TITLE INSURANCE: COST AND COMPETITION

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND COMMUNITY OPPORTUNITY

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

APRIL 26, 2006

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Wednesday, April 26, 2006

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TITLE INSURANCE: COST AND COMPETITION

Wednesday, April 26, 2006

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:55 p.m., in room 2188, Rayburn House Office Building, Hon. Robert Ney [chairman of the subcommittee] presiding.

Present: Representatives Ney, Miller of California, Tiberi, Neugebauer, Campbell, Waters, Lee, Scott, Cleaver, and Green.

Ex officio: Chairman Oxley.

Chairman NEY. This afternoon, the Subcommittee on Housing and Community Opportunity meets to discuss title insurance and its role in the real estate transaction. I do look forward to today's panel, and I want to thank you for coming and sharing your views on title insurance, costs, and competition in the marketplace.

Title insurance, of course, is designed to protect homeowners and lenders from future claims to their property. It helps protect against the risk that property may be encumbered at the time of sale by unknown rights and claims that would be asserted by others.

Title problems can limit the homeowner's future use of real estate and threaten the security interests the mortgage lender holds on that property.

Unlike most other types of insurance which focus on potential future events and are renewed annually, such as homeowners or automobile insurance, title insurance, of course, protects against losses arising from past defects, and is only paid at the purchase or refinancing of a home.

For the past several years, regulators, industry groups, and others have suggested several changes to regulations that would affect the way title insurance is sold. In 2002, HUD proposed revisions of the Real Estate Settlement Procedures Act—RESPA, as everybody knows—that were designed to increase competition in the real estate settlement industry. The proposed revisions included the development of guaranteed mortgage packages and a more binding good faith estimate, both of which would have affected the pricing and sale of title insurance. Such revisions appear to be controversial, and HUD was forced to withdraw the proposal in 2004.

However, HUD announced in June of 2005, that it was again considering revisions to the regulations implementing RESPA, and was seeking input from the industry and others. Given the intense member interest in this issue during the previous Congress, and the attention this issue has received in the media, RESPA reform, I don't think, is going to be a simple one. Rather, it's pretty complex. It's important that HUD take a cautious and thorough approach, weighing all the perspectives, of course, as it moves forward.

While title insurance differs from many other insurance products in the marketplace, it's a valuable tool in protecting homebuyers and lenders from problems that may arise in a real estate transaction. However, buying a home has become pretty complex. It has to be simplified, so there is more transparency in the pricing of settlement services.

While we all may agree on that goal, there are differences in how to achieve it. It's my hope that today's hearing will focus on the importance of regulation that balances the need for vigorous consumer protections with vibrant business competition to provide a healthy insurance marketplace for consumers. And with that, I will yield to the Chairman of the Full Committee, Mr. Oxley.

The CHAIRMAN. Thank you, Mr. Chairman, for holding this hearing, and for your continued leadership in making it easier for consumers to buy homes. This subcommittee, under your leadership, has led the way with the American Dream Downpayment Act, the Zero Downpayment Act, and other initiatives to make the dream of home ownership a reality for an impressive 69 percent of American families.

Congress could still do more, however, to reduce barriers that limit competition in the real estate marketplace. Many home buying services with relatively fixed costs, such as realtor fees, title searches, and lending fees, have skyrocketed, along with the value of the homes, even though the amount of work involved has actually been reduced with improved automation and computerization.

If a house has doubled in value, does it really cost the realtor twice as much to sell it, and the title agent twice as much to do the automated title search? Consumers are paying home purchase costs that are artificially high, because of the lack of competition in real estate services.

I am particularly concerned about the ongoing investigations of title insurance fraud that have already resulted in tens of millions of dollars in settlements. In Colorado, Deputy Insurance Commissioner Toll, who is with us today, has unraveled a web of illegal kick-back schemes using captive re-insurance, and involving title insurance agents, builders, realtors, and other real estate service providers.

These schemes have inflated the price for title insurance for thousands of people. Few consumers will hold up their new home purchase over a few thousand dollars in title insurance. But what the consumer doesn't know is that, in many cases, a large percentage of the consumer's title insurance payment is kicked back to the real estate professional who set up the closing in the first place.

Illegal kickbacks are already a violation of RESPA. But the investigations by Colorado, Minnesota, California, and other States make it clear that this is an endemic problem. That is why I ask the GAO to investigate for Congress how title insurance gets sold in the real estate marketplace.

GAO's interim report raises some very troubling questions for members of this committee. According to GAO, in several cases, title insurers, or agents, have created fraudulent businesses and arrangements to provide potentially illegal kickbacks to realtors, mortgage brokers, lenders, and attorneys, in return for steering business their way.

GAO is finding that instead of focusing on consumers, title agents normally market their business to these real estate providers, creating a potential conflict of interest that benefits the providers at the expense of the consumer.

I believe that most business professionals are beyond reproach, and provide consumers with the best services that they have available. Some of these individuals are here with us today. Unfortunately, the majority of professionals find themselves undercut by unscrupulous actors who are circumventing RESPA's rules on illegal kickbacks. Given the number of annual home purchases and refinancing, I don't believe it's a lack of price competition in real estate services, it's something we can just enforce our way out of.

HUD and State insurance departments simply do not have the resources to monitor every property transaction. This is a structural marketplace problem that, at some point, Congress will have to address.

I want to thank our witnesses for joining us today to help shed some light on this critical consumer issue. Ms. Toll has been the leader in uncovering title insurance problems and opening the path for others to follow in protecting consumers. GAO and HUD have been very helpful in analyzing the marketplace and initiating a discussion of potential next steps.

And the witnesses on our second panel will be enormously helpful in providing us with the industry and consumer group perspective to separate fact from fiction, and to underscore why a vibrant title insurance marketplace is so important for our consumers.

Mr. Chairman, I look forward to working with you, Ranking Member Waters, and other members of the committee, as we begin this discussion of the problem, and a search for solutions. And I yield back.

Chairman NEY. Well, I thank the chairman for his participation in this, and for his leadership on the committee. And the gentlelady from California, Ms. Lee?

Ms. LEE. Thank you, Mr. Chairman. I do want to thank you and our ranking member, Maxine Waters, for convening this very important hearing on title insurance. And also, I want to thank our witnesses for being here today.

The home ownership process, we all know, is filled with confusion. Countless documents, fees that consumers must weed through, trying to understand this whole process, is quite overwhelming. Many in the real estate industry want to see a consolidation of the paperwork, and make the process easier for potential homeowners. We all agree that the process must be consolidated.

And one of the ways to make the home ownership process benefit consumers is to look at the fees and the competition, or lack thereof, in shopping for a lender or a broker, appraisers, and home inspectors, and title insurance. All of these issues demonstrate why we must, quite frankly, reopen the RESPA, and why it's so important that we are here today.

This hearing, I hope, will highlight some of the bad actors—and there are some—in the title insurance industry, and how we can correct the problems while maintaining a competitive market for consumers to choose from.

Title companies really should have to compete, and consumers should have choices. That's the bottom line. So I hope that our witnesses will discuss the RESPA violations by title companies, the kickbacks, the lenders, realtors, brokers—these kickbacks, and that's what they are, they often receive these kickbacks from business referrals, as well as—I hope we talk about the price of insurance compared to the low percentage of payouts.

So, I look forward to hearing from our witnesses, and working on—with our chairman and ranking member on drafting meaningful bipartisan RESPA legislation in the near future. Thank you, and I yield the balance—

Chairman NEY. I thank the gentlelady. The gentleman from Texas, do you have an opening statement? And with that, when the ranking member comes, of course, we will have an opening statement.

We will go to panel one. We have Erin Toll, who is the deputy insurance commissioner of compliance and market regulation for the State of Colorado. She also co-chairs the National Association of Insurance Commissioners' Title Insurance Working Group. Ms. Toll's investigations in the title insurance arrangements in early 2005 led to multi-million dollar settlements with title insurers.

Orice Williams is currently Director in GAO's Financial Markets and Community Investment Team. Mr. Williams is responsible for overseeing and producing reports on topics affecting the insurance, banking, and securities industries.

Gary Cunningham has been the Deputy Assistant Secretary for Regulatory Affairs and Manufactured Housing at HUD since April of 2004. The office has responsibility for enforcement of the Real Estate Settlement Procedures Act, RESPA, and the Interstate Land Sales Act, and for the administration of HUD's manufactured housing program.

With that, we will begin with Ms. Toll. Thank you.

STATEMENT OF ERIN TOLL, DEPUTY COMMISSIONER OF INSURANCE COMPLIANCE, COLORADO, AND CO-CHAIR OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS' TITLE INSURANCE ISSUES WORKING GROUP

Ms. TOLL. Thank you for the warm welcome. My name is Erin Toll and I am deputy commissioner at the Colorado Division of Insurance. I am also the co-chair of the title insurance working group for the National Association of Insurance Commissioners, and I am here today testifying on behalf of the NAIC.

I would like to begin by thanking Chairman Ney, Congresswoman Waters, and the members of the subcommittee for inviting me here to testify. I would also like to thank Chairman Oxley for his leadership and interest on these important issues.

Today I would like to address three basic points. First, what is title insurance and how is it regulated? Second, what problems have we, as State regulators, found with title insurance, and what are we doing about it? And third, what are some possible solutions?

So, what is it? How is it regulated? Title insurance is a necessary but unique product. It protects homeowners and lenders in the event that a lien, or what's called a cloud, is found on a title. Unlike other lines of insurance, which protect against things that may happen in the future, title insurance protects against something that already happened in the past.

In addition, the competition is different. Consumers rely on recommendations from their real estate professionals when choosing a title insurance agency and a title insurer, unlike in homeowners and auto insurance. Title insurance entities and all the participants are regulated by a variety of State laws and RESPA, the Real Estate Settlement Procedures Act.

Because State and Federal regulators understood the unique way in which title insurers compete, they created laws that said it's illegal to give or receive remuneration in any form for the referral of business. This exchange of something of value for the referral of business is defined in Federal law as a "kickback."

As insurance regulators, our jurisdiction only extends to those who are giving the kickbacks. So what are we seeing in our investigations? What are the kickbacks, and what are States doing about it?

Our investigations show that a black market has been created in the residential real estate transaction world. The good actors absolutely cannot compete with the bad actors, because the playing field is not level. We have initiated exhaustive investigations to try and level the playing field, and ensure a free market.

Settlement service providers are demanding, and title entities are giving, kickbacks. And the kickbacks usually take two forms: you've got your unsophisticated direct kickbacks; and there are sophisticated, indirect kickbacks. And the sophisticated kickbacks include things like free spa trips, or free just-listed, just-sold cards, or free farm packages. But the sophisticated indirect kickbacks, those are the ones that make my job interesting. Those are a lot harder to discover, and they include sham affiliated business arrangements and captive title reinsurance.

Affiliated business arrangements are nothing more than ownership arrangements between and among settlement providers and title insurance entities. And they are legal, unless they are not real, and they are referred to as shams. Our investigations in Colorado have determined that many of these affiliated business arrangements are simply vehicles to provide kickbacks. Where we have found these kickbacks, we have shut them down, and we have imposed penalties.

Now, captive title reinsurance is a lot more complicated, and so I have brought some flow charts, and I look forward to your questions and answers on that. And I will put up the flow charts. And it's also in your packet of materials.

But in Colorado, our investigations uncovered that these reinsurance mechanisms are nothing more than vehicles that were created to provide kickbacks to those who were referring business to the title insurers.

To date, Colorado has negotiated multi-state settlements that provide restitution directly into the pockets of consumers. Settlements negotiated, I am proud to say, by all States today equal almost $50 million. And we are not done.

Regardless of the form, these kick-back schemes distort the marketplace, they inflate prices, and they harm consumers. So what are some possible solutions? States are exploring various ways to help with these problems. In Colorado, we are looking at ways to regulate all the players in the transaction. We do not regulate mortgage brokers yet in Colorado, but we have three bills that are pending that look for some sort of regulation.

Colorado's general assembly has just passed a bill that actually goes beyond RESPA, and it tightens up enforcement for us, penalties, and it provides directly for restitution. But importantly, cooperation and information-sharing between and among all the regulatory bodies that are involved is necessary if we're going to stop this problem.

