**Comments of the Center for Economic Justice**
**A National System of Title Insurance Data Collection**

**November 13, 2008**

In response to the working group's request for comments on a national title insurance data collection program, we start by suggesting that the data collection must be driven by the purposes for which the data will be used. We suggest three possible uses, all of which can be inferred from the GAO report which indicated that state regulators did not collect sufficient data about the business of title insurance.

1. Generally monitoring title insurance and escrow markets;
2. Evaluating the reasonableness of title insurance and escrow rates; and
3. Identifying and discouraging prohibited inducements resulting from reverse competition.

Once the purposes of data collection are identified, then the necessary data and means of data collection can be identified. While this seems like an obvious point, our experience is that the title industry has taken a different approach – here is the data we can provide and regulators will need to make do.

There is an important reason why data collection is important for title insurance and why such data collection must differ from data collection for property casualty lines of insurance – reverse competition.

Reverse competition is the dominant characteristic of title insurance and escrow markets. Reverse competition refers to a market structure in which title agents and title insurers market their products and services to real estate professionals who are in a position to steer the ultimate consumer – the consumer paying for the title insurance or escrow – to the title agent or title insurer. The competition for the referrers' business involves the title agent or title insurer providing things of value to the referrers and passing these sales and marketing costs onto consumers, who have no ability to exert market pressure on title insurance or escrow prices. As a result, there can be no assumption that actual expenses incurred – and reported – by title agents and title insurers are reasonable expenses for purposes establishing reasonable title insurance rates.

Residential consumers have little, if any, market power because title insurance and escrow services are required for the closing of a real estate transaction, resulting in inelastic demand. In a reverse competitive market, expenses are inflated as title insurers compete for the producers of title business – the real estate agents, mortgage brokers and lenders and others involved in real estate settlements – by providing a variety of considerations to the referrers of business. These considerations often take the form of services which benefit the referrer and not the purchaser of title insurance, but which expenses are passed on to the purchaser of title insurance.

Professor Jack Guttentag succinctly describes the phenomena of reverse competition:

> Why third-party settlement service charges are too high:
>
> Third parties involved in the lending process include title insurance companies, mortgage insurance companies, appraisers, credit-reporting agencies, flood insurance companies and escrow companies. Their costs are generally higher than they would be if they were purchased in a normally competitive market.
>
> The reason is that third-party service providers compete not for the favor of borrowers, who pay their fees, but for the favor of the lenders who select them. This type of competition is perverse because it drives up the costs of the service providers. This in turn raises prices to borrowers or prevents prices from falling in response to improvements in technology.[1]

Title premium consists of basically three components – expenses, losses and profit. Unlike most property/casualty lines of insurance in which losses are the biggest part of the premium dollar, expenses generally comprise over 90% of the title premium dollar.

The determination of reasonable expenses is the dominant issue in setting title insurance rates. However, because of the reverse competitive structure of title insurance markets, actual historical expenses incurred cannot be relied up upon an indicator of reasonable expenses associated with title insurance. It is therefore necessary to identify and exclude from the rate development analysis unreasonable expenses resulting from reverse competition.

Numerous studies and reports have described the reverse competitive structure of title insurance markets, including my December 2005 report to the Commissioner of Insurance in California, *An Analysis of Competition in California Title Insurance and Escrow Industry*. Chapters 5 and 6 from my report review various studies and reports describing reverse competition in title insurance markets and the implications of this reverse competition on title insurance expenses and prices.

In addition to the studies discussed in my California report, the Government Accountability Office issued two reports on title insurance which also confirm the reverse competitive nature of title insurance market. In its April 2006 report, *Title Insurance: Preliminary Views and Issues for Further Study*, the GAO found:

---

[1] Jack Guttentag, "Real Estate Settlement Services Take Bite Out of Borrowers," *Inman News*, September 6, 2005. Dr. Guttentag is Professor Finance Emeritus from the Wharton School at the University of Pennsylvania. See http://www.mtgprofessor.com.

