactions. Among the six state insurance regulators we spoke with, although most agreed that insurers made more money on higher-priced transactions, only one told us that subsidization of consumers on lower-priced transactions was intentional on the part of the state. Among the rest, three said that there was no intentional subsidization, and two said that they did not know.

Industry Officials Said That Recent Higher Profitability Compensated for Years of Lower Profitability, but Industry Return on Equity Has Been Relatively Stable

Recent high profits within the title insurance industry have raised additional questions about the prices being paid by consumers. Several title insurance industry officials acknowledged that insurers' profits had been good over the past several years as a result of increased home prices and large numbers of consumers refinancing their home mortgages, but these officials said that such profits made up for very low profits during weaker markets. However, we found that title insurers' financial performance, as measured by return on equity, has been positive since at least 1992 and, in every year except one, has been above that of the property-casualty insurance industry as a whole. As shown in figure 8, the combined return on equity for the largest five title insurers has been at or above 9 percent, in every year except one, over the period from 1992 to 2005, and in most years it was above 12 percent. Over that same period, only one insurer had a year with a negative return on equity. In addition, during 2006 public conference calls with financial analysts, several of the largest insurers said that they expected business to be profitable even during the weakest real estate markets.

Figure 8: Combined Return on Equity for the Five Largest Title Insurers, and the Property-Casualty Insurance Industry as a Whole, 1992-2005



Source: GAO analysis of insurer financial data submitted to SEC and Insurance Services Office and Insurance Information Institute data.

Note: The combined return on equity data for title insurers are based on consolidated operating results, which for some title insurers may include some services other than title insurance.

An industry-sponsored study stated that several insurers had reduced title insurance rates in the last several years, and that such reductions provided evidence of price competition, at least in California.²⁶ We were able to obtain historical premium rate information in five of our six sample states. Between 2000 and 2005, premium rates for the median-priced home went down in three of those five states, stayed the same in one state, and increased by only 2 percent in the other state (see fig. 9). However, because total premiums are determined by applying that rate to the home price or loan amount, and median home prices increased substantially over that period, total premiums paid by consumers in most of our sample states also increased substantially. For example, among these five sample states, consumers' premiums fell in one state, but rose in the remaining

²⁶ *An Economic Analysis of the California Department of Insurance Proposal.*

four states, sometimes dramatically. Specifically, premiums decreased by 12 percent in one state but increased 93 percent in another, and in one state where premium rates fell by 29 percent, actual premiums paid rose by 75 percent. Historical information on possible additional amounts charged by title agents in our sample states was not available.

Figure 9: Percentage Change in Premium Rates and Premiums Paid on Median-Priced Homes in Selected Areas in Five Sample States, 2000-2005

	Change in median home price		Owner's policy on median-priced home—change in:	
			Premium rate per \$1,000	Premium paid by consumer
Los Angeles, CA	145%	-29% ^a	75%	
New York, NY	98	-3 ^b	93	
Chicago, IL	66	2 ^a	69	
Des Moines, IA ^c	25	0 ^a	25 ^d	
Dallas, TX	20	-27 ^b	-12	
Percentage change increase				
Percentage change decrease				

Source: GAO analysis of data provided by the National Association of Realtors, state insurance regulators, and title insurers.

Note: We were unable to obtain historical premium rate information in the sixth sample state—Colorado.

^aPremium rates in California, Illinois, and Iowa are those for the insurer writing the most premiums in 2005.

^bPremium rates in New York and Texas are those promulgated by the state insurance regulator.

^cLender's policy rate was used in the Iowa data because a rate was not given for the owner's policy.

^dPremium paid by consumer does not include any additional amounts that may have been charged by title agents.

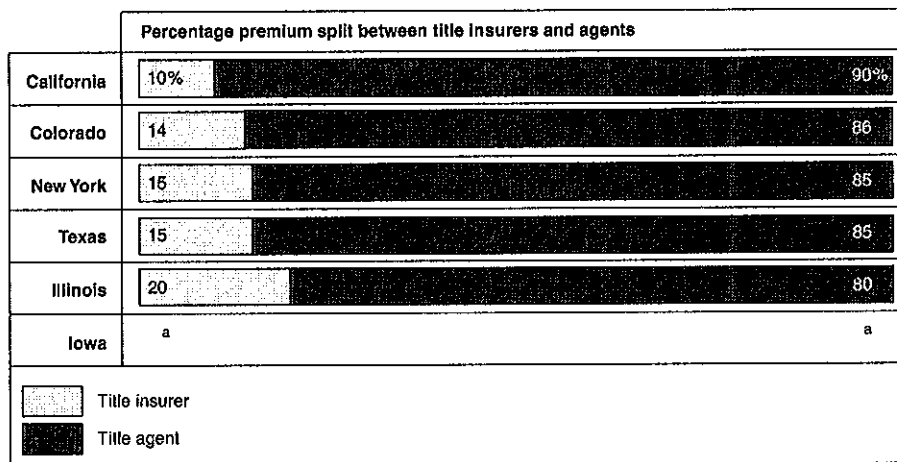
In States Where Agents Charge Separately for Search and Examination Services, It Is Unclear Whether Those Charges Are Fully Supported by Underlying Costs

One more factor that raises questions concerning the prices consumers pay for title insurance is that in states where agents' charges for their search and examination services are not included in the premium paid by the consumer (i.e., agents charge separately for these services), it is unclear whether consumers may be overpaying for those services. The lack of clarity stems from the way in which title insurers determine premium rates that consumers will pay.

Officials from title insurance companies told us that they generally determined their premium rates on the basis of their expected expenses, which include losses from claims, as well as the amounts retained by the title agents that write insurance for them. Title insurers know what share of consumers' premiums the title agents that write policies for them will retain—generally around 80 to 90 percent—and what share the insurer will receive.²⁷ Insurers then set their premium rates at a level sufficient to ensure that their share of the premiums will be enough to cover their expected costs and earn them a reasonable profit. These calculations take into account the portion of the premiums that title agents retain, but not whether that amount reflects the agents' actual costs. Officials of insurance companies and title agencies told us that the split was negotiated between the insurer and agent on the basis of a number of factors, including the agent's volume of business, the quality of the agent's past work, and the insurer's desire to increase its share of business in a certain geographic area. Among our sample states, the amount retained by title agents ranged from around 80 percent in one state to 90 percent in another (see fig. 10). Some insurance company officials told us that they had an idea of what agents' costs should be based on their experience with their own direct agents, but these officials said that they did not analyze how the amounts retained by agents compared with those costs.

²⁷Title insurers also have direct operations where none of the premium is retained by an agent. As a result, while title agents typically retain from 80 to 90 percent of the premium paid by consumers, in 2005, agents retained only 70 percent of total premiums written by insurers.

Figure 10: Typical Premium Splits between Insurers and Agents in Six Sample States



Source: GAO analysis of interviews with title insurers, title agents, and state insurance regulators.

Note: We did not independently verify the information in this figure.

*There is no premium split in Iowa on policies issued by the state-owned Iowa Title Guaranty Division.