In conclusion, a black market exists regarding real estate transactions. We, as State and Federal regulators, need to aggressively enforce the laws that we have. Lawmakers need to enact laws to regulate all the players and strengthen fines and penalties. Thank you so much for inviting me to testify, and I look forward to your questions.

[The prepared statement of Ms. Toll can be found on page 180 of the appendix.]

Chairman NEY. Thank you. And our ranking member has arrived, so we will have an opening statement. I also wanted to thank—our ranking member requested a hearing, and we had one, in Los Angeles on CDBG. I want to thank Chairman Oxley and his staff, and Mr. Frank's staff, and ours out there. It was a very productive hearing, and we appreciated the comments that we received in Los Angeles. Ranking Member Waters?

Ms. WATERS. Thank you very much. Good afternoon, ladies and gentlemen. I would like, too, to thank Mr. Oxley, Chairman of the Financial Services Committee, for his interest in the title insurance industry. And I would like to thank Chairman Ney, who is the chairman of this subcommittee, and he certainly must be commended for holding today's hearing. I would like to also thank him for the hearing that was held in Los Angeles on CDBG. We have already begun to get a lot of response from the elected officials there.

This hearing on the title insurance industry is important for a number of reasons. Primary among them is the varying degree of opinions about the title insurance industry. There are those who believe that the industry is in great shape, and that the imposition of additional regulations is not warranted.

Of course, there are those who believe that the industry is not operating competitively, because of fraud and abuse. Indeed, there have been published reports of fraud and abuse in the title insurance industry in the State of California.

However, whether you support one position or the other, I believe that industry practices need to be examined closely, to shed light on issues surrounding the industry. To that end, I believe today's hearing represents an initial step in the right direction.

Why are the abuses in the title insurance industry so prevalent that we should consider legislation to reform the industry? Can the industry police itself? Are there any measures, short of legislation, that this subcommittee might consider to ensure that the consumer is protected from any competitive forces that could be at play in the marketplace?

We all know that the true cost of any alleged fraud and abuse weighs most heavily on the consumer. Consumers cannot avoid paying for title insurance, but they need not pay for overpriced products because the market is not competitive. Title insurance is a fact of life in most real estate transactions, in every State in the Nation, although three States do not require licensing of title insurance agents: New York, Tennessee, and Georgia.

Why? The cost of title insurance varies from State to State. Indeed, it is the lack of uniformity between the different title insurance systems that makes this an important issue.

In addition, approximately 90 percent of the title insurance business is concentrated in the hands of a few large title insurance companies. Higher mortgage loan amounts can also result in higher title insurance premiums for the buyer. Loans in the sub-prime market carry higher insurance premiums. Does this benefit consumers?

While today's testimony has generated broad interest, I could not find any agreement about why the industry is in its current state. Therefore, of particular interest to me is the GAO preliminary study, because it can provide a blueprint for this committee to examine the underlying factors, economic and non-economic, influencing the title insurance industry. Is it a competitive industry? How are title insurance rates determined?

While it is too early to rely on the GAO report exclusively for guidance on the appropriate legislative response to these questions, the completed study will ultimately provide this committee with instructive suggestions on what remedies to entertain.

Accordingly, I would strongly urge the chairman of the GAO to expedite the study of the title insurance industry before we reach any final conclusions about what is the appropriate response. I thank you, Mr. Chairman, and I yield back my time.

Chairman NEY. I thank the gentlelady.

Ms. Williams? Thank you.

STATEMENT OF ORICE M. WILLIAMS, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Ms. WILLIAMS. Chairman Ney, Chairman Oxley, Representative Waters, and members of the subcommittee, I am pleased to be here today to discuss our views and issues concerning the title insurance industry.

As you are aware, title insurance is designed to ensure clear ownership when a property is sold or refinanced, and is a required part of most real estate purchases.

While title insurance costs may be small compared to overall closing costs, title insurance costs can account for as much as one-third of closing costs for buyers in certain parts of the country. As Deputy Commissioner Toll has explained, recent Federal and State investigations have raised questions about certain practices and competition within the industry.

My comments today will focus on our preliminary report, which identified issues that warrant further study, and raise a number of questions as part of our ongoing work for Chairman Oxley. Specifically, I would like to discuss issues involving agent practices and competition.

Agents play a much more vital role in title insurance than other lines of insurance. In fact, most of the title insurance premium is paid to or retained by title agents, generally, to pay for title search and examination costs and agent commissions.

As shown in our graphic, in 2004, about 71 percent of total title insurance premiums written were paid to or retained by title agents. The remainder is broken out as follows: about 21 percent went to expenses paid by insurers for salaries, rent, plant, and other costs; about 5 percent went to losses; and the remaining 5 percent was the difference between total expenses, including the 71 percent paid to agents, and total premiums.

What we don't know is how much of the 71 percent represented the actual costs incurred by title agents to do the title search and examination, and take corrective actions. In fact, in certain parts of the country, agents can retain as much as 90 percent of premiums paid.

Despite the key role agents play in the underwriting process, the extent to which State insurers review their operations is unclear.

In fact, we found few States regularly collect information on title agents' operations, and three States do not license title agents. Moreover, most States do not take all of the various components of these agent costs into account during premium rate reviews, because they aren't considered part of the premium.

The last issue I would like to discuss is competition, which appears to occur at various levels. That is, the competition among insurers, as well as among agents for the business of other real estate professionals, such as builders, lenders, or real estate agents who refer clients.

Title insurance is largely a relationship-based business driven by connections among real estate professionals. While consumers have the right to select their insurer, most consumers lack the knowledge necessary to shop around for title insurance. Instead, they usually rely on real estate professionals, knowingly or unknowingly, to make these decisions. Given this type of ignorance-is-bliss environment, it is unclear whether the competition that exists always works to the consumer's benefit.

These issues are further complicated by the recent trend of real estate brokers, lenders, and builders becoming full or partial owners of title agencies in what are called affiliated business arrangements. While these arrangements can be part of a legitimate business model that may benefit consumers, they also create potential conflicts of interests that may put consumers' interests at odds with those of the real estate professionals.

In closing, these are just a few of the issues we are addressing as part of our ongoing work. All of these issues are significant, because they affect virtually everyone who has purchased, refinanced, or taken out a home equity loan, or plans to do so in the future. In other words, almost 70 percent of Americans.

Mr. Chairman, this concludes my oral statement, and I would be happy to answer any questions that you may have. Thank you.

[The prepared statement of Ms. Williams can be found on page 199 of the appendix.]

Chairman NEY. Thank you very much.

Mr. Cunningham?

STATEMENT OF GARY M. CUNNINGHAM, DEPUTY ASSISTANT SECRETARY FOR REGULATORY AFFAIRS AND MANUFACTURED HOUSING, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. CUNNINGHAM. Chairman Ney, Ranking Member Waters, Chairman Oxley, and distinguished members of the subcommittee, I appreciate the opportunity to be here today to discuss important issues related to title insurance under the Real Estate Settlement Procedures Act.

Enforcement of RESPA is a high priority of Secretary Jackson and Brian Montgomery, the Assistant Secretary for Housing and Federal Housing Commissioner. We view RESPA enforcement as a very important part of HUD's mission to increase home ownership.

Let me say also that while the hearing today is on title insurance, RESPA enforcement is an industry-wide issue. We recognize that most settlement service providers desire a level playing field on which to compete, and take their obligations under RESPA seriously.

RESPA was enacted in 1974, in response to Congressional findings that consumers needed more timely information on the cost of the settlement process, and that referral fees and kickbacks were driving up the costs of buying a home. A study of the title industry conducted for HUD as long ago as 1980 found that title insurers compete for referrals from settlement service providers, rather than for consumers. Current market case investigations indicates that this practice still exists in the title insurance market.

HUD is actively investigating captive title reinsurance arrangements, in cooperation with several States, and the National Association of Insurance Commissioners. Our focus has been on companies receiving reinsurance premium payments.

It is HUD's position that any captive title reinsurance arrangement in which payments to the reinsurer are not bona fide compensation, and exceed the value of the reinsurance, violates section eight of RESPA. In HUD's view, there is almost never any bona fide business purpose for reinsurance on a single family residence. When there is a history of few or no claims being paid, or the premium payments to the captive reinsurer far exceed the risk borne by the reinsurer, there is strong evidence that there is an arrangement constructed for the purpose of the payment of referral fees.

I would like to mention briefly just a few recent enforcement actions that the Department has taken for violation of section eight that prohibits the payment of kickbacks and referral fees. There are other examples in my written testimony.

HUD investigated a reinsurance arrangement between a title insurance underwriter and a home builder. The home builder created a title reinsurance company, and referred title insurance business to the insurer. The title insurer paid a premium to the builder's affiliated reinsurance company that far exceeded the risk assumed.

In Memphis, a title company established eight affiliated title companies with various builders, real estate agents, and mortgage brokers. The affiliated companies were paid for certain title and settlement work that they did not perform, and HUD determined were only created to make referral payments to the providers who owned the affiliated companies.

In Detroit, a title company paid real estate brokers for the use of conference rooms at rates that were substantially higher than the fair market rent, in return for the referral of business.

In Atlanta, a real estate broker ordered its sales agents—offered its sales agents—incentives, including trips, Atlanta Braves tickets, and higher commission splits, based on the number and volume of referrals to the broker's affiliated title company.

HUD has increasingly devoted more resources to RESPA enforcement. It contracts with a private firm to provide nationwide investigative services, and working with its Office of Inspector General, the Department continues to coordinate investigations and conduct joint enforcement actions with other Federal agencies, and is developing increasingly close relationships with State regulators and their associations.

The success of HUD's regulatory efforts to implement RESPA for the benefit of both industry and consumers depends greatly on RESPA enforcement. Certain statutory amendments may advance the goals of RESPA. For example, RESPA does not currently include authority for regulators to enforce violations of the requirements relating to the good faith estimate, or the HUD–1 settlement statement.

The effectiveness of RESPA could be enhanced by ensuring that creative business structures do not defeat the purposes of RESPA, and by providing the Secretary and State regulators with necessary tools to enforce the statute.

I appreciate the opportunity to discuss these important issues regarding title insurance and the settlement services industry, as they relate to RESPA.

[The prepared statement of Mr. Cunningham can be found on page 46 of the appendix.]

Chairman NEY. Thank you. Chairman Oxley?

The CHAIRMAN. Thank you, Mr. Chairman, for yielding me your time for questions. And Ms. Toll, in your testimony and in the chart, it appears that 5 percent of total annual premiums represent the losses in title insurance, which is a stark contrast to property and casualty, which is 80, 90, sometimes 100 percent.

I practiced law for 9 years and I did my share of title searches, which, by the way, were painful and boring. And I probably still got some exposure, somewhere along the line, with that. But I guess the bottom line is why on earth would somebody who has a 5 percent loss ratio, something that the property and casualty insurers would die for, what would be any reasonable explanation for setting up a reinsurance program, particularly one that is closely held?

Ms. TOLL. Thank you, Congressman Ney. Before I get to what title reinsurance is, captive reinsurance, I wanted to say that I, too, searched titles from the old, dusty books with mildew all over them, so I know your pain. I feel your pain.

The CHAIRMAN. There is a fraternity of that, I think.

Ms. TOLL. I am a very visual person, so I created a diagram to help you understand this. First, about loss ratios, I have to explain that title insurance is unique—and, indeed, if they were doing their job perfectly well, their loss ratio would be at or near zero, because the risk exists on the day of the closing, which gets to your second question about why you would ever reinsure.

There is no financial necessity to reinsure in a residential single family dwelling. There is absolutely none. And that's why we in Colorado and other States who joined on to the multi-settlement said that these are nothing more than vehicles to provide kickbacks.

If you want to know more exact details about how it works, I could also get into agent splits, and why that indicates that this isn't real.

The CHAIRMAN. When you did your investigation, did you have cooperation from the title insurance companies?

Ms. TOLL. Oh, I would like to say that I had a lot of cooperation. And I did, from two of the largest insurers. And in fact, one of the title insurers afterward told me that they really didn't want to be in the practice, but they had to, because they were losing market share.