> Third, the extent to which a competitive environment exists within the title insurance market that benefits consumers is also not clear. Consumers generally lack the knowledge necessary to "shop around" for a title insurer and therefore often rely on the advice of real estate and mortgage professionals. As a result, title agents normally market their business to these professionals, creating a form of competition from which the benefit to consumers is not always clear. Fourth, real estate brokers and lenders are increasingly becoming full or part owners of title agencies, which may benefit consumers by allowing one-stop shopping, but may also create conflicts of interest.
>
> Recent state and federal investigations have identified potentially illegal activities—mainly involving alleged kickbacks—that also merit further study. The investigations alleged instances of real estate agents, mortgage brokers, and lenders receiving referral fees or other inducements in return for steering business to title insurers or agents, activities that may have violated federal or state anti-kickback laws. Participants allegedly used several methods to convey the inducements, including captive reinsurance agreements, fraudulent business arrangements, and discounted business services. For example, investigators identified several "shell" title agencies created by a title agent and a real estate or mortgage broker that had no physical location or employees and did not perform any title business, allegedly serving only to obscure referral payments. Insurers and industry associations with whom we spoke said that they had begun to address such alleged activities but also said that current regulations needed clarification.

In its April 2004 report, *Title Insurance: Actions Need to Improve Oversight of the Title Industry and Better Protect Consumers*, the GAO found:

> 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.

In summary, reverse competition in title insurance markets leads to excessive sales and marketing expenditures by title agents and title insurers that do not benefit the consumer paying for the title insurance. The inclusion of such excessive and unreasonable expenses, resulting from reverse competition, in the development of title insurance rates is unreasonable. Such unreasonable expenses must be identified and excluded.

There are hundreds of examples of illegal payments from title insurers and title agents to real estate middlemen driven by reverse competition. The Washington, California and Colorado Departments of Insurance have found many examples of illegal inducements – often repeat violations by the same title insurer. The United States Department of Housing and Urban Development has initiated and settled dozens of enforcement for actions for violations of the federal Real Estate Settlement Practices Act (RESPA) and most of those actions concern illegal rebating for title insurance referrals. Consider the following example:

In February 2007, HUD settled an enforcement action with Longford Home of New Mexico. HUD alleged that Longford, a homebuilder, had an illegal rebating agreement with Fidelity National Title Company from 1999 through 2005 in which Fidelity agreed to pay and Longwood agreed to accept "up to $25,000 annually for reimbursement of expenditures related to promoting Longwood's business in exchange for Longford referring its title business to FNT." Copies of the settlements between HUD and Longford and between HUD and Fidelity are attached. Longwood agreed to pay $20,700 and Fidelity agreed to pay $68,635 to the federal government as part of the settlement.

It is likely that there have been similar illegal rebating activities by other title agents and title insurers because of the limited enforcement resources available to HUD.

**Principles for Data Collection**

1. Comprehensive data collection for title insurers and title agents for title, escrow and other services related to the business of title insurance.

If the purposes are either rate oversight or monitoring the market for problems associated with reverse competition, there must be comprehensive oversight of all the activities of title agents and title insurers. If not, there will be a shifting of reported expenses or activities between regulated and non-regulated activities to avoid meaningful oversight.

It will be necessary that model laws be developed to ensure each state has authority to collect data from title insurers and title agents. Absent such authority, meaningful data collection will not be possible.

2. Collection of data by core function to allow meaningful analysis of the reasonable costs of producing title insurance and escrow products and services.

Title underwriters currently allocate non personnel expenses by function and by type of sales (affiliated agent, not affiliated agent or direct business). But the largest portion of title insurance expenses – by far – is personnel expenses for which there is no allocation to functional activity. Consequently, there is no ability to evaluate the reasonableness of the costs of title insurers. Add to this that the major portion of title insurance premium goes to title agents and, in most states, there is no collection of income and expense data from title agents, it becomes clear that most regulators have little information to review the reasonableness of title rates or perform market analysis to identify illegal payments.

3. A comprehensive national approach.

No state has the necessary data collection program in place. There are a few states which collect detailed data from title insurers (in addition to the data reported in the statutory annual statement) and title agents – Texas, New Mexico and Florida. Yet, even in these states, the data have not allowed the evaluation of the reasonableness of title insurance expenses because of the absence of information by cost function. For example, despite having a very detailed statistical plan for both title agents and title insurers, the Texas Insurance Commissioner issued an addition request / demand for information with over 400 questions / requests.

The current – but soon to be replaced – California statistical plan provides an example of the type of data collection necessary for both rate oversight and market monitoring.

While the regulatory approach to title insurance varies across the states, a national system of detailed data collection could enable all states to perform meaningful market monitoring and allow states – which desire to do so – to perform meaningful rate oversight. A national system would also provide great efficiencies to national title insurers.