Insurers that we spoke with also told us that they generally share the same percentage of the premium with their agents, around 80 to 90 percent, regardless of whether those agents were in states where consumers were to pay for agents' search and examination services within the premium rate—known as all-inclusive states—or whether they were in states where agents can charge consumers separately for those services—known as risk-rate states. However, if title agents are charging separately for their search and examination services, outside of the premium, you would generally expect the percentage of the premium retained by agents to be lower because they would not need to recover the costs for those services from the premium. Because insurers told us that the percentage of the premium given to the agent does not depend on whether the title agent is in a risk-rate or all-inclusive state, this practice raises the possibility that in some risk-rate states, title agents may be (1) retaining 80 to 90 percent of the premium—a percentage meant to be sufficient to cover agents' search and examination costs in all-inclusive states—and (2) charging the consumer a separate, additional amount intended to pay for those same services. According to HUD officials, in risk-rate states, the amount consumers pay title agents for their search and examination services, which is in addition to the title insurance premium, can sometimes be as large as the premium itself. However, reliable data did not exist to

determine whether consumers in risk-rate states consistently paid more, in total, than those in all-inclusive states.

Disagreement Exists among Industry and Regulatory Officials over the Extent of Price Competition and the Appropriateness of Title Insurance Prices

While many title industry officials acknowledge that competition in title insurance markets is based primarily on service rather than price, disagreement exists between the industry and regulators over the extent of actual price competition. According to some of the title industry officials we spoke with, price competition does exist within the title insurance industry. While these officials acknowledged that consumers generally rely on referrals from real estate and mortgage professionals, they argued that these professionals could have an interest in obtaining lower-priced title services for their customers and, thus, could exert downward pressure on premium rates. Others cited various factors, such as changes in premium rates and increased levels of coverage, as evidence of price competition and have stressed the benefits for consumers of competition that is based on service.

In contrast, insurance regulators in two of our sample states have concluded that premium rates are too high relative to costs, potentially due to a lack of price competition. In California, the state insurance regulator concluded in 2006 that title insurance markets were lacking competition, resulting in increased prices for consumers. The regulator there has also proposed lowering current title rates. In Texas, where title insurance premium rates are promulgated by the state insurance regulator, in each of the last two rate hearings, the regulator has proposed a premium rate reduction to account for a competitive structure that inflates prices for consumers. That is, the regulator has requested premium rate reductions to account for a market structure in which consumers pay for title insurance but others generally choose the title agent and insurer, which the Texas regulator says can result in unnecessary and unreasonable expenses.

Limited State and Federal Oversight of the Title Insurance Industry Has Resulted in Proposals for Change

In the states we visited, we found that regulators did not assess title agents' costs to determine whether they were in line with premium rates; had made only limited efforts to oversee title agents (including ABAs involving insurers and agents); and, until recently, had taken few actions against alleged violations of antikickback laws. In part, this situation has resulted from a lack of resources and limited coordination among different regulators within states. On the federal level, authority for alleged violations of section 8 of RESPA, including those involving increasingly complex ABAs, is limited to seeking injunctive relief.²⁸ Some state regulators expressed frustration with HUD's level of responsiveness to their requests for help with enforcement, and some industry officials said that RESPA rules regarding ABAs and referral fees need to be clarified. Industry and government stakeholders have proposed several regulatory changes, including RESPA reform, strengthened regulation of agents, a competitor right of action with no monetary penalty, and alternative title insurance models.²⁹

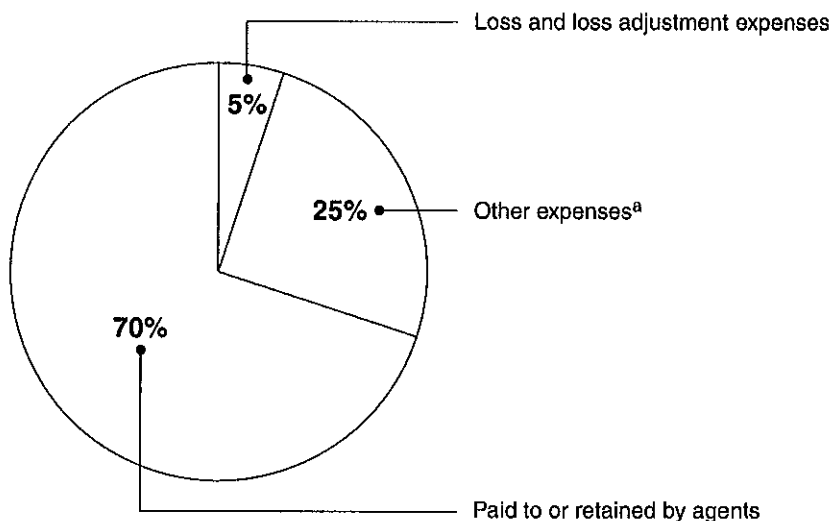
Regulators Do Not Fully Assess Title Agents' Costs during Rate Reviews

Because consumers can do little to influence the price of title insurance, they depend on regulators to protect buyers from, for example, excessive premium rates. As they do with most lines of insurance, such as property-casualty coverage, regulators seek to ensure that title insurance premium rates are representative of the underlying risks and costs associated with the policies that are issued. In reviewing insurance rates, regulators generally focus on confirming that insurers' projections of their expected losses on claims are accurate, because for virtually all lines of insurance, the majority of consumers' premiums go to pay such losses. For property-casualty insurance in 2005, for example, 73 percent of total premiums were used to cover losses. For title insurers, however, only 5 percent of title insurance premiums went to cover losses (see fig. 11), while more than 70 percent went to title agents.

²⁸RESPA does provide criminal sanctions for violations of section 8, a fine of up to \$10,000 or up to 1 year in prison. However, according to HUD officials, such sanctions are rarely used, in part because they require prosecutions to be conducted by U.S. attorneys from the Department of Justice.

²⁹A competitor right of action would allow industry participants to seek to stop activities of their competitors that they think violate the law.

Figure 11: Title Industry Costs as a Percentage of Premiums Written, 2005



Source: GAO analysis of NAIC data.

^aThe "Other expenses" category includes salaries, rent, and equipment costs, among other things.

Despite this difference, few regulators review the costs that title agents incur to determine whether they are in line with the prices charged. In fact, in the majority of states, agents' costs for search and examination services are not considered part of the premium and, thus, receive no review by regulators. Therefore, title agents charge separately for their search and examination services, yet they receive about the same percentage of the premium as agents in states where these costs are included in the premium. In our six sample states, one regulator did not regulate premium rates for title insurance at all, and one state sold title insurance through a state-run program that did not regulate title search and examination costs. In the remaining four states, agents' search and examination costs were considered part of the premium, but regulators in only one of those states regularly reviewed title agents' costs as part of the rate review process. The other three regulators saw the amount retained by the agents as a cost to the insurer that they would review as justification for insurers' premium rates. However, these states did not go beyond the insurer to review the agents' costs.