Unfortunately, the third company has refused to settle with Colorado on a multi-state basis, and was saying some—I was informed by another regulator—was saying some very personal things to try and discredit me in front of other State regulators and I don't know who else. And that was very disconcerting and alarming, and I felt very nervous and threatened by that.

The CHAIRMAN. What is the status of that now?

Ms. TOLL. The status of that now is that I haven't had any communication with them. I don't know. I honestly don't know. We are trying hard, and we will keep pushing. We issued a bunch of subpoenas against this particular insurer's customers late last week, in an effort to reach some sort of settlement. But the last words to me from the company were, "We're not settling with you on a multi-state basis."

The CHAIRMAN. And do these companies have captive reinsurance entities?

Ms. TOLL. This is the company that began the practice 9 years ago. Now it's been 10 years. So they began the practice, and—

The CHAIRMAN. They began the practice of reinsuring?

Ms. TOLL. Of captive title reinsurance. And they were allowed to continue, I guess—well, they continued doing this practice for years and years, and then the two other big companies jumped on the bandwagon when they saw that they were losing market share, is how it was explained to me by the companies.

The CHAIRMAN. And how would that fee, if at all, show up on the closing statement?

Ms. TOLL. You know, on that I do not know. I'm sorry, I don't know. I can do my best to find out and get back to you, but—

The CHAIRMAN. It would be my guess that it was hidden somewhere in the closing statement, would be a—

Ms. TOLL. I don't know how you would ever see that fee.

The CHAIRMAN. Let me ask—you testified that eliminating kickbacks is the only way to ensure a level playing field. And kickbacks are already illegal in Colorado and most States, and actually in Federal law, as well. What would be the most effective way to eliminate that kind of practice?

And secondly, what kind of penalties exist, for example, in Colorado for illegal kickbacks, and are they regularly enforced?

Ms. TOLL. Well, I am proud to say that in Colorado, our legislature just passed a bill that goes beyond RESPA, so it really strengthens the penalties and that gets to the first part of your question, which is—I mean, I agree with Mr. Cunningham, that RESPA needs to be strengthened. There needs to be more penalties and restitution available if we are ever going to stop this practice.

On the State level, we are taking many, many steps to halt the practices, including posting interactive rating guides, so consumers can actually shop for title insurance in an effort to show rate transparency, and try and get the prices down, through operation of the free market.

The CHAIRMAN. Okay. Mr. Cunningham, how long have you been at HUD?

Mr. CUNNINGHAM. Two years.

The CHAIRMAN. And so you were participating in the initial RESPA—

Mr. CUNNINGHAM. Yes, I came in near the end of that process, when the rule was withdrawn by Secretary Jackson. I mean, what would have been the RESPA reform rule.

The CHAIRMAN. Do you recall the initial RESPA package that was offered by Secretary Martinez? Refresh my memory. How did the RESPA reform effort deal with this particular issue of kickbacks and reinsurance?

Mr. CUNNINGHAM. The RESPA reform proposal—which is still something that the Secretary is very much committed to—was designed to increase the transparency, if you will, and to make more certain the closing costs. The original proposal, which was withdrawn, had a portion in it where packages of settlement services could be developed and sold in the marketplace.

And the idea was that there could be direct competition between packagers or others in the marketplace, with respect to the settlement service package. I mean, that was one aspect of it. The current process with the good faith estimate, and so forth, would have continued to be available, but—

The CHAIRMAN. It would be price-based competition?

Mr. CUNNINGHAM. Yes. And frankly, that is still part of HUD's goal, is to try to bring competition to the marketplace for all settlement services.

The CHAIRMAN. Yes, I—the Secretary was here a week or so ago, and I asked him that question, and I understand that is still very much alive at HUD, the RESPA reform effort. And I would urge you folks to keep moving in the right direction, because a lot of these issues that continue to bubble to the surface are directly related to the kind of RESPA reform that is absolutely critical to the market. Ms. Toll, did you have a comment?

Ms. TOLL. No.

The CHAIRMAN. All right. I yield back, Mr. Chairman.

Chairman NEY. Thank you, Mr. Chairman, and our ranking member, the gentlelady from California?

Ms. WATERS. Thank you very much, Mr. Chairman. I think somewhere along the line I was told that there were only about five title insurance companies in the country. Is that true?

Ms. TOLL. May I?

Ms. WATERS. Yes.

Ms. TOLL. Congresswoman Waters, no, that is not correct. It is correct that 5 companies control a huge percentage of the market, but there are actually 86 insurers. I checked before I left the office.

Ms. WATERS. All right. Thank you. That does help. And I would like to know—I would like to try and understand the pricing. What is reflected in the pricing that consumers are paying? How much of this reflects the agent's costs, premiums, etc.? Is there any consistency in pricing? Is there any competition? How does it work?

Ms. TOLL. Congresswoman Waters, it varies from State to State. And in Colorado, you file the rate and use it, and the companies are required to maintain justification for their rates. And we would ask for justification in the event that there was a problem.

To get at what you're really asking, we are trying to get the rates down, because it's our position that there couldn't be kickbacks if there wasn't a whole bunch of fluff somewhere in these rates. So we are posting an interactive rating guide up on the Internet, to hope that consumers will start shopping, and then pushing the title insurers to get the price down. That is one of the things that we are doing. But it does vary from State to State. Some States don't even regulate the agents or the agencies.

Ms. WATERS. Do you find that more expensive properties pay higher rates, and less expensive properties pay lower rates? And what's the relationship to the cost of the property and the title insurance rate?

Ms. TOLL. That's a good question. The cost is directly related to the price. The more expensive the property, the higher the title insurance premium.

Ms. WATERS. Why? The agents have to do more research? I mean, what causes that? They have to justify them in your State. What do they say? I mean, how do they do that?

Ms. TOLL. They submit actuarial justification, where actuaries—please don't ask me to explain actuarial justifications—where they break down the components. But we are just beginning this process.

I mean, it was just a little over a year ago now that we found all these problems, and all the other States have banded together, and we share information through the NAIC, all the working groups there, and other States—because I also co-chair the NAIC title insurance issues working group. So we're all working together to figure out ways to examine these rates. It's highly unusual. Title insurance is just so different from all the other lines of insurance that we regulate. Indeed, it's only 1.9 percent of all the premium volume that we regulate.

So, sadly, I think regulators just—it just hasn't been on the radar screen. But it is now.

Ms. WATERS. Let me just ask you, this committee is very much involved in dealing with predatory lending, and trying to determine how we protect consumers from predatory practices in the financial services community. And I am wondering if we now have to expand our look, and take a look at title insurance, as we begin to try and reduce these costs to consumers.

Do you think that there is an issue here, as it relates to predatory practices that is causing consumers to have to pay unnecessarily exorbitant fees for premiums, etc.?

Ms. TOLL. In Colorado, we are very concerned about predatory lending. The problem is, we don't regulate mortgage brokers. So, there is a lot of room for improvement there. And as I stated earlier, there are three bills that are currently pending in the State legislature that would address issues with respect to mortgage brokers.

Ms. WATERS. Let me just ask—I guess that I would ask this of Ms. Williams. What specific steps should be taken, if any, to reform the industry?

Ms. WILLIAMS. This is one of the issues that we are planning to address in our ongoing work. Right now, we aren't in a position to make any conclusions about specific steps. But we hope, through the course of the work that we plan to do over the next several months, that we would be in a position to provide information that would be useful in laying out some of those next steps.

Ms. WATERS. Will that include perhaps some advice about how to expand competition in the industry?

Ms. WILLIAMS. We are definitely looking at the issue of competition, the dynamics of competition in the market, and trying to come to terms with competition in the title insurance industry. At this point, we don't know if we will have recommendations.

Ms. WATERS. All right. Thank you very much. Mr. Chairman, I will yield back the balance of my time.

Chairman NEY. Thank you. One quick question, and I have to go, but I will be back, and I yield my time to Mr. Miller.

The quick question I have is for GAO. The report indicates that a lot of the title insurance companies offer discounted refinance rate for title insurance.

Ms. WILLIAMS. Yes.

Chairman NEY. Do you get that automatically, or do you have to ask for that discounted rate?

Ms. WILLIAMS. This is one of the fundamental questions that we are currently grappling with. At this point, it's not clear whether refinance rates are automatic. We understand that in certain States it may be a requirement that these rates be provided automatically. In other places, it appears that you have to actually ask for the discounted or refinance rate.

And in our review of consumer information posted on various websites, this is the guidance that they are giving to consumers. That is, you have to make sure that you ask for certain types of discounts.

Chairman NEY. And I am going to recognize Mr. Scott, and then yield my remaining time to Mr. Miller. Mr. Scott?

Mr. SCOTT. Thank you very much, Mr. Chairman. I want to thank you and Ranking Member Waters for holding this important hearing on the cost of title insurance.

I guess my first question would be to Ms. Toll. Is there a problem, in your opinion, with assessing the cost of title insurance, due to the varying State regulations covering this product?

Ms. TOLL. I think everything is different in every State. So, on a State level, there are varying factors to take into account, depending on what systems they use, and so forth. In Colorado, we can ask for anything of virtually anyone to get rate justification, have anyone come in and testify to explain things to us. Did that answer your question?

Mr. SCOTT. Yes. Since the title search process is automated, why have insurance costs not decreased? I would think that, since they were automated, that would have an impact on bringing down the cost. Why has that not happened?

Ms. TOLL. You would think that. The competition is very different in title insurance, and there is not a lot of competition around price. There is—it's just not there.

The competition is on the quality and the service. As long as a realtor, a lender, and a mortgage broker have an incentive to go with someone who will facilitate the deal, the consumer will be protected. It's when they start—the real estate agent and the broker and the home builder—start getting influenced by these kickbacks, that the interests get out of line between the consumer and the person who is in the position that is doing all the referring of a business. I mean, that's the problem.

Mr. SCOTT. Can you give us a little more detail on the characterizations of the kickbacks?

Ms. TOLL. Sure. The direct kickbacks, they're the easiest. In Colorado, we have this agency that flew the four top real estate agent producers in the State to a spa—female real estate agents in the State—to a spa in Arizona, and they said it was marketing. It was for an all-expenses-paid, 3-day thing, and they said it was marketing. And we went after them for the value of the whole package. And they said, "Oh, no, you have to subtract a lot of the value, because we took the company jet." Anyway, we fined them.

Mr. SCOTT. Ms. Williams, you're with GAO. In your opinion, what barriers prevent consumers from choosing their own title insurance products?

Ms. WILLIAMS. Based on the information we have collected to date, a lot of it has to do with a lack of understanding. The entire home purchasing process is overwhelming. It's a lot of information to absorb. It also moves quickly. And you're dealing with uninformed consumers.

Mr. SCOTT. So you would think that a large part of the answer to this is more financial literacy?

Ms. WILLIAMS. That may be part of it. I am not sure it's the total solution—but literacy is likely some part of the solution. The other issue to be considered is that this is something that most homeowners do on a fairly infrequent basis. They may purchase a home, refinance a home, or take out an equity line on their home. However, it happens infrequently.

But title insurance tends to be a small piece of the process, and I think that's part of the reason that it just gets rolled up into the entire closing process, and the buyers' attention isn't drawn to that particular piece of it.

Mr. SCOTT. Now, in your opinion, do affiliated business arrangements provide cost savings to consumers, or to real estate companies?

Ms. WILLIAMS. This is one of the issues that we are currently dealing with in the study. And based on the work that we have done preliminarily, we aren't in a position to answer this definitively, one way or the other. But it does raise a set of questions about conflicts of interest, and if the consumers are benefitting.

Mr. SCOTT. So your answer to that would be probably the real estate companies? Okay. I will take that as a yes, without you having to say that.

To the gentleman from HUD, Mr. Cunningham, why was HUD so unclear on its guidance on captive reinsurance arrangements?

Mr. CUNNINGHAM. I don't know that HUD was so unclear. I think the issue with respect to captive reinsurance, the whole scheme, if you will, or the whole set-up, we viewed in the analysis as an arrangement which had no legitimate purpose, and it was a way to get fees to a referring entity—the builder, or the lender, or the real estate agent that had a captive insurance company.

We did put some—a letter out referring to captive mortgage insurance as guidance, but we felt that there was, because of our affiliated business sham-control business entity policy guidance that was out there, that people were warned, and should have known that, essentially, in a transaction that had no real substance, that HUD and other regulators would be looking at it.

Mr. SCOTT. In your opinion—

Mr. MILLER OF CALIFORNIA. [presiding] The gentleman's time has expired about 35, 56 seconds ago.

Mr. SCOTT. Very fine, sir.

Mr. MILLER OF CALIFORNIA. I think it's very appropriate we talk about cost and competition and the title insurance company, and Ms. Toll and Mr. Cunningham, I thank you for your comments and your testimony you have given today. I think it's very enlightening.

But it's—to me, I mean, I have been in the real estate business for about 35 years as a developer, a home builder, and a realtor. And the title company—and this is very complex, very complicated. And I will tell you that when we talked about why different fees are charged for different amounts of money, we also need to discuss the concept that it doesn't matter how extensive the title search is, or how limited it is, the cost is the same, based on the amount of the title policy.

And I have had properties that I have bought that the title searches had to go back to the 1800's, water easements, and rights, and things you might have, and you get to a point where you want to clear your title to buy the property, and you ask these title companies to write around those easements and such which are old and antiquated. And in doing that, there is a cost associated with that, and a liability associated with that.

And I noticed from the checking I've done over the years on the cost—because I always wondered why I paid as much as I paid for title policies—most of it is in the research, going back and checking the title. That's the bulk of the cost with most title companies. I know in California, they are extremely regulated. I mean, California law is very extensive on title companies, and they go to extensive issues on disclosure, enforcement, liability issues, and those type of things.

And it's important that we deal with competition, because competition is good for everybody. It keeps the costs down, it creates a very robust marketplace. And just speaking for myself, it seems that in California I have no shortage of title company options. And of all the years that I have been in that business—and I know a lot of people in the business—I can tell you the truth, I don't know one person—and I speak for myself—I have never been offered anything, a kick-back from a title company, I don't know a realtor who has been, I don't know a builder who has been.

But Ms. Toll, you talked about some bad apples in the industry, and I applaud you for that, for going after those bad apples, because—and I know HUD does the same thing, through RESPA. The good players don't want the bad guys in the marketplace. They just want to do their job.

And I will tell you, when it comes to something going wrong—and we talked about, in the last year, about allowing banks to do title policies, and the real problem I had with that, I felt it was just a built-in conflict of interest, because you had a lender making a loan on a piece of property, and they guaranteed the title. And I will give you an example.

I had—I bought a piece of property one time that had an easement for ingress and egress that looked real good on paper, but it had expired, because the municipality had not enacted that easement, and by law that easement expired after "X" amount of time.

Now, had my lender, whom I borrowed the money from, written that title, he would be trying to find all kinds of ways to get out of the liability. But I went back to the title company. I said, "You issued me a title policy that didn't have an easement. There is no easement. Fix the problem." And that was their liability and their problem.

That's why I think all the aspects we deal with in the industry are integral, whether it be a realtor, a mortgage broker, a banker, a title company, whatever it is. All of those entities make the industry work.

And I mean, I go back—when I was in my twenties, I used to do HUD work. I bid about the first 10 or 11 jobs with HUD, and I got every one of them, because my partner and I were the lowest bidder. And all of a sudden, one day the director from LA called my partner into his office and he said that if I don't give him a third of my profits in a kick-back before I ever get the HUD contract, I will never be issued another HUD contract. And I was young and naive, believing that they couldn't keep me from being low bidder. I never got a contract after that. They always found something wrong in the way they prepared the bid, and it went out.

So there can be bad apples in any industry. And HUD, you're doing a great job. I'm not impugning HUD today. Alfonso Jackson, I just think highly of the man. But there are bad apples in everything.

But my question for you, Ms. Toll, is are there adequate regulations on the books, if they are enforced properly, to deal with the bad apples?

Ms. TOLL. My first comment is that you talked about how complex this whole process is, and you were in it, and you couldn't even understand it hardly. Imagine the average consumer—

Mr. MILLER OF CALIFORNIA. Oh, I do.

Ms. TOLL. Which gets to the other Congressman's comments.

Mr. MILLER OF CALIFORNIA. I do.

Ms. TOLL. You know, in a lifetime you buy six homes. I actually had my market analyst look at this. So you have only six contacts with a title insurance agency. You just don't have any incentive to learn about title insurance.

Mr. MILLER OF CALIFORNIA. Yes.

Ms. TOLL. Really, realtors are in the best position to know what's going on. And as long as they're not taking kickbacks, everything is great. Are there existing laws—

Mr. MILLER OF CALIFORNIA. Is it illegal to take a kick-back?

Ms. TOLL. It is illegal to—yes.

Mr. MILLER OF CALIFORNIA. I agree.

Ms. TOLL. Oh, did you just want me to say, "Yes?"

Mr. MILLER OF CALIFORNIA. No, no, no. I just want—I'm asking. When you said—

Ms. TOLL. You know—

Mr. MILLER OF CALIFORNIA. I applaud you for that. I am not arguing with you. I think it's great. Go ahead.

Ms. TOLL. I was going to say that RESPA actually gives the State insurance commissioners authority to enjoin violations of it, as well as our own State laws.

Mr. MILLER OF CALIFORNIA. I am aware of that.

Ms. TOLL. And so we—yes, I do think that there are laws on the books—

Mr. MILLER OF CALIFORNIA. So I think my question would go more along the lines of what do we need to do to guarantee adequate enforcement of the laws that are currently on the books, or do you need additional laws? I mean, how many hammers do you need to beat the same guy up with?

Ms. TOLL. You know, I think the—thanks to the NAIC, and being able to share all this information, I think we're doing a great job at—

Mr. MILLER OF CALIFORNIA. I think you are, too.

Ms. TOLL. And actually, if I can say this, working with HUD has been a delight. I think we could institutionalize the fact that we need to cooperate. I mean, Ivy Jackson and I have a great relationship, and we call each other and send each other e-mails. So we are sharing. But what happens if, you know, God forbid, she gets bored with her job, or I do, you know.

Mr. MILLER OF CALIFORNIA. Yes.

Ms. TOLL. That could be institutionalized, that cooperation among all the different regulatory bodies.

Mr. MILLER OF CALIFORNIA. I am a great supporter of sub-prime, and I detest predatory lending. I really do. But there is a huge market that the sub-prime lenders fill. And there is a huge need that legitimate title companies fill in the marketplace, and I applaud them for that.

And if nothing else, if we are sending a message today that Congress and the States are looking at predators who are violating the law, and we are going to enforce the law, then we are going to accomplish a lot today. But I don't know what else we can do.

I mean, my wife owns a business, and I am approached all the time by people wanting to provide title policies. And there is no shortage of competitors. In California, we have everybody you can imagine. Well—and there are big companies and there are little companies.

But what we have always based our decision on is who gives us the best service, and do they act in a timely fashion? And if there is a problem, are they accountable? That's all I care about. When I sold houses to people, that was my main concern: timing, are you competitive; and are you accountable; and responsive. And I used the people who were. And if I didn't think they were, and somebody else came along who I thought gave me a better—did a better job, I used them.

And I guess I'm going to open it up to the three of you. What do you need from us that you cannot do on your own?

Ms. TOLL. First of all, if everybody operated the way you did, I don't think we would have as big of a problem as we have right now. So I just wanted to offer that comment, and then let my—the rest of the panel—

Mr. MILLER OF CALIFORNIA. You're up.

Mr. CARTER. Mr. Miller, I would say this. Nobody disagrees about the valuable role that title companies play, or the service they provide. I think some of these we are finding, particularly in the arena with respect to the fees and kickbacks area and section eight, that entities are being developed, more sophisticated entities, some of them tied to affiliated business arrangements which, again, are not, per se, bad. And if done properly, as many groups do, benefit the consumer, from the standpoint of service.

But there has not been the directed competition on price issues, because the marketing of title business is not done directly to the consumer. So we have got to—the consumer has a right to pick a title company, but they don't know that. They don't know how to shop for it, etc. So that's one—I guess that is one side of it.

We also think, from a RESPA enforcement standpoint, we only have, in essence, injunctive authority. We can get an injunction to stop a violation of section eight. We don't have a civil money penalties type statute which would enable HUD to go—or the State attorneys general, or the insurance commissioners, or anyone else—to go against somebody who has violated—

Mr. MILLER OF CALIFORNIA. Can you do that regulatorily, or is it—do you need legislation?

Mr. CUNNINGHAM. No, we need legislation to do that.

Mr. MILLER OF CALIFORNIA. Okay, then we will write that down.

Mr. CUNNINGHAM. So, we can't really directly enforce a number of the provisions of RESPA, from that standpoint. There—

Mr. MILLER OF CALIFORNIA. I would encourage you, in your RESPA proposal, for us to include that, then.

Mr. CUNNINGHAM. All right.

Mr. MILLER OF CALIFORNIA. Because you are doing that. You are coming forth with one. That would be a great recommendation.

Mr. CUNNINGHAM. And there are two or three other things. We might expand the injunction relief—and again, these are not proposals that I am making today on behalf of HUD, these are—you have asked the question, "What could we possibly do?"

The statute of limitations under HUD—under RESPA, right now, for private enforcement actions is only 1 year for private actions, and it's 3 years for governmental actions.

Mr. MILLER OF CALIFORNIA. Then maybe—

Mr. CUNNINGHAM. We might think about doing something like that. We might make it—right now, the HUD–1 only has to be given a day before closing to the home buyer, if the home buyer asks. But there is no direct enforcement for—of somebody's failure to do that—

Mr. MILLER OF CALIFORNIA. Do we need to enact guidelines?

Mr. CUNNINGHAM. What?

Mr. MILLER OF CALIFORNIA. We need to enact guidelines that are clearly understood, and we need to provide for enforcement.

Mr. CUNNINGHAM. And we could—

Mr. MILLER OF CALIFORNIA. And I think that's good. And we need to work together to do that.

The issue you brought up on pricing, though, Ms. Toll, don't they have to propose their pricing structure to you for approval?

Ms. TOLL. Actually, they file their rate with us, and they use their rate. And if we find a problem with it, we require justification.

Mr. MILLER OF CALIFORNIA. And I think all States do that. So they just can't go out and dream up some figure, they have to file those figures with you. You review them, and you make comments and ask for—your questions will be answered.

Ms. TOLL. Yes.

Mr. MILLER OF CALIFORNIA. Okay. Thank you very much. Mr. Green, you are recognized.

Mr. GREEN. Thank you. I thank the chairman and the ranking member for hosting these hearings, and I thank you, members of the panel, for appearing.

Permit me to introduce a new term into the dialogue. But first, let me make mention of the fact that in Texas, title insurance will cost, on average, $1,443 for a $180,000 home. The national average is $756. Quite a difference. Gouging, something that we have heard a little bit about lately, haven't talked about it as it relates to title companies. But price gouging. Is that a term that we can apply to some of what we are seeing in these disparities, Ms. Toll?

Ms. TOLL. I have never heard that term used, and I believe Texas sets their rates, so they're a little different from the rest of the States. They actually fix the rate and say that, "You have to use this rate."

And I wanted to add also, because it hasn't been said, that title insurance agencies have to charge consumers the rates that they have on file with us. They can't deviate. You can't go in and bargain, if that makes a difference to you.

Mr. GREEN. They have to charge a rate that they have on file with you. But before it's filed with you, they use some process in making a final determination as to what they will file with you.

Ms. TOLL. That's correct. That's called rate justification.

Mr. GREEN. Right, and that's the part that we have some difficulty comprehending, totally.

Ms. TOLL. And that's the part where the actuaries get into the picture. And that's also the part that we are working on together, as State regulators. It varies across States, but all of us are looking for more rate transparency. We believe that if you can just shine some light on the components, the questions you're asking for—if you could see the components of the rate, by then, automatically, justification would be provided and the rates, we would hope, would start to go down, by operation of the free market.