Furthermore, only two of the six regulators we reviewed collected financial and operational data on title agents, and regulatory officials in both those states said that the data that they currently collect were

insufficient to analyze the appropriateness of current premium rates. For example, while officials from the California insurance regulator have concluded that a lack of competition exists and that premium rates are excessive, they have determined that they would need to collect a significant amount of additional information before they could assess the extent of overpricing. In July 2006, the officials proposed an extensive plan for collecting these data that involved gathering information at the individual transaction level. Similarly, the Texas insurance regulator has been collecting financial data on title agents, but officials there have concluded that these data, which are not organized by functional categories, are insufficient for determining the extent of potentially excessive costs. Because costs incurred by title agents receive such limited review, most state insurance regulators are limited in their ability to assess whether the amounts that consumers are charged for title insurance reflect the costs they are intended to cover. Appendix II describes the types of information that would be helpful in assessing title agents' costs and operations.

States Conduct Only Limited Regulation and Oversight of Title Agents

Some aspects of agent regulation, such as licensing, varied across our sample states, while other aspects, such as capitalization and education requirements, were minimal. Of our six sample states, four required agents to register or obtain a license. Iowa had no title agents, and New York had no licensing or registration requirements.³⁰ Furthermore, state regulators rarely audited agents, and the audits that were done were usually limited to examining only accounts that title agents use to hold customers' money, known as escrow accounts. Audits of operating accounts were uncommon, although some industry participants said that these accounts were a source of agent defalcations.³¹ Table 2 summarizes some aspects of title agent regulation in our sample states.

³⁰Because the sale of title insurance within Iowa—one of our sample states—is prohibited, attorneys and abstractors do title work.

³¹Agent defalcation occurs when an agent misappropriates funds and fails to pay off a prior mortgage.

Table 2: Regulation of Title Insurance Agents in Six Sample States

State	State licensing	Continuing education	Capitalization requirements	State audits	Insurer oversight	Proposed regulations
California	Yes	No	Net worth of \$75,000 to \$400,000	Quarterly financial statements	Oversees escrow procedures and approves agent bonding	Yes
Colorado	Yes	No	\$10,000	With cause	Compliance with title insurance laws, report fraud or late premium payments	Yes
Illinois	Yes (registration only)	No	No	With cause	Can withdraw agent registration.	No
Iowa	Must have law license ^a	No	No	Attorneys are subject to state audits.	Participating attorneys are subject to relevant state law.	N/A
New York	No	No	No	No	General Agency Law governs	Yes
Texas	Yes	Yes	No	Annual	Report failure to provide annual audit report	Plans to call for more agent data

Source: GAO analysis of state insurance laws and regulations.

^aAttorneys and abstractors, rather than title agents, perform title work in Iowa.

Moreover, few states we visited require strong insurer oversight of agents. The nature of such oversight is usually negotiated between the insurer and the agent and defined by contract. Typically, the insurers sign up agents based on the quality of their service and their reputation in a certain area and audit their escrow accounts every 18 to 36 months. Industry participants told us that contractual stipulations and questions of unfair competitive practices were among the reasons that prevented insurers from looking into independent agents' operating accounts. When we asked the major title insurers that we spoke with for information on title agents' costs, they said that they did not collect data from title agents in a manner that would allow for an analysis of costs and profitability and, thus, could not provide us with such information. For example, these insurers said that while they reviewed the records of agencies that wrote policies for them, contracts with the agencies generally limited such reviews to escrow accounts and policy records—that is, only enough review to ensure that the insurer had received its share of premiums for the policies issued, but not enough review to evaluate the components of agent costs.

Although insurers may not have access to all of the data they need from independent title agents (1) that write for several companies and (2) that do not want insurers to see financial information related to their entire business, the situation with affiliated title agents is generally different. In affiliated arrangements, the insurer has an ownership interest in the title agent and seemingly would have access to the agent's financial records—especially in cases where the insurer has a controlling interest in the agent and may be required to consolidate its affiliated agent's financial statements with its own. According to regulators, however, the industry has been resistant to calls for more extensive data collection because of the potential cost burden on the insurers and their agents.

Regulators in California and Colorado have recently implemented or plan to implement stronger regulations for title agents, including more stringent qualifying examinations, higher capitalization requirements, criteria to identify sham business arrangements, and more detailed data calls focusing on the costs of providing title insurance. The regulators said that these stronger regulations would be key to preventing illegal actions by agents by eliminating both bad actors and questionable practices in the title industry.

Until recently, state regulators had done little to oversee ABAs. Although three of our six sample states have some type of restriction on the amount of business a title company can get from an affiliated source, enforcement of these laws appeared to be limited. In California, the laws specify that a title company can get no more than 50 percent of its orders from a controlled source. In Colorado, until recently, an insurance licensee was prohibited from receiving more in aggregate premium from controlled business sources than from noncontrolled sources.³² However, one regulator told us that, until recently, it had not rigorously examined data from agents to verify their compliance with the percentage restrictions.

Amid recent reports of enforcement actions taken by HUD and some states against allegedly inappropriate ABAs, some state insurance

³²Under Colorado's new law, ABAs are authorized provided that they meet conditions similar to those in RESPA, and ABAs must be disclosed to the state division of insurance or real estate in connection with license applications. In addition, the divisions of insurance and real estate are to consult with one another to promulgate ABA rules, and to share information derived from investigations of ABAs. New Colorado regulations include specific rate and fee rules; standards of conduct for title insurance entities, including standards for ABAs; and rules regarding consumer protections.

regulators told us that they had begun looking into these increasingly popular arrangements. Regulatory officials told us that they had found various problems, including the level of compliance with mandatory percentage restrictions from controlled sources; the existence of potentially illegal referral fees and kickbacks among ABA owners; and title work performed at some agencies that might not qualify as “core” title work for which liability arises (such as the evaluation of title to determine insurability, clearance of underwriting objections, issuance of the title commitment and policy, and conducting the title search and closing). In Colorado and Minnesota, officials estimated that the number of ABAs had doubled in the past few years. Colorado regulatory officials attributed some of the growth to lax agent-licensing requirements, including low capitalization requirements and minimal prelicense testing. In contrast, California regulatory officials credited the relative lack of ABAs in their state to more stringent licensing and capitalization requirements. Agents in California, referred to as Underwritten Title Companies, must raise between \$75,000 and \$400,000 in capital to conduct business, depending on the number of documents recorded and filed with the local recorder’s office. Furthermore, California has an extensive licensing process, including a review of the character, competency, and integrity of prospective owners; a financial assessment; and a review of the reasonableness of their business plan. As we previously noted, from 2003 to 2006, a growing number of federal and state investigations into ABAs alleged that these arrangements were being used to provide illegal referral fees and kickbacks. Colorado’s regulator has implemented stronger agent regulation, such as a stricter review of agents’ applications, mandated disclosure of any affiliated relationships, and higher capitalization and testing requirements. Regulatory officials said that these changes would help prevent future illegal actions by title agents, especially through the improper use of questionable ABAs. However, the more limited regulation and oversight of title agents and ABAs in other states could provide greater opportunity for potentially illegal marketing and sales practices.