Mr. GREEN. Well, have we not concluded at some point in life that people can justify almost anything that they really set out to justify? I mean, doesn't that seem to happen quite a bit in the world that we live in?

And given that we can justify these things, it just seems to me that there is something that we need to look into when we have the kinds of disparities that we are talking about. There really ought to be some desire to protect the consumer from—I will say it—price gouging. And it doesn't matter to me who is involved in it, whether it's just the entity, the title insurance entity, or whether the State is involved in it.

When you charge the consumer more than you can justify —much, much more; sometimes it's arbitrary and capricious, but you can justify it—seems to me that you are taking advantage of a person who is involved in this process, maybe for the first time. And it moves very fast. Very fast. You have paper thrown at you, one after another, one piece after another, "Sign here, sign there." And most people don't read what they are signing. Most people don't know that they can shop. Most people just want to fulfill the American dream and own a home.

And on that day, if someone said, "You are paying $1,000 too much for your title insurance," my suspicion is a good many people would say, "Can I get the house? Will I still be able to have my house? And if the answer is yes, I will pay $1,000 too much."

So, it seems to me, that we ought to want to find some way to look out for the consumer who has, in a sense, said, "Look, I am sending you up there to Congress, Al, and I want you to be my eyes and my ears, and I want you to look out for me, because I don't know all of these things about this process." And it seems to me that you ought to be concerned when the prices vary so greatly.

So, how would you have us try to pull these prices in line, such that we don't have these great disparities in pricing?

Ms. WILLIAMS. Pricing is another issue that GAO is planning to look at in its study. One of the things that we have discovered so far is that in States that have a file and use policy, that means that the insurers simply file a rate. And it's not that they have to wait for any type of formal approval from the State regulator before they can use it. They file it, they wait the required period of time, and then they can start using that rate.

So, one of the things we are trying to get our arms around is this issue of how the rates actually are set from State to State, and what that variation is, and explanations for the variation. So this is one of the things that we are planning to look into further.

Mr. MILLER OF CALIFORNIA. The gentleman's time has expired. Mr. Neugebauer, you are recognized for 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. I guess my question to the panel is—and just for a little bit of background, I have been a land developer, home builder, and in the real estate business pretty much all of my life, and so I have, you know, purchased and done business with title companies for a number of years. And I understand the benefit of title insurance to the system.

So, when you start talking about kickbacks, and things that are going on in the industry, I guess the first question I have is, is this a big problem, or a systemic problem throughout the whole industry, or is this isolated companies and States—and you mentioned two States, California and Colorado.

Because sometimes what we do, we chase the 1 percent, and then punish the 99 percent while we're trying to chase the 1 percent of the people that aren't playing by the rules. So I would like to hear your reflection on that.

Ms. TOLL. Sadly, it's a problem that we are seeing all across the country. It's not just Colorado and California. We do see it concentrated, the kick-back schemes are concentrated in areas where there is a lot of real estate development, such as Colorado, California, Nevada, Florida, and Arizona—places where we see a lot of new development. But it's a problem all across the country, and that is why it is so critical that all the States and all the different regulatory bodies work together to combat the problem, and we share information, including at the Federal level.

Mr. NEUGEBAUER. Ms. Williams?

Ms. WILLIAMS. On this particular question, I think it would be wisest for me to defer to Ms. Toll or Mr. Cunningham, because we are still in the process of doing our work, and we are relying on the work that they are doing.

Mr. CUNNINGHAM. Congressman, I am not sure that we have statistical information in terms of how big a problem it is. We see it on a pretty regular basis, and we believe that it's not the direct payment kind of thing, where I pay you for this referral.

What it is, is some sophisticated kind of relationship like captive reinsurance was, like paying above-market rent for conference rooms to close a loan in Detroit, like title companies that set up affiliated—and this is not just a title problem, this is across the industry.

You won't see it, I think, because my experience in private practice is a lot from the commercial development side, where you're used to bigger projects, and you're used to reinsurance, and so forth. You don't see it in that setting, I think. But in a single family real estate transaction—and what HUD thinks is—we need to find a better way to let title companies and other settlement service providers compete on the basis of price.

And do an education process, maybe. Use the Internet. We have a consumer settlement booklet that is already part of RESPA that is supposed to be given out. We just collectively need to let people know, "Hey, before you buy title insurance or hire a real estate appraiser, or anybody else in this process, realize that you have some choices. Shop it some. Talk to people, and you know, do those kinds of things."

And then, do some things on the enforcement side, so that when the rules are out there, and the rules are clear, and you know, you're trying to set up an entity that really does no work or performs no valuable service, and somehow is going to get a premium or referral fee, that folks are going to suffer the consequences for that. And they do. And when there are settlements, they get posted on the Internet, it gets picked up in your local paper, that this and that real estate agent or whatever, paid a kick-back, or received a kick-back, and so forth, and let people know.

So, competition, we think, is part of the heart of the thing. But competition that's directed at the consumer. And then sell the services and, "My services are better than her services," and so forth, too, as part of that process, but don't market primarily to the referrers of the title service.

Mr. NEUGEBAUER. Do you think that States ought to set title insurance rates, or do you think they ought to just be open to the market, and—

Mr. CUNNINGHAM. Well, I mean, this is me talking. I don't think that—I think the States who regulate the title insurance business, their job is to make sure that there is somebody of substance standing behind the title policy that's issued, and so the regulatory function that Erin is talking about, in terms of we look at numbers and financial soundness, and those kinds of things, are legitimate and should be done.

But beyond that, I think that the companies are going to have to say, "Our price is cheaper, and we can still make money at a lower price, rather than a higher price, and so forth." And if the playing field is level, and there is enforcement, etc., most people will like that situation, and it can benefit businesses and the consumer.

Mr. NEUGEBAUER. So I'm clear about your answer, did I hear you say that you think the State's focus ought to be on safety and soundness, and that the marketplace ought to set the price?

Mr. CUNNINGHAM. That's my opinion, based on what I know.

Chairman NEY. Time has expired.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Chairman NEY. The gentleman from Missouri, Mr. Cleaver.

Mr. CLEAVER. Thank you, Mr. Chairman. I am going to digress just a moment, and I will come back about the subject at hand.

I am interested in knowing whether or not you are familiar with an issue that has been at least surfacing around the country in various places with regard to title companies. California, 2 years ago, and Kansas, the State of Kansas, our next door neighbor, the Kansas legislature met last week, and they passed legislation that removed all references to race, in terms of covenants, from titles.

My—I have introduced a bill here. Unfortunately, it's not going anywhere. It's already, of course, unconstitutional, but the language is still on probably tens of thousands of titles all over the country.

One of the issues that has surfaced, as title companies have watched what's going on, has been the cost, they say, of going back and trying to take care of removing all of that. And so it's going to be State-by-State that it's going to end up, unfortunately, having to be removed. But is that an issue that has any—that resonates with any of you, with the title industry?

Ms. TOLL. Congressman, that issue does not resonate with us in Colorado. Our general laws prohibit discriminating on pricing, and I believe that's part of model acts that virtually every State has. But I can check on the specifics. But no, we haven't seen a specific—

Mr. CLEAVER. No, no, no—

Ms. TOLL. Am I not understanding your question?

Mr. CLEAVER. I am sorry. It's unconstitutional. It's unconstitutional. The language is still there. Probably in Colorado, too. But the language—I'm not saying that because it's in the—it's on deeds or on titles that it's a legal problem. It is not. But just still having that archaic language, which is still offensive, is an issue that some are concerned about.

California passed legislation for it to be removed. And so whatever the cost was, it had to be removed. The State of Kansas passed legislation 2 weeks ago to have it removed, no matter the cost. And I—are we still on the same—

Ms. TOLL. I'm not familiar with the issue at all. I'm sorry.

Mr. CLEAVER. Sir?

Mr. CUNNINGHAM. I share your Missouri background. I'm from St. Louis, so I know you as mayor of Kansas City, and so forth.

I think that, whatever the records were 100 years ago—and that's—Missouri has obviously got the same kind of problem—will stay. But I sure haven't seen any recent title policies that come up where that sort of racial restriction is listed as something that is still part of the policy, or the real estate. So it's going to be there and in the books, but I am not—and I don't know how you ever get rid of that. But I'm not sure that people are still seeing those kinds of racial restrictions, even if they still exist in a particular title on current day documents.

Mr. CLEAVER. The Kansas City Star did a—one woman went to buy a home, found it, and went to the Kansas City Star. They did research, and found out that it was rampant. I mean, all over. And after a conversation with the woman, I started checking in it, found out that California had already done something about it.

And it doesn't mean that we have a legal problem, it means that we have an ugly problem. And—okay. I will leave that. Let me go to another.

There is a lot of paranoia on the Gulf Coast, as you can imagine, most of which is justifiable. And I'm wondering if you had any issues down in the Gulf Coast with regard to titles. Some of the folk—we have held hearings here, and many of the people say that, you know, they are living on property that was owned by their mother, and before that their grandmother. And after the flood came, they found out miraculously that they didn't own the property.

Many people are saying—I don't know if this is anecdotal or not—but that, you know, property is actually being snatched from individuals who owned it, you know, for a century.

And I don't know what all of the issues are in the Gulf Coast region. I am wondering if you have had any—if you have seen any issues like that surface since Katrina and Rita hit.

Ms. TOLL. I'm sorry, no. In Colorado, we haven't seen those issues. I could check with the NAIC, who could check with the Gulf States, Louisiana and any States affected. But I haven't heard of that. So, I'm sorry, I have to say, "I don't know" twice, but I don't.

Mr. CLEAVER. I have to tell my children that, too. But no, I appreciate it. Thank you.

Chairman NEY. Mr. Campbell?

Mr. CAMPBELL. Thank you, Mr. Chairman. A couple of questions for Ms. Toll, please, if I may. In your testimony, you talked about large title companies setting up this sort of reinsurance arrangement. Did they all, all the big players, did they all do it?

Ms. TOLL. You know, I'm really glad you asked that question. No. About five large groups of insurers control about 90, or 95 percent of the market; it's a huge portion of the market. And in Colorado, we found that three of the four top companies were engaged in the process. But the fourth was not engaged in captive title reinsurance. And when I asked them why not—because I was just, frankly, curious so I asked their principals why they did not engage in these practices. And they said that they believed that they were illegal, so they never entered into them.

Mr. CAMPBELL. Did they lose market share?

Ms. TOLL. They claim they lost—their exact words were, "Erin, we're taking a beating in the market, but it's not right."

Mr. CAMPBELL. Can title insurers in Colorado pay a sales commission?

Ms. TOLL. A sales—I don't know what you mean, I'm sorry.

Mr. CAMPBELL. Okay. If this—this arrangement, or a kick-back, if it were not illegal, wouldn't we say that that was a sales commission? You are paying someone to market your product for you?

Ms. TOLL. Yes, that's a really interesting way to look at it, and it gets back to the competition and the unique way that insurers compete for business. If it were like other lines of insurance, we wouldn't have anti-kick-back laws, and we don't have them for other lines. You can split your commissions in other lines of insurance.

But it's because this product is not marketed to the consumer, they're not controlling it, they don't have knowledge about it. It's those reasons that we have these kick-back laws. Whoever came up with—oh, you all came up with RESPA—and the various State legislatures passed mirror laws, or similar laws. It's because they understood that the competition was different. And so, it would not be illegal in other lines, at least not in Colorado.

Mr. CAMPBELL. Okay. I am trying to think if there—aren't there other forms of insurance where—I'm just trying to think—where someone else—I mean, you might have mortgage insurance on the same transaction, which is really often recommended, or put together, by the title company or the lender, or whomever.

Ms. TOLL. Okay, you're getting into this anecdotal information I am starting to hear about.

Mr. CAMPBELL. Okay.

Ms. TOLL. I keep getting sort of anonymous calls and whispers in the hallways, which is how I learned about captive title reinsurance, that there is a problem with the issue you're talking about. But I am not prepared to discuss it now; I don't know anything about it.

Mr. CAMPBELL. Okay. All right. Well, thank you. That's all. I yield back my time, Mr. Chairman.