States’ Enforcement of Antikickback and Referral Fee Provisions Was Uneven

Kickbacks are generally illegal under both RESPA and most state insurance laws. Although the enforcement provisions of laws in five of the six states in our sample included suspension or revocation of agents’ licenses and monetary penalties, state regulators and others did not see these sanctions as effective deterrents against kickbacks. One state regulator and some industry participants expressed concern that title insurers and agents saw the fines simply as a cost of doing business, since these businesses stood to gain much more in market share and revenue through illegal kickbacks than they would lose in state-assessed monetary

penalties. From 2003 to 2006, officials in states we reviewed settled with insurers for over \$90 million in penalties for alleged referral fee violations. In comparison, in 2005 alone net earnings for the five biggest title insurers totaled almost \$2 billion. In addition, at least one group of industry participants told us they took the fact that regulators had taken little action in the past to mean that they would not get caught if they engaged in illegal activity.

RESPA specifies that states—through their attorneys general or insurance commissioners—may bring actions to enjoin violations of section 8 of RESPA. In nearly all of our sample states, title insurance laws contain antikickback and referral fee provisions similar to those in RESPA. Also, although RESPA provides for injunctive action by state regulators, they have hesitated to use it and have only recently begun to look into RESPA section 8 violations. In one state, regulators concluded that they were prevented by state law from seeking injunctive relief under section 8 of RESPA because their only available court for complaints was an administrative one that did not satisfy RESPA requirements.³³ Moreover, some state insurance regulators said that they had limited enforcement options against those that they identified as the major contributors to the kickback problem: real estate agents, mortgage brokers, and other real estate professionals. Even though receiving kickbacks is generally illegal under RESPA, some state regulators told us that they had no authority to go after these entities, which were regulated by other state agencies. Meanwhile, the regulators that oversee these real estate professionals have shown little interest in or knowledge of potential violations of their licensees. In California and, until recently, in Colorado, regulators said that inconsistencies in laws governing kickbacks for title insurers and other real estate professionals have made it difficult to pursue recipients of illegal kickbacks. Furthermore, some state officials told us that they received little response when they forwarded potential kickback cases to HUD investigators. A lack of consistent enforcement of antikickback and referral fee provisions by all relevant state regulators, as well as HUD, could limit the effectiveness of enforcement efforts.

³³ Actions pursuant to section 8 of RESPA may be brought in the United States district court or in any other court of competent jurisdiction, with certain other limitations. HUD officials disputed the regulators' assertion.

Limited Resources and Lack of Coordination among Regulators within States May Limit the Effectiveness of Enforcement Efforts

Regulators at the state and federal levels told us that limited resources were available to address issues in title insurance markets. Title insurance is a relatively small line of insurance, and title insurers and agents often get even less than the usual limited market conduct scrutiny that state insurance regulators give other types of insurers.³⁴ With little ongoing monitoring, selected regulators told us that their attention is drawn to problems largely through complaints from competitors. Complaints from consumers have been rare because, as we have discussed, they generally do not know enough about title insurance to know that they have a problem.

Furthermore, the many entities besides title insurers and agents that are involved in the marketing and sale of title insurance often have their own regulators. These entities include real estate agents, mortgage brokers, lenders, builders, and attorneys, all of which may be regulated by different state departments. Our previous work has shown the benefits of coordinated enforcement efforts between state insurance regulators and other federal and state regulators in detecting and preventing illegal activity.³⁵ According to some state officials' comments, varying levels of cooperation exist among different state regulators, with some states demonstrating little or no cooperation and other states having more structured arrangements, such as a task force that might include the state insurance regulator, mortgage lending department, real estate commission, and law enforcement officials. Until a recent Colorado law was passed, however, these arrangements stopped short of being codified in legislation or regulation in any of our sample states. The previously mentioned task force in Texas meets monthly to discuss current and potential fraud cases, and the regulators involved noted that it has helped them identify and investigate cases of which they would have otherwise been unaware.

In our discussions with some noninsurance regulators, we observed that they had an apparently nominal understanding of violations of laws such as RESPA, and that they had taken few actions against their licensees for violations. Two of the state real estate regulators we spoke with, for

³⁴Market conduct examinations are performed by state insurance commissioners, and they review agent-licensing issues, complaints, types of products sold by the company and agents, agent sales practices, proper rating, claims handling, and other market-related aspects of an insurer's operation. See GAO-03-433.

³⁵GAO, *Insurance Regulation: Scandal Highlights Need for Strengthened Regulatory Oversight*, GAO/GGD-00-198 (Washington, D.C.: Sept. 19, 2000).

instance, said that they were not aware that referral fees were illegal under their state laws or under RESPA.³⁶ Another real estate regulator said that the department did not maintain a complaint category for RESPA violations against licensees and, thus, could not provide us with the number of RESPA-specific complaints the agency had received. In 3 years, this department had not revoked any licenses and could only identify one RESPA violation case in which licensees were publicly censured and fined. All of these actions were less than what was allowed by state law.

One difficulty for state insurance regulators may be that the state laws and regulations for mortgage brokers, real estate agents, and others may differ from those for title insurers and agents, and these laws and regulations may not view referral fees in the same way, thus making interdepartmental enforcement difficult. For example, Illinois and New York real estate law contains no reference to referral fees related to settlement service providers, although the title insurance laws prohibit these fees. However, given the lack of coordination we noted among regulators in the same state, it is not surprising that different regulatory agencies were not aware of differences in the way state laws and regulations treat certain activities. Without greater communication and coordination among the various state regulators, some potentially illegal activities carried out by those involved in the sale and marketing of title insurance could go undiscovered and uncorrected.

HUD Officials Expressed Concern over Lack of Enforcement Authority for Violations of Section 8 of RESPA

The investigative actions HUD has taken have largely resulted in voluntary settlements without admission of wrongdoing by the involved parties. According to HUD officials, it is difficult to deter future violations without stronger enforcement authority, such as civil money penalties, because, as we previously mentioned, companies view small settlements as simply a cost of doing business. While HUD has obtained a number of voluntary settlements from 2003 to 2006, the average amount assessed by the department was approximately \$302,000. During the same period, the combined net earnings of the five major national title insurers averaged about \$1.6 billion each year.

One particular area of possible section 8 violations about which HUD officials expressed concern was the difficulty of investigating complex

³⁶During the course of our communication with these regulators, we informed them that referral fees were generally illegal under the state law in question and under RESPA.

ABA relationships. RESPA provides an exemption to the antikickback provision for compensation for goods or services actually provided. However, HUD officials told us that it was often difficult to establish what type of and how much work an entity actually did. In the past, the most common type of ABA was an entity, such as a real estate broker, that owned another entity, such as a title agent. Recently, the arrangements have begun to involve three or more entities, making it difficult to trace the flow of money among entities and the responsibilities of each entity.

HUD's enforcement mechanism is also complaint-driven, but, as we previously noted, most consumers are not well-informed enough to bring complaints. Thus, violations could exist that HUD would not know about. HUD has few staff focused on RESPA issues, although their number has increased from 5 full-time employees in 2001 to more than 19 in 2006. According to other regulators, these employees are generally limited to responding to some complaints and pursuing a few large cases. Recently, HUD officials responsible for enforcing RESPA have begun training employees in HUD's Office of the Inspector General on RESPA issues. The officials said that they have received some forwarded cases as a result of the training. In addition to staff specifically assigned to RESPA issues, resources in other parts of HUD, such as the Office of the General Counsel, also provide support, according to HUD officials. HUD also spends \$500,000 per year on an investigative services contract to assist RESPA enforcement efforts. HUD tracks cases of alleged RESPA violations along with their disposition, staff assigned, closing date, and settlement, but we did not obtain this information by the time this report went to print.

Some state regulators expressed frustration with HUD's level of responsiveness, saying that the agency did not always follow up with them on forwarded cases, potentially limiting the success of investigative efforts. State regulators told us that they looked to HUD to enforce kickback provisions beyond what they had concluded was allowed by state insurance laws—for example, against mortgage brokers, real estate agents, and others that state insurance regulators do not oversee. Yet HUD officials and state regulators told us that there was no formal plan for coordinating with states, and that cooperation, where it existed, relied on requests and informal relationships.

HUD officials cited several possible reasons for not communicating the results of forwarded cases to the states. Among these reasons were state and federal jurisdictional issues, constrained resources, and complaint-driven enforcement that limited HUD's scope. As we mentioned, our

previous work has shown the benefits of coordinated enforcement efforts between state insurance regulators and other federal and state regulators to detect and prevent illegal activity. A September 2000 report recommended that state insurance regulators improve information sharing by developing mechanisms for routinely obtaining data from other regulators and implementing policies and procedures for sharing regulatory concerns with other state insurance departments.³⁷

Some industry officials also said that the rules under RESPA were not always clear and that HUD had not been responsive in answering their inquiries, potentially resulting in activities that HUD later deemed to be illegal. For example, in the case of captive reinsurance, two large underwriters told us that they had never received clear answers from HUD to inquiries about the legality of such arrangements, and that they entered into them as a result of competitive pressures. Eventually, these underwriters ended the arrangements after federal regulators investigated and deemed them improper. As a result, these underwriters and other entities paid over \$66 million in settlements with states and HUD. Some industry participants, including HUD's former general counsel, have suggested that HUD clarify RESPA by instituting a no-action letter process similar to the one that the SEC uses to address industry questions on potential activities and to the process that HUD uses in its Interstate Land Sales Program.³⁸ Although clarifying regulations can provide benefits, without greater enforcement authority and more coordination with state regulators, HUD's effectiveness at deterring, uncovering, and stopping potentially illegal title insurance activities may be limited.

HUD, State Regulators, and Industry Stakeholders Have Developed Proposals for Improving the Regulation and Sale of Title Insurance

With knowledge gained from their recent investigations into the title insurance industry, and in line with their mission to increase access to affordable housing, HUD has developed a two-pronged approach to regulatory changes. First, HUD plans to propose reforms to the regulations that govern RESPA. Agency officials said that the reforms will help consumers shop for settlement services, and that, hopefully, consumer-driven competition will put downward pressure on prices. However, agency officials have not yet made public the specifics of these reforms.

³⁷GAO/GGD-00-198.

³⁸SEC's no-action letter process allows an individual or entity that is not certain whether a particular product, service, or action would constitute a violation of the federal securities law to request a "no-action" letter from the SEC staff.

Second, HUD plans to seek substantial authority to levy civil money penalties that it expects will deter future violations of section 8 of RESPA. HUD officials said that having the authority to levy civil money penalties would greatly enhance their RESPA enforcement efforts. HUD's obtaining civil money penalty authority in section 8 of RESPA, however, would require a legislative change.

Some state regulators also have proposed changes in oversight of the title insurance industry. Regulatory officials found that weak licensing regulations may have contributed to problems in the industry, and that a lack of data on title agents' costs hindered their ability to analyze prices paid by consumers and to ensure such prices were not excessive. As a result, regulators have proposed the following changes:

- In Colorado, state regulators have made changes that are primarily aimed at making the identification and, thus, the elimination of improper ABAs easier—for example, through mandatory disclosure of ownership structures on agent applications and higher capitalization requirements. At least one industry participant has welcomed the changes, which it said will help level the playing field for independent agents.
- In California, state regulators have concluded that premium rates are excessive and have proposed premium rate rollbacks derived from a detailed evaluation of costs.
- In Texas, state regulators are attempting to collect more detailed information on agent costs, shifting their emphasis to comprehensive data on functional categories that would allow them to more easily identify excess costs and illegal kickbacks.

In addition, the NAIC Title Working Group is looking at modifications to the model laws in an effort to align referral fee provisions with those of RESPA and enhance state regulators' enforcement authority.

Finally, some industry officials have said that state and federal regulators either did not have the ability or lacked the will to address violations, which the officials said was the fault of only some in the industry. Other officials said that they had concluded that the industry would be better off policing itself, and some underwriters proposed giving insurers the right to seek private injunctive relief against competitors suspected of engaging in illegal activities, but with no monetary award. One underwriter official said such self-policing by the industry would help government enforcement and maintain honesty among industry participants. However,

it was not clear whether such actions could be used punitively or as a way to stifle competition.

Some industry stakeholders, however, see the current model of selling and marketing title insurance as irretrievably broken and have put forth two alternative title insurance models designed to benefit and protect consumers through lower prices and government intervention. The first alternative model would require lenders to pay for title insurance, on the theory that as regular purchasers of title insurance, lenders would be better informed and could potentially use their market power to obtain lower prices. However, some fear that this model would make the process less transparent, and that lenders would not pass on any cost savings. The second alternative model would be a system like Iowa's, with state-run title underwriters. But it is not clear that this system would make the necessary changes to the current model or that it would save consumers money. For example, although title underwriters are barred from selling title insurance in Iowa, nothing prevents consumers from choosing to purchase it from them out of state, and the underwriters end up providing title insurance to about half of the market. Furthermore, while premium rates for Iowa Title Guaranty might be lower, although not the lowest, than rates in many other states, the total costs that consumers pay for title searches, examinations, and clearing of any title problems might not differ substantially. In Bankrate.com's survey of closing costs, Iowa's total costs were about the same as those in Maryland, Nebraska, South Dakota, Washington State, and West Virginia, where private title underwriters are free to do business.

Conclusions

Title insurance can provide real benefits to consumers and lenders by protecting them from undiscovered claims against property that they are buying or selling. However, multiple characteristics of current title insurance markets, as well as allegedly illegal activities by a number of those involved in the marketing of title insurance, suggest that normal competitive forces may not be working properly, raising questions about the prices consumers are paying. Compounding this concern is the apparently very limited role that most consumers play in the selection of a title insurer or agent, and the fact that consumers must purchase title insurance to complete a real estate purchase or mortgage transaction. This puts consumers in a potentially vulnerable situation where, to a great extent, they have little or no influence over the price of title insurance but, at the same time, they have little choice but to purchase that insurance. Furthermore, federal and state regulators have identified a number of recent allegedly illegal activities related to the marketing and sale of title

insurance, which suggests that some in the title insurance industry are taking advantage of consumers' vulnerability. To begin to better protect consumers, improvements need to be made in at least three different areas.

First, price competition between title insurers and between agents, from which consumers would benefit, needs to be encouraged. Educating consumers about title insurance is critical to achieving this objective. Some state regulators have begun to encourage competition by attempting to educate consumers and improve transparency by publicizing premium rate information on their Web sites. While HUD's existing home-buyer information booklet also provides some useful information on buying a home, the information on title agent ABAs and available title insurance discounts is outdated and fails to provide sufficient detail. As a result, home owners may not be making informed title insurance purchases. Moreover, although some in the industry complain about ambiguity in the regulations concerning referral fees associated with ABAs, their use has continued to grow even while the extent to which any realized benefits from such arrangements are passed along to consumers is unknown. In addition, these arrangements can create potential conflicts of interest for the real estate and lending professionals involved that may disadvantage consumers.