Chairman NEY. Thank you. Mr. Tiberi?

Mr. TIBERI. Thank you, Mr. Chairman. To the three of you, obviously we all have experiences in the marketplace, whatever market we're in. I will give you my bias and my experience, and maybe we can have some sort of exchange.

Clearly, what you all are talking about is these affiliated agreements in the marketplace. I was a realtor. Not a broker. I didn't get anything out of referring somebody to a particular title agency, whether they were in the office that I worked or not. Nothing. Zero. I did it for one reason, and that's to benefit my client. And I had an interest in benefitting my client as a realtor, because if I serviced my client well, hopefully they would be a client again.

And in the marketplace, I have to tell you, as a realtor, I didn't have any clients say, "I will pay an extra $1,000 to get in this house." It was usually them beating on me to reduce my commission, and beating on me to reduce wherever I could reduce. So it was in my interest, quite frankly, to refer them to different services.

And I usually did three, whether it was three mortgage bankers, or three title insurers, or three termite inspectors, or whatever, so they could be part of the process. But it was in my interest, quite frankly, to try to do everything I could, as a real estate professional, to get the best deal at the best cost for my client.

Now, I'm not saying that every single realtor is going to do that. But the ones that are most successful, and are going to be in this for the long term, are doing that in the marketplace for the benefit of their client. And I think that's probably with most industries in the marketplace.

My question, I guess to you, going from your right to left, my left to right, is isn't there an acknowledgment that in today's world the real estate industry is so competitive that the majority—certainly not all—the majority of folks that are, number one, realtors at least, who aren't legally allowed to get a—I think the word used earlier was kick-back—are in a position in a competitive environment, and refer based upon their reputation in the marketplace, and on behalf of their client?

Ms. TOLL. Congressman, am I on your left, because you wanted—

Mr. TIBERI. Yes, that's right.

Ms. TOLL. All right, then I will go first. As long as your interests—pretending you're a realtor—are aligned with those of the consumer, that is you are choosing appraisers and termite control people based on quality of service, then I don't think there is a big problem in the market.

Mr. TIBERI. But isn't it in my best interest to do that?

Ms. TOLL. Yes, it—well, yes. But if I were standing there, handing you money, maybe—not everybody is swayed by this—but you might say—I hate to use you personally, but—

Mr. TIBERI. No, you can use me, because no one ever handed me money.

Ms. TOLL. But someone, a less scrupulous broker, might say, "I will take that $1,000, and direct my business to the company that you own." And then it's not based on the reputation and the quality of the service that the title insurance agency is providing, and it's not—you know, it might not be a seamless closing. And so that's not in your interest.

But because title insurance is what's called a long claim tail business, the consumer might not know about it for about 8 years, because it's only when you go to sell your house that you went, "Oh, my goodness, there was a problem." So you might not find the problem right away, which is why we, as State regulators—

Mr. TIBERI. And how are you defining the problem?

Ms. TOLL. The kick-back or the lien.

Mr. TIBERI. The illegal kick-back.

Ms. TOLL. Right. If you don't use a reputable title insurance agency, there are a number of things that can go wrong. They might not file the release of the liens on time. There might be problems with disbursement of fees. It might not be a seamless transaction. But you might not find that that release was not filed until you go to sell your house. You know, we don't all go around going, "Oh, I think I'm going to go over to the records and see if my note was released."

So that's why it's critical that you use a reputable title insurance agency, and that's why, if a realtor is referring someone to somebody just based on the service, to a title agency just based on the service, I don't think there is a big problem. And unfortunately, it is a few bad actors that are tainting the industry. It's a—and we're trying to get rid of the bad actors so everybody else that does it right can compete, and—

Mr. TIBERI. So you would acknowledge that it's a few bad apples?

Ms. TOLL. It's a pervasive problem in the sense that it exists in every State. I think, as a percentage of premium, that would be an interesting thing to explore. All I know is we are just going crazy at the Colorado Division of Insurance, finding the bad actors. And a lot of our complaints actually come from competitors. So we know there are good guys out there that want the playing field to be level, and we are trying to respond.

Mr. TIBERI. Could you imagine that there might even be, in a competitive marketplace, actually a benefit to consumers, meaning if the three of you are title insurers, and I know all three of you, and I said to my client, Mr. Campbell here, "Go talk to these three, and get the best deal possible," don't you think that actually encourages competition and lowering the cost?

Ms. TOLL. If I, as a consumer?

Mr. TIBERI. No, he is the consumer. You are the title agency.

Ms. TOLL. Oh.

Mr. TIBERI. You three are the title agency, and he talks to all three of you, and asks for a bottom line.

Ms. TOLL. Sure.

Mr. TIBERI. Thank you.

Ms. TOLL. We would start competing.

Mr. TIBERI. Okay, next—oh, I ran out of time.

Chairman NEY. Quickly, for the next—

Mr. TIBERI. Thank you, Mr. Chairman.

Chairman NEY. You want to answer?

Ms. WILLIAMS. This is one of the issues that we are also looking at in our study.

Chairman NEY. Okay. Mr. Cunningham?

Mr. CUNNINGHAM. I think if you do it that way, and price is one of the considerations that you use to base the referral, absolutely. Anybody who refers business and takes price into account as well as the other factors, that is part of the solution to this whole problem.

Chairman NEY. Thank you. I yielded my time to Mr. Miller, so I'm not going to take the time now. But I am going to put in writing the question to you about competition. I want to thank you for your time today.

Thank you. I want to thank panel two for being here. Bob Hunter is the director of insurance for the Consumer Federation of America, and a consultant on public policy and actuarial issues. Mr. Hunter is the former commissioner of insurance for the State of Texas. He also found the National Insurance Consumer Organization.

Doug Miller is the president and CEO, and co-owner of Title One, Incorporated, in Bloomington, Minnesota. Title One, founded in 1992, currently has 8 offices with 55 employees. Mr. Miller is certified by the Minnesota State Bar Association as a real property law specialist.

Mr. Arthur Sterbcow has been president of New Orleans-based Latter and Blum, Incorporated since 1995. He is also a member of the board of directors for the Real Estate Services Providers Council, Incorporated. Mr. Sterbcow was appointed by former Louisiana Governor, Mike Foster, to the State's property insurance task force.

Tom Stevens is a 2006 president of the National Association of Realtors. The association represents more than one million members, and is involved in all aspects of the residential and commercial real estate industries. Mr. Stevens is a past president of the Virginia Association of Realtors, and was named Realtor of the Year by the State association in 1991.

And Rande Yeager is president and CEO of Old Republic Title Insurance Company Group of Minneapolis, Minnesota. He joined the company in 1987, and is responsible for all operations of Old Republic Title and its subsidiaries. Mr. Yeager is also the 2006 president of the American Land Title Association. Welcome, and we will start with Mr. Hunter.

STATEMENT OF ROBERT HUNTER, DIRECTOR OF INSURANCE, CONSUMER FEDERATION OF AMERICA

Mr. HUNTER. Good afternoon, Mr. Chairman, members of the subcommittee. Excessive title insurance premiums are not a new problem. In 1977, I assisted as Federal Insurance Administrator when the Justice Department first criticized the practice of reverse competition in title insurance. We haven't used the word reverse competition, but this is the crux of the problem.

Reverse competition is a feature of certain insurance transactions in which the buyer of the insurance is not the shopper, but is really looking for something larger, like a car or a home, and insurance is either required or suggested as part of that process.

At that point, a third party—a real estate broker, car dealer, or someone—is in a position to steer the consumer to a particular insurer. The third party is often influenced in making the selection of an insurer by kickbacks that take many forms: commissions, underpriced services, captive reinsurance, and so on. The focus of competition is on rewarding the third party for the steering. Since this increases the price of the insurance, the competition is the reverse of normal.

I heard Prudential say in a reverse competition situation, that they could not sell insurance, because they were—their price was too low. This was credit insurance. Their price was too low, therefore they were non-competitive.

In the case of title insurance, title insurers market their products to real estate professionals who, because of their position of market power in the real estate transaction, can steer consumers to a particular title agent or insurer. The consumer has little or no market power in this transaction, because title insurance is required, because the consumer infrequently purchases reinsurance, and has little knowledge.

It is very powerful uninformed consumers buying required insurance subject to market power exercised by trusted professionals, and only breaking the power of this incentive can end reverse competition and bring title insurance premiums down.

In 2005, consumers paid $17 billion in title insurance premiums: 4 times what they paid in 1995. This increase was driven by increased home sales, mortgage refinancings, and growth in home values. Yet the—given automation, there should have been savings, and prices should not have gone up at the same rate as these other factors.

BankRate estimates that national average premiums for title insurance on a $180,000 loan is $925. I am an actuary, and I am using the title report and other estimates, that it should only cost somewhere between $200 and $300 for the 5 percent that was paid out in claims, and for the costs. So we're talking about triple the fair price.

The majority of title insurance costs are not for losses or operating costs, but payments to title agents. The top four title insurance paid an average of 80 percent of the title insurance premiums to their agents, and it's not disclosed to borrowers.

The widening number of investigations, State and Federal, into allegations of illegal kickbacks are helpful, but too little and too late. Congress must act to remove the financial incentive for reverse competition.

There are two possibilities for doing this. One, replace title insurance with a Torrens-type system. Torrens title is another method for protecting buyers. It started in Australia in 1858, and is used throughout the world in most countries. In Torrens, title to the properties is created by the act of registration in the central register. Once your name is on the register, you are the owner, by the fact of registration. Title by registration is the pivotal concept of Torrens.

The State of Iowa uses this system, and it saves a lot of money. The current premium in Iowa is $110 for mortgages up to $500,000. Here, in D.C., a $500,000 mortgage costs, for title insurance, $1,775, 16 times what it was charged in Iowa. Given that most of the world—and even Iowa—has moved to an efficient method of protecting home buyers from defects in titles, Congress should encourage more States to experiment with less expensive alternatives.

Second, make lenders pay for their title insurance. Another alternative is to have lenders pay for the title insurance policies, and include the cost in the APR, which is clearly subject to positive competitive forces. The general approach would be to make those requiring title insurance pay for it: the lender for lender's policies, and the buyers for the buyer or owner's policies. This would hold down the cost of insurance premiums, because there would no longer be an ability to indirectly pass the costs through to the home buyer. The direct pass-through approach, part of the APR, will pressure lenders to squeeze out excessive kickbacks from title insurance products.

We have known about these kickbacks for decades. Study after study has shown that they exist, and that they are very powerful, and have doubled or tripled the real price. As has been true since 1977, these incentives for kickbacks are great.

And you just can't outlaw them by saying they are illegal—

Chairman NEY. I'm sorry—

Mr. HUNTER. You have to stop them by taking away that incentive.

[The prepared statement of Mr. Hunter can be found on page 55 of the appendix.]

Chairman NEY. I'm sorry, Mr. Hunter, your time has expired. The reason I am—I just got notice that we are going to have votes, so I want to get everybody's testimony in, so I am just staying strict to the time because of that reason.

Mr. HUNTER. Fine.

Chairman NEY. Mr. Miller? Thank you.

STATEMENT OF DOUGLAS R. MILLER, PRESIDENT AND CEO, TITLE ONE, INC., MINNEAPOLIS, MN

Mr. MILLER. Thank you. I am here today because I am being shut out of the Minnesota title industry by controlled business relationships. My company can no longer compete because we won't pay referral incentives to realtors and loan officers. There are a lot of realtors and loan officers who would like to send me business, but because of management pressures, they can't do it.

When you mix controlled business and fiduciary relationships, competition becomes, "Who can pay the most in referral fees?"

I have been in business for 14 years. I have a great company. We strive to have the best service, product, and pricing. We are one of the most technologically advanced companies in the Nation. We have 60 great employees and 8 convenient locations. But none of that matters any more. Consumers typically rely upon realtors to select their title company.

For title service providers, there is almost irresistible incentive to financially influence these realtors to refer them business. And nowhere are there more referral incentives tainting the market than in Minnesota.

Minnesota is the most corrupt place in the Nation to close a home. Service excellence and price are now meaningless in my market. Instead, we have a system that rewards real estate professionals for manipulating their clients into selecting the highest priced title companies. That system is called controlled business.