Second, to ensure that consumers are paying reasonable prices for title insurance, more detailed analysis is needed on the relationship between the prices consumers pay and the underlying costs incurred by title insurers and, especially, title agents. Because of the key role played by title agents, such analysis will not be possible until state regulators collect and analyze data on those agents' costs and operations, including those operating as ABAs.

Third, to ensure that consumers are not taken advantage of because of their limited role in the selection of a title insurer or agent, more needs to be done to detect and deter potentially illegal practices in the marketing and sale of title insurance, particularly among title agents. HUD and several state regulators have already begun to take steps in this area, but these efforts often face challenges, such as HUD's limited enforcement authority, statutory limitations of RESPA, potentially confusing regulations, and a lack of coordination among multiple regulators. Increased regulatory scrutiny of the increasing number of complex ABAs appears to be particularly important because although only a few state regulators have looked at such arrangements in detail, those that have looked at this issue have discovered potentially illegal activities. Because

entities other than insurance companies are integrally involved in these transactions, identifying approaches to increase cooperation among HUD, state insurance, real estate, and other regulators in the oversight of title insurance sales and marketing practices is also critical. Ultimately, because of the involvement of both federal and state regulators, including multiple regulators at the state-level, effective regulatory improvements will be a challenge and will require a coordinated effort among all involved.

Congress can also play a role in improving consumers' position in the title insurance market by reevaluating certain aspects of RESPA. For example, HUD currently lacks the authority to assess civil money penalties for violations of section 8 of RESPA, generally forcing HUD to rely on voluntary settlements, which can be seen by some in the title insurance industry as simply a cost of doing business. In addition, RESPA dictates when and under what circumstances HUD's home-buyer information booklet is to be distributed to prospective buyers and borrowers. Revisiting RESPA to ensure that consumers receive this information as soon as possible when they are considering any type of mortgage transaction, not just when purchasing real estate, could be beneficial.

Matters for Congressional Consideration

As part of congressional oversight of HUD's ability to effectively deter violations of RESPA related to the marketing and sale of title insurance, Congress should consider exploring whether modifications are needed to RESPA, including providing HUD with increased enforcement authority for section 8 RESPA violations, such as the ability to levy civil money penalties. Congress also should consider exploring the costs and benefits of other changes to enhance consumers' ability to make informed decision, such as earlier delivery of HUD's home-buyer information booklet—perhaps at a real estate agent's first substantive contact with a prospective home buyer—and a requirement that the booklet be distributed with all types of consumer mortgage transactions, including refinancings.

Recommendations for Executive Action

We are recommending that HUD take the following two actions, as appropriate. The Secretary of HUD should take action to (1) protect consumers from illegal title insurance marketing practices and (2) improve consumers' ability to comparison shop for title insurance. Among the actions they should consider are the following:

-
- expanding the sections of the home-buyer information booklet on title agent ABAs and available title insurance discounts;
 - evaluating the costs and benefits to consumers of title agents' operating as ABAs;
 - clarifying regulations concerning referral fees and ABAs; and
 - developing a more formalized coordination plan with state insurance, real estate, and mortgage banking regulators on RESPA enforcement efforts.

Likewise, we are recommending that state insurance regulators, working through NAIC where appropriate, take the following two actions. State regulators should take action to (1) detect and deter inappropriate practices in the marketing and sale of title insurance, particularly among title agents, and (2) increase consumers' ability to shop for title insurance based on price. Among the actions they should consider are the following:

- strengthening the regulation of title agents through means such as establishing meaningful requirements for capitalization, licensing, and continuing education;
- improving the oversight of title agents, including those operating as ABAs, through means such as more detailed audits and the collection of data that would allow in-depth analyses of agents' costs and revenues;
- increasing the transparency of title insurance prices to consumers, which could include evaluating the competitive benefits of using state or industry Web sites to publicize complete title insurance price information, including amounts charged by title agents; and
- identifying approaches to increase cooperation among state insurance, real estate, and other regulators in the oversight of title insurance sales and marketing practices.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from HUD and NAIC. We received written comments from the Assistant Secretary for Housing of HUD and the Executive Vice President of NAIC. Their letters are summarized below and reprinted in appendixes III and IV, respectively.

The Assistant Secretary for Housing at HUD generally agreed with our findings, conclusions, and recommendations. Specifically, he indicated that the report accurately assessed the issues that adversely affect

consumers in the title insurance market. He also acknowledged the importance of protecting consumers and improving their ability to shop for title insurance. In response to our recommendation to expand the sections of the home-buyer information booklet on ABAs and discounts, he noted the importance of home-buyer education and amending the home-buyer's booklet to include this information. Addressing our recommendation to evaluate the costs and benefits of ABAs, he said that while ABAs are currently legal, HUD is in the process of evaluating various ABA structures to ensure they operate as Congress intended. We also recommended that HUD clarify regulations about referral fees and ABAs. The Assistant Secretary stated that HUD will continue its efforts to clarify existing guidelines, as well as develop new guidelines, to address practices that negatively impact consumers. Furthermore, he generally agreed with our recommendation for greater coordination with state regulators, noting that such coordination is necessary and pointing out past instances of HUD coordination with state regulators on RESPA enforcement that have resulted in successful outcomes. Lastly, he emphasized the ongoing challenge of RESPA enforcement without civil money penalty authority, stating that consumers would benefit if such authority were granted to HUD.

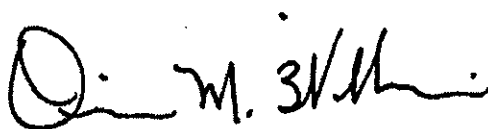
The Executive Vice President of NAIC agreed that our report identified concerns in the area of consumer protection. She also said that our recommendations are worthy of exploration, and that NAIC would continue to work to improve consumer education, consumer protections, and price transparency in the title insurance market.

We also received separate technical comments from staff at HUD and NAIC. We have incorporated their comments into the report, as appropriate.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the report date. At that time, we will send copies to the Chairman, House Committee on Financial Services, and the Chairman and Ranking Member, Senate Committee on Banking, Housing, and Urban Development. We will also send copies to the Secretary of Housing and Urban Development, the President of the National Association of Insurance Commissioners, and each of the state insurance commissioners. We will make copies available to others upon request. The report will also be available at no charge on our Web site at <http://www.gao.gov>.

Please contact me at (202) 512-8678 or williamso@gao.gov if you or your staff have any questions about this report. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix V.

Sincerely yours,

A handwritten signature in black ink, appearing to read "O. M. Williams".

Orice M. Williams
Director, Financial Markets
and Community Investment

Appendix I: Objectives, Scope, and Methodology

We previously provided a report and testimony identifying characteristics of current title insurance markets that merited additional study, including the extent to which title insurance premium rates reflect underlying costs and the extent of state oversight of title agents and other real estate professionals.¹ This report focuses on issues related to (1) the characteristics of title insurance markets across states, (2) the factors that raise questions about prices and competition in the industry, and (3) the current regulatory environment and planned regulatory changes.

Because of our awareness that title insurance regulation varies considerably from state to state, we chose six states in which to perform a detailed review of their laws, and regulatory and market practices. These states were California, Colorado, Illinois, Iowa, New York, and Texas. We chose these states to obtain a broad variety of state title insurance activity across the following dimensions:

- Proportion of the premiums written nationwide.
- Differences in the process of purchasing title insurance and the real estate transaction, including the relative importance of attorneys and alternative systems for title insurance.
- Domiciling of the largest national insurers and larger regional insurers.
- Varying rate-setting regimes and total premiums.
- The existence of ongoing or past Department of Housing and Urban Development (HUD) investigations in the state.
- Different combinations of premium rates, annual home sales, and rate-setting regimes.
- The activity of known proactive regulators in some states.

Except where noted, our analysis is limited to these states. We used the information obtained in the states to address each of our objectives, in addition to other work detailed in the following text.

¹GAO, *Title Insurance: Preliminary Views and Issues for Further Study*, GAO-06-568 (Washington, D.C.: Apr. 24, 2006); and *Title Insurance: Preliminary Views and Issues for Further Study*, GAO-06-569T (Washington, D.C.: Apr. 24, 2006).

To gain an overall understanding of the characteristics of national and local title insurance markets, we reviewed available studies. These included the study on the California title insurance market (as well as numerous criticisms of that study) and recent studies conducted on behalf of the Fidelity National Title Group, Inc., and the Real Estate Settlement Providers Council (RESPRO).² We discussed the studies' results with the authors and raised questions about their methodology and conclusions to further broaden our knowledge of the varying approaches in analyzing title insurance markets.

To better understand the effect consumers have on the price and selection of title insurance, we obtained information from title insurers, title agents, and state title industry associations about typical consumer behavior in the title insurance transaction. To deepen our understanding of the dynamics of the industry and current practices and issues within the title insurance industry that affect consumers, we gathered views from a variety of national organizations whose members are involved in the marketing or sale of title insurance or related activities. These organizations included the American Land Title Association (ALTA), RESPRO, the National Association of Realtors, the Mortgage Bankers Association of America, the American Bar Association, the National Association of Home Builders, and the National Association of Mortgage Brokers.

To better understand the relationship between premium rates and underlying costs, we discussed these issues with insurers, agents, and title industry associations. We attempted to obtain cost data from agents and insurers, but they were not able to provide us with data that would allow analysis of agent costs. In some states, we toured title plant facilities and observed the title search and examination process to broaden our analysis of underlying title insurance costs. To gain a better understanding of how title insurance premiums are shared between insurance companies and agents, we reviewed annual financial data collected by the National Association of Insurance Commissioners (NAIC) from title insurance companies and, to some extent, data collected by the Texas Department of

²Birny Birnbaum, *Report to the California Insurance Commissioner: An Analysis of Competition in the California Title Insurance and Escrow Industry* (Austin, TX: December 2005); Donald Martin, PhD, and Richard Ludwick, Jr., PhD, *Affiliated Business Arrangements and Their Effects on Residential Real Estate Settlement Costs: An Economic Analysis* (Washington, D.C.: October 2006); and Gregory Vistnes, *An Economic Analysis of Competition in the Title Insurance Industry* (Washington, D.C.: March 2006).

Insurance, the California Department of Insurance, and ALTA.³ We analyzed these data to deepen our understanding of title insurer and agent costs and revenues. We also consulted other publicly available financial information on title insurers and agents and spoke with agents. To determine how insurers account for premiums, we also looked at financial data filed with the Securities and Exchange Commission and spoke with officials from three of the largest title insurance underwriters.

To assess the current state and federal regulatory environment, we reviewed laws and regulations, and interviewed key regulators. To determine the role that states play in overseeing the various parties involved in the title insurance industry, we reviewed laws and regulations governing title insurance, real estate, and mortgage banking in six selected states. We also spoke with insurance, banking, mortgage, and real estate regulators in each state. To obtain an understanding of the federal oversight role in the title insurance market, we interviewed officials from HUD and reviewed relevant laws and regulations. We also discussed these issues with officials at the Federal National Mortgage Association and the Federal Home Loan and Mortgage Corporation to better understand the relationship between the secondary mortgage market and title insurance. Furthermore, we interviewed staff and state regulators working with NAIC to get their views on the industry and to obtain information on the activities of their Title Insurance Working Group.

We performed our work in Washington, D.C.; Chicago, Illinois; and selected sample states between February 2006 and March 2007 in accordance with generally accepted government auditing standards.

³NAIC is a voluntary organization of the chief insurance regulatory officials of the 50 states, the District of Columbia, and the four U.S. territories. NAIC assists state insurance regulators by providing guidance, model (or recommended) laws and guidelines, and information-sharing tools. ALTA is a national trade association for title insurers and agents, but its members also may include attorneys, builders, developers, lenders, and real estate brokers.

Appendix II: Potential Approach to Better Understand Title Agents' Costs and How These Costs Relate to Insurance Premiums

Understanding title agents' costs and how these costs relate to title insurance premiums that consumers pay is important because title agents do or coordinate most of the work necessary for issuing title insurance policies, and they retain most of the premium. Understanding these costs would require state insurance regulators to gather and analyze financial data on title agents. The list below illustrates the types of data that might be gathered and analyzed. This would be a multistep process and could involve detailed analysis of some title agents, such as those that look quite different financially from group (such as county or statewide) averages. Reasonable explanation for such differences could be informative of agency costs, while the absence of reasonable explanation could raise questions about the legitimacy of such costs.

We identified the following information on affiliated agents and direct operations that could be requested from insurers:

1. A complete list of underwriters' affiliated title agents and title service companies that would include the company name and address and the year acquired or established by the underwriter.
2. Financial data on each affiliate that would include balance sheets and statements of changes in owners' equity.
3. Revenue data that would include title premium revenues and production fees earned from others (e.g., search and examination, closing, and recording).
4. Title premium revenues and policies written that would be broken out between residential and commercial.
5. Personnel cost data that would include salaries, commissions, bonuses, benefits, and full-time equivalent employees, by function.
6. Other personnel data that would include average salaries, bonuses and benefits, and brief descriptions of any incentive pay systems, by job type and function.
7. Five years of other expense data that would include search and examination fees paid to contractors, advertising, entertainment, plant maintenance, rent, office supplies, and legal fees and settlements.
8. Expenses allocated to and from the underwriter.

Appendix II: Potential Approach to Better Understand Title Agents' Costs and How These Costs Relate to Insurance Premiums

9. For each affiliated title service company, the names of the 10 largest clients.
10. For each subsidiary of the underwriter, the names of any other underwriters, escrow companies, realtors, builders, developers, mortgage brokers, lenders, or other entities in the title, real estate, or mortgage industry
 - that have ownership interests in the subsidiary,
 - in which the subsidiary has an ownership interest, or
 - that are vendors of the subsidiary and owned by subsidiary management.