My title company is stopped at the door at most real estate brokerage houses in town. They have their own affiliated title company, and don't want to hear about us. Loan officers who are loyal to our cause are powerless to risk making a title company recommendation that is contrary to the realtor's recommendation, for fear of losing a referral source. Consumers are carefully guarded from key information about competing title companies, and agents are chastised if they recommend a title company other than their in-house company. I could give away my services for free, and still be shut out.

RESPA was designed to prevent exactly what happened in Minnesota. Unfortunately, RESPA created some loopholes for certain affiliated businesses. Minnesota is now one big anti-competitive loophole.

Real estate agents are trustees of their clients' real estate affairs. They are fiduciaries. Controlled business and fiduciary relationships don't mix. When you start talking about capture rates in fiduciary relationships, it is the equivalent of talking about manipulating fiduciary relationships for financial gain.

It may be a great business plan, may make tons of profit and they may be hugely successful, but for the same reason that they are so successful is also why they are very illegal. It is self-dealing and anti-competitive.

NAEBA, the National Association of Exclusive Buyer Agents, is one organization of realtors that takes the position that it would be self-dealing, and an obvious breach of fiduciary duties, to accept pressures or incentives in the selection of a title company. Take a look at Exhibit A.

CBA's don't have to compete, so they are expensive. In fact, CBA's are the most expensive title companies in the Twin Cities marketplace, sometimes by as much as 40 percent. And you can take a look at my price comparison over there. The entire basis for a CBA's existence is to control fiduciaries, so that their clients are prevented from making an informed decision. A vulnerable and trusting consumer will pay more, so controlled business charges them more.

If you have a CBA, then you have a license to charge whatever you want. CBA's are bad for consumers, and they destroy competition. Joint ventures are the worst form of CBA. They are created by title companies for the purpose of paying referral incentives. Instead of competing on service and price, the title company captures the realtor's business by setting up a joint venture with them.

The joint venture provides identical services that the title company already provides, but the realtors get to share in the profits. There is no legitimate reason for their existence, they add nothing to the transaction, except an extra step and kickbacks or referral incentives to realtors. This adds a huge, unnecessary step and cost to a transaction that is already very complex and expensive.

The realtor just tells the client where to go for their closing, the HUD will show an extra line item to the JV for services that should have been done by the original title company, the companies that compete on service and price never even have a chance. The realtor's advice has been bought and tainted, just as clearly as if they had been paid a cash kick-back.

Where there used to be a handful of title companies in the Twin Cities market, there are now over 500, and most of them are JV's.

Although the elderly, first-time home buyers, and some protected classes may be victimized the most, these schemes cross over all racial and demographic borders.

The impact of CBA's is nowhere more apparent than in Minnesota. The Federal Housing Finance Board conducted a survey of mortgage closing costs in U.S. cities, and concluded that our closing costs were more than twice the national average. A recent investigation by Money Magazine concluded that widespread existence of controlled business relationships was the main reason Minnesota now has the highest closing costs in the Nation.

Conclusion. Minnesota's free market system has been horribly perverted, and it is harming consumers and legitimate business to the tune of billions of dollars per year. Whether legal or not, controlled business in a fiduciary relationship will always have an anti-competitive effect. Why would any fiduciary, truly acting in a client's best interests, repeatedly send those clients to an affiliate that it knows will cost them hundreds of dollars more, on average? The system has been breached, and the culprit is controlled business. Thank you.

[The prepared statement of Mr. Miller can be found on page 78 of the appendix.]

Chairman NEY. Thank you.

Mr. Sterbcow?

STATEMENT OF ARTHUR STERBCOW, PRESIDENT, LATTER AND BLUM, REALTORS, NEW ORLEANS, LA, ON BEHALF OF THE REAL ESTATE SERVICES PROVIDERS COUNCIL, INC.

Mr. STERBCOW. Good afternoon, Mr. Chairman, and members of the subcommittee. My name is Arthur Sterbcow, and I am president of Latter and Blum Realtors, a full service real estate brokerage company, headquartered in New Orleans, Louisiana, since 1916. Despite Hurricane Katrina, we are still around.

Latter and Blum Realtors has 28 real estate brokerage offices that engage in real estate sales and leasing in Louisiana and southern Mississippi through over 1,000 sales associates and 250 employees. Latter and Blum offers mortgage services through our wholly owned subsidiary, Essential Mortgage Company, and we offer title and closing services through Essential Title, another wholly owned subsidiary.

We also offer insurance through Latter and Blum Insurance Services, which is a joint venture, jointly owned by Latter and Blum and Hartwig Moss Insurance Agency.

Today I am representing the Real Estate Services Providers Council, known as RESPRO, as a member of its board of directors, and as its 2006 vice chair. RESPRO is a national, non-profit trade association of approximately 275 residential real estate firms, mortgage lenders, home builders, title companies, and other settlement service companies. The bond that unites this diverse membership is that we all offer one-stop shopping for home buyers and home owners through what are known under RESPRO as affiliated business arrangements.

My testimony today will primarily focus on one topic of this hearing, affiliated title businesses, and particularly the difference between legitimate affiliated businesses and sham affiliated businesses.

In RESPRO's opinion, affiliated title businesses that comply with RESPA and similar State laws, which I will refer to today as legitimate affiliated businesses, increase competition by facilitating entry into the title industry by non-traditional providers such as real estate brokers, home builders, and mortgage lenders. They have also been documented over the years as providing consumers the benefits of convenience, accountability, and potentially lower costs.

One of the reasons that companies like Latter and Blum have entered the title business over the last several years is because it allows us to improve the quality of the title and closing process for our customers. Another reason is consumer surveys—that are more fully explained in my written testimony—have shown that the majority of home buyers prefer to be able to get everything they need in one place.

The reason these home buyers said they prefer one-stop shopping, or that they have just one person to contact, it speeds up the home buying process. It prevents potential problems and falling through the cracks. It ensures one standard level of service from all providers in the entire real estate transaction.

Over the last 15 years, there have been a number of economic studies by both independent economists and HUD that have documented the increased competition and potentially lower costs that legitimate affiliated business arrangements have brought to the marketplace. In the interest of time, I won't repeat their findings here. But the details are provided in my written statement, and I will be glad to provide the complete studies to the subcommittee for the record.

It is important, however, for affiliated businesses to comply with the Federal regulatory framework governing them that Congress and HUD have provided under RESPA. This regulatory framework requires a person referring business to an affiliate to disclose the nature of the financial interest. It prohibits that person from requiring the use of the affiliated service, and it prohibits that person from accepting illegal referral fees from the affiliated company.

RESPRO has served as a regulatory compliance resource for our members' affiliated businesses throughout the years through our publications, a comprehensive desktop reference kit on regulatory compliance issues for managers of affiliated businesses, our workshops, and through our website at www.respro.org.

Our organization, however, is very frustrated, frustrated that some providers in today's marketplace are violating RESPA and similar State laws by creating sham affiliated businesses that are established primarily through a vague RESPA's anti-kickback prohibitions.

In addition, we see illegal kickbacks in the marketplace, such as certain title agents or mortgage originators blatantly paying certain real estate agents for referrals of business.

RESPRO has long been concerned about these violations, because they make it more difficult for legitimate affiliated businesses to compete, and because they tarnish the reputation of our companies. It is, frankly, frustrating for companies like mine to devote substantial resources to assuring that our affiliated business are in compliance with RESPA and similar State laws, and then observe competitors bypassing those protections with clear-cut violations.

For that reason, we totally support efforts by HUD and the States to more effectively enforce RESPA and State laws, and we support State efforts to put more teeth in their State laws, to enable them to more effectively curb sham affiliated businesses and illegal cut-backs by both affiliated and unaffiliated title companies.

In fact, RESPRO's Colorado chapter recently worked closely with Colorado regulators on a new State law governing affiliated businesses that is modeled after RESPA. We believe this law could provide a workable framework that can be a model for other States in the future.

Mr. Chairman, we offer our assistance to Congress, HUD, and State regulatory agencies, as you effectively deal with shams and illegal kickbacks in the future. I thank the committee for the opportunity to testify, and I will be happy to answer any questions.

[The prepared statement of Mr. Sterbcow can be found on page 153 of the appendix.]

Chairman NEY. Thank you.

Mr. Stevens?

STATEMENT OF THOMAS M. STEVENS, PRESIDENT, NATIONAL ASSOCIATION OF REALTORS

Mr. STEVENS. Thank you, Chairman Ney, and members of the subcommittee. Thank you for inviting me here today. My name is Tom Stevens, and I am the former president of Coldwell Banker Stevens Realtors, which is now Coldwell Banker Residential Mid-Atlantic, right here in the Washington/Baltimore area.

As the 2006 president of the National Association of Realtors, I am here to testify on behalf of our nearly 1.3 million realtor members, representing all aspects of the residential and commercial real estate industry. I appreciate the opportunity to share our views on title insurance costs and competition in the marketplace.

Realtors take concerns about competitiveness and any sector of the real estate services industry very seriously. In fact, just a few months ago, the Government Accountability Office was asked to analyze competition among real estate brokerages. The GAO concluded that the industry has a number of attributes associated with active price competition. These include a large number of relatively small firms that are active throughout the country, and the ease of entry into the profession.

Realtors have a particular interest in ensuring competitiveness in the title industry, as title companies play an important role in the real estate transaction. As you may know, real estate professionals interact with title companies in a number of ways. Let me highlight one, in particular, that explains why we believe the industry is competitive.

Through affiliate business arrangements, a real estate broker or agent may refer business to a settlement service provider, such as a title company that is owned in whole or in part by the referring party. Under this arrangement, the referring party receives no direct payment for the referral, but he or she can benefit indirectly, based on the financial growth of the affiliated provider.

While NAR does not have comprehensive data on nationwide real estate affiliated title companies, based on my experience I estimate that about 20 percent of real estate professionals have established title company affiliations. Industry experts acknowledge that the average capture rate, or the number of transactions completed by the affiliate, is around 30 percent.

Why is this number so low? First, a broker-owner has little influence over how real estate agents manage their clientele. Second, agents are highly motivated individuals, whose future business depends on giving their clients a high level of customer satisfaction. Consequently, an agent will recommend the provider that they believe will provide the best experience for their client. More often than not, it is not the broker's affiliated company.

Title insurance providers must be highly competitive to win business from their partners in the transaction. I have detailed in my written testimony additional reasons why we believe title insurance also is competitive. These facts are not in serious dispute among real estate service providers.

The question we have often heard debated is, if the business is so competitive, why haven't the costs of title insurance decreased, especially with the proliferation of the Internet? Simply put, there is no do-it-yourself easy way to issue title insurance. Each home has its unique title and history. Each sales transaction requires its own title search, its own title examination and commitment, title policy, and settlement closing.

Purchasing a home requires weeks, if not 1 or 2 months of work, and there is tremendous liability at stake for all parties. So while a person can go on the Internet and in just a few minutes have an airline ticket to virtually anywhere in the world, the time, complexity, and liability part of the real estate transaction precludes a point and click approach.

However, there is one area of the title insurance market that greatly concerns realtors: illegal kickbacks. Not only are illegal kickbacks wrong, but they drive up closing costs for consumers. Real estate professionals want to see sham companies who engage in such practices removed from the marketplace quickly. NAR applauds HUD and State insurance commissioners for shining a bright light on sham companies and illegal kickbacks.

We are optimistic that HUD's increased enforcement and coordination with Federal agencies and State regulators will send a clear signal to the bad actors, that they are not welcome in our industry.

We also wish to issue a challenge to our industry partners to allocate resources to RESPA education efforts, as NAR has done with its RESPA awareness campaign. NAR is committed to ensuring that realtors understand RESPA, and fully comply with its provisions. We welcome every opportunity to work with HUD on our compliance efforts, to ensure that the real estate industry remains strong and competitive, well into the future.

And I want to thank you for your time, and I would be happy to answer questions.

[The prepared statement of Mr. Stevens can be found on page 171 of the appendix.]

Chairman NEY. Thank you.

Mr. Yeager?