Likewise, we identified the following information on independent title agents that could be requested from insurers:

1. The number of independent agents, by state.
2. The number of offices of each independent agent, by state.
3. Each agent's title premiums written for the underwriter as a percentage of the agent's total title premiums written.
4. Premiums written by each agent for this underwriter, by state.
5. Revenue data that would include title premium revenues and production fees earned from others (e.g., search and examination, closing, and recording).
6. Expense data that would include employee and owner salaries, commissions, bonuses, and benefits; director fees; search and examination fees paid to contractors; advertising; entertainment; plant maintenance; rent; office supplies; legal fees and settlements; and claim losses.

Appendix III: Comments from the Department of Housing and Urban Development



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

March 29, 2007

Orice M. Williams, Director
Financial Markets and Community Investment
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Williams:

Thank you for providing the Department of Housing and Urban Development (HUD) with the opportunity to respond to the Government Accountability Office (GAO) draft report entitled, "TITLE INSURANCE: Actions Needed To Improve Oversight of the Title Industry and Better Protect Consumers" (GAO-07-0401).

GAO concludes that normal competitive forces may not be working properly in the title industry and that increased oversight of the title insurance industry may be necessary due to a potential lack of competition and conflicts-of-interest between settlement service providers and consumers, lack of uniformity in federal and state regulations and differing state licensing requirements. The GAO further concludes that sufficient data is not available to analyze the reasonableness of the cost of title insurance.

HUD believes that the report accurately assesses issues that adversely impact consumers related to the title insurance industry. The recommendations of the report pertaining to HUD are addressed below.

GAO Recommendation for Executive Action by HUD:

That HUD take actions to protect consumers and improve their ability to comparison shop for title insurance.

General Response:

HUD strongly agrees that taking action to protect consumers and improve their ability to comparison shop for title insurance is very important. As the report notes, HUD has been actively working on reform of its RESPA regulations to provide greater opportunity for the consumer to shop. Clearer and more certain disclosure of settlement costs are key objectives of these efforts.

www.hud.gov

espanol@hud.gov

Special GAO Recommended Actions:

Action 1: Expanding the sections of the homebuyer information booklet on title agent affiliated business arrangements (ABA) and available title insurance discounts.

HUD Response: Homebuyer education is an important part of HUD's mission. HUD views expanding the homebuyer booklet to include additional information related to title insurance as beneficial to consumers. Further, HUD will include information that will alert consumers to inquire about all available discounts when purchasing title insurance.

Action 2: Evaluating the costs and benefits to consumers of title agents operating as ABAs.

HUD Response: HUD agrees with the GAO report that there are challenges in attempting to evaluate the costs and benefits of ABAs. HUD notes that Congress amended the Real Estate Settlement Procedures Act (RESPA) in 1983 to allow for ABAs. HUD is currently evaluating numerous ABA structures to ensure that they operate in the manner Congress intended.

Action 3: Clarifying regulations concerning referral fees and ABAs.

HUD Response: The Department will continue its efforts to clarify its current guidelines and develop new guidelines to address new and questionable patterns and practices that may have an adverse impact on consumers.

Action 4: Developing a more formalized coordination plan with state insurance, real estate, and mortgage banking regulators on RESPA enforcement efforts.

HUD Response: HUD agrees that further coordination with state insurance, real estate and mortgage banking regulators on RESPA guidance and enforcement actions is necessary. HUD regularly coordinates with many state and federal regulatory agencies. In the past two years, in addition to coordinating with various federal agencies including the Federal Deposit Insurance Corporation, Federal Trade Commission and Office of the Comptroller of the Currency, among others, HUD has coordinated regulatory and enforcement efforts with Alaska, Arizona, Colorado, Florida, Minnesota, New Mexico, Tennessee and Texas. HUD appreciates the efforts of state regulators in enforcing RESPA and looks forward to strengthening its relations with these and other state agencies.

The report reviews recent enforcement actions taken by HUD and state regulators regarding captive title reinsurance. Captive reinsurance cases were an area of cooperation between HUD and state regulators working through the National Association of Insurance Commissioners (NAIC).

Other HUD Comments:

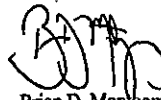
As noted in the report, the inability to assess civil money penalties for violations of RESPA Section 8 continues to present enforcement challenges. Amending RESPA to allow HUD to assess civil money penalties for violations of RESPA Section 8 would significantly increase HUD's ability to protect consumers from unnecessarily high settlement charges caused by kickbacks and referral fees that tend to increase unnecessarily the costs of title insurance and other settlement services.

Making delivery of the HUD-1 to the consumer mandatory two or three days in advance of closing, and granting HUD civil money penalty authority to enforce this and other provisions of RESPA that directly or indirectly relate to title insurance and settlement cost disclosure would additionally benefit consumers.

While the report delineates the numerous challenges presented in homebuyer education, regional "pattern and practice" differences and state regulatory incongruities, HUD remains committed to strong enforcement of RESPA.

The Department appreciates the opportunity to respond to the draft report. If you have any questions, please contact Gary M. Cunningham, Deputy Assistant Secretary for Regulatory Affairs and Manufactured Housing at (202) 708-6401.

Sincerely,



Brian D. Montgomery
Assistant Secretary for Housing-
Federal Housing Commissioner

Appendix IV: Comments from the National Association of Insurance Commissioners



NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

March 21, 2007

**EXECUTIVE
HEADQUARTERS**

2301 MCGEE STREET
SUITE 800
KANSAS CITY MO
64108-2662
VOICE 816-843-3600
FAX 816-783-8175

Orice Williams
Government Accountability Office
441 G St. N.W., Rm. 2A28
Washington, DC 20548

Dear Ms. Williams:

**GOVERNMENT
RELATIONS**

HALL OF THE STATES
444 NORTH CAPITOL ST NW
SUITE 701
WASHINGTON DC
20001-1509
VOICE 202-624-7750
FAX 202-624-8579

Thank you for the opportunity to review the Government Accountability Office (GAO) report *TITLE INSURANCE: Actions Needed to Improve Oversight of the Title Industry and Better Protect Consumers*. The report was reviewed by Ms. Catherine Weatherford, Executive Vice President and Chief Executive Officer of the NAIC; Mr. Andrew Beal, Deputy Executive Vice President and Chief Legal Officer; and Eric Nordman, Director of Research.

We thought the report was very detailed and evidenced a great deal of work on the part of the GAO. The GAO raises certain issues in the area of consumer protection, recognizes shortcomings in consumer protection, and presents some interesting recommendations that are worthy of exploration.

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We appreciate the opportunity to review and comment on the report and look forward to working with you and HUD to improve consumer education, consumer protections and price transparency.

Sincerely,

Catherine J. Weatherford
Executive Vice President and CEO

**WL
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Appendix V: GAO Contact and Staff Acknowledgments

GAO Contact

Orice Williams, (202) 512-8678, williamso@gao.gov

Staff Acknowledgments

In addition to the contact person named above, Lawrence Cluff, Assistant Director; Patrick Ward; Tania Calhoun; Emily Chalmers; Jay Cherlow; Nina Horowitz; Thomas McCool; Marc Molino; Donald Porteous; Carl Ramirez; and Melvin Thomas made key contributions to this report.

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