STATEMENT OF RANDE YEAGER, PRESIDENT AND CEO, OLD REPUBLIC NATIONAL TITLE INSURANCE CO., MINNEAPOLIS, MN, ON BEHALF OF THE AMERICAN LAND TITLE ASSOCIATION

Mr. YEAGER. Thank you Chairman Ney, members of the subcommittee. Again, I am Rande Yeager. I am president and CEO of Old Republic National Title Insurance Group. But today I am appearing as the 2006 president of the American Land Title Association.

ALTA represents those poor souls sentenced to life in painful title insurance. We have over 3,000 members, including title insurers, title insurance agents, abstractors, and attorneys.

Mr. Chairman, all of us who work in the land title business are justifiably proud of the essential role our industry plays in making our real estate market the envy of the world. Nowhere else is the creation and transfer of interest in real property accomplished more efficiently and securely than in the United States. It is because we are so proud of the many good and unnoticed things that our industry does, that we are so concerned about any questionable practices involving our members.

Let me make this clear at the outset. We support strong, consistent enforcement of State and Federal regulations that address referral fee arrangements. Businesses that do not play by the rules gain an unfair competitive edge, and often provide inferior services at higher prices to the consumer.

Because my time is so limited today, I will urge you to read our comprehensive written statement.

And while consumers today are more knowledgeable about real estate transactions than they ever were in the past, the fact remains that most consumers still look for advice to their real estate agent or mortgage lender in selecting a title company. That is not likely to change in the foreseeable future.

When title companies compete for recommendations on the basis of service, quality, and price, consumers benefit. However, captive reinsurance and sham affiliated business arrangements may involve indirect kickbacks or referral fees to the builder, lender, or broker, as a way of securing their recommendations.

It's important for the subcommittee to appreciate that ALTA has always been a strong supporter of RESPA, and its objective to insure that competition is not skewed by illegal referral fees and other kickbacks. The reason for this support is clear. Such payments and practices cause great harm to the vast number of ALTA members who are complying with RESPA.

Our association, therefore, has a strong interest in working with HUD and State authorities, and we do applaud the efforts of Erin Toll to insure that the rules are enforced fully, consistently, and fairly. Indeed, most enforcement actions are brought due to industry complaints to regulators.

Accordingly, some of the changes we recommend to build on this private relationship are: section eight should be amended to provide competitors to bring a section eight case for injunctive relief. At present they do not have that right. Companies in the industry know when their competitors are engaged in unlawful payments to get business, and they have a strong incentive to stop such practice.

Second, we would ask HUD to respond with a reasonable time to request for guidance on RESPA issues that are submitted by ALTA or other national settlement service associations. This screening process will ensure that only important questions with broad significance will be brought to HUD's attention.

Third, we believe that States should be encouraged to adopt and enforce referral fee prohibitions against the recipients of such payments. Frequently, it is the title companies that are under pressure from persons in a position to refer business to make questionable payments in order to get referrals.

Fourth, greater emphasis should be placed on consumer education, both directly and through the Internet. ALTA allocates substantial resources to educating its members, and for many years has been actively engaged in consumer education. ALTA's website contains clear and helpful information for consumers, as well as regulators.

ALTA appreciates this opportunity to provide its views to the subcommittee, and I am prepared to respond to questions that any of the members have about the title insurance or its industry.

[The prepared statement of Mr. Yeager can be found on page 212 of the appendix.]

Chairman NEY. Thank you. Without objection, the statement of the American Homeowners Grassroots Alliance will be entered into the record.

Chairman NEY. Mr. Green, do you have a question?

Mr. GREEN. Mr. Chairman, I do realize that we have the vote, and I will just compliment the persons who have appeared for doing so, and thank you for your testimony. And I thank you, Mr. Chairman, for providing the opportunity.

Chairman NEY. Thank you for your participation in the hearing. I appreciate the second panel and I think it's important for your views to have been here today, to be part of the record.

And I would note that some members, including myself, may have additional questions that they wish to submit in writing so, without objection, the hearing record will remain open for 30 days for members to submit written questions to the witnesses, and for the responses to be placed in the record. Thank you.

With that, the hearing is adjourned.

[Whereupon, at 4:55 p.m., the subcommittee hearing is adjourned.]

A P P E N D I X

April 26, 2006

Opening Statement

Chairman Michael G. Oxley

Financial Services Committee

Subcommittee on Housing and Community Opportunity
Title Insurance: Cost and Competition

April 26, 2006

Thank you, Mr. Chairman, for holding this hearing and for your continued leadership in making it easier for consumers to buy homes. This Subcommittee has led the way with the American Dream Downpayment Act, the Zero Down Payment Act, and other initiatives to make the dream of homeownership a reality for an impressive 69 percent of American families.

Congress can still do more, however, to reduce barriers that limit competition in the real-estate marketplace. Many home-buying services with relatively fixed costs, such as realtor fees, title searches, and lending fees, have skyrocketed along with the value of the homes, even though the amount of work involved has actually been reduced with improved automation and computerization. If a house has doubled in value, does it really cost the realtor twice as much to sell it and the title agent twice as much to do the automated title search? Consumers are paying home-purchase costs that are artificially high because of the lack of competition in real estate services.

I am particularly concerned about the ongoing investigations of title insurance fraud that have already resulted in tens of millions of dollars in settlements. In Colorado, Deputy Insurance Commissioner Toll has unraveled a web of illegal kickback schemes using captive reinsurance and involving title insurance agents, builders, realtors, and other real estate services providers. These schemes have inflated the price for title insurance for thousands of people. Few consumers will hold up their new home purchase over a few thousand dollars in title insurance. But what the consumer doesn't know is that, in many cases, a large percentage of the consumer's title insurance payment gets kicked back to the real estate professional who set up the closing.

Illegal kickbacks are already a violation of RESPA. But the investigations by Colorado, Minnesota, California, and others make it clear that this is an endemic problem. That is why I asked the Government Accountability Office to investigate for Congress how title insurance gets sold in the real estate marketplace. GAO's interim report raises some very troubling questions for Members of this Committee. According to GAO, in several cases title insurers or agents have created fraudulent business arrangements to provide potentially illegal kickbacks to realtors, mortgage brokers, lenders, and attorneys, in return for steering business their way. GAO is finding that instead of focusing on consumers, title agents normally market their business to these real estate providers, creating a potential conflict of interest that benefits the providers at the expense of the consumer.

I believe that most business professionals are beyond reproach and provide consumers with the best services they are able. Some of those individuals are here with us today. Unfortunately, the majority of professionals find themselves undercut by less scrupulous actors who are circumventing RESPA's rules on illegal kickbacks. Given the number of annual home purchases and refinancings, I don't believe that the lack of price competition in real estate services is something we can just enforce our way out of. HUD and State insurance departments simply do not have the resources to monitor every property transaction. This is a structural marketplace problem that at some point Congress will have to address.

I want to thank our witnesses for joining us today to help shed some light on this critical consumer issue. Ms. Toll has been the leader in uncovering title insurance problems and opening the path for others to follow in protecting consumers. GAO and HUD have been very helpful in analyzing the marketplace and initiating a discussion of potential next steps. And the witnesses on our second panel will be enormously helpful in providing us with the industry and consumer group perspective to separate fact from fiction and underscore why a vibrant title insurance marketplace is so important for consumers.

I look forward to working with the panelists, Chairman Ney, Ranking Member Ms. Waters, and other Members of the Committee, as we begin a discussion of the problem and a search for solutions.

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Opening Statement of the Honorable Bob Ney
Chairman, Subcommittee on Housing and Community Opportunity

Hearing on

"Title Insurance: Cost and Competition"

Wednesday, April 26, 2006

This afternoon the Subcommittee on Housing and Community Opportunity meets to discuss title insurance and its role in the real estate transaction. I look forward to today's panel of witnesses sharing their views on title insurance costs and competition in the marketplace.

Title insurance is designed to protect homeowners and lenders from future claims to their property. It helps protect against the risk that property may be encumbered at the time of sale by unknown rights and claims asserted by others. Title problems can limit the homeowner's future use of the real estate and threaten the security interest that the mortgage lender holds on the property. Unlike most other types of insurance that focus on potential future events and are renewed annually, such as homeowners or automobile insurance, title insurance protects against losses arising from past defects and is only paid at the purchase or refinancing of a home.

In the past several years, regulators, industry groups, and others have suggested several changes to regulations that would affect the way title insurance is sold. In 2002, HUD proposed revisions to the Real Estate Settlement Procedures Act (RESPA) that were designed to increase competition in the real estate settlement industry. The proposed revisions included the development of guaranteed mortgage packages and a more binding good faith estimate, both of which would have affected the pricing and sale of title insurance. Such revisions proved to be controversial and HUD was forced to withdraw the proposal in 2004.

However, HUD announced in June of 2005 that it was again considering revisions to the regulations implementing RESPA and was seeking input from the industry and others. Given the intense Member interest in this issue during the previous Congress and the attention this issue has received in the media, RESPA reform is not a simple one. Rather, it is very complex. It is important that HUD take a cautious and thorough approach – weighing all the perspectives – as it moves forward.

While title insurance differs from many other insurance products in the marketplace, it is a valuable tool in protecting homebuyers and lenders from problems that may arise in a real estate transaction. However, buying a home has become too complex and must be simplified so that there is more transparency in the pricing of settlement services. While we all may agree on that goal, there are differences on how to achieve it. It is my hope that today's hearing will focus on the importance of regulation that balances the need for vigorous consumer protections with vibrant business competition to provide a healthy insurance marketplace for consumers.

Opening Remarks for Congresswoman Maxine Waters
April 26, 2006

Hearing on Title Insurance Industry

Good afternoon ladies and gentleman. First, let me thank Mr. Oxley, Chairman of the Financial Services Committee for his interest in the Title Insurance industry. Mr. Ney, Chairman of the Subcommittee on Housing and Community Affairs should be commended for holding today's hearing. This hearing on the Title Insurance industry is important for a number of reasons. Primary among them is the varying degree of opinion about the Title Insurance industry. There are those who believe that the Industry is in great shape, and that the imposition of additional regulations is not warranted. Of course, there are those who believe that the industry is not operating competitively because of fraud and abuse. Indeed, there have been published reports of fraud and abuse in the Title Insurance industry in the State of California.

However, whether you support one position or the other, I believe that Industry practices need to be examined closely to shed light on issues surrounding the Industry. To that end, I believe today's hearing represents an initial step in the right direction. One, are the abuses in the Title Insurance industry so prevalent that we should consider legislation to reform the industry? Can the industry police itself? Are there interim measures short of legislation that this Subcommittee might consider to ensure that the consumer is protected from anti-competitive forces that could be at play in the market place?

We all know that the true cost of any alleged fraud and abuse weighs most heavily on the consumer. Consumers can not avoid paying for Title Insurance, but they need not pay for overpriced products because the market is not competitive.

Title Insurance is a fact of life in most real estate transactions, and in every state in the nation, although three States do not require licensing of Tile Insurance agents -- New York, Tennessee and Georgia. Why? The cost of Title Insurance varies from state to state. Indeed, it is the lack of uniformity between the different Title Insurance systems that makes this an important issue. In addition, approximately 90 percent of the title insurance business is concentrated in the hands of a few large Title Insurance companies. Higher mortgage loan amounts can also result in higher

Title Insurance premiums for the borrower. Loans in the sub prime market carry higher insurance premiums. Does this benefit consumers?

While today's testimony has generated broad interest, I could not find any agreement about why the industry is in its current state. Therefore, of particular interest to me is the GAO preliminary study, because it can provide a blueprint for this Committee to examine what are the underlying factors – economic and non-economic -- influencing the Title Insurance industry. Is it a competitive industry? How are Title Insurance rates determined? While it is too early to rely on the GAO report exclusively for guidance on the appropriate legislative response to these questions, the completed study will ultimately provide this Committee with instructive suggestions on what remedies to entertain. Accordingly, I would strongly urge the Chairman to request that GAO expedite its study of the Title Insurance industry before we reach any final conclusions about what is the appropriate response. Thank you. Mr. Chairman

Statement for the Record
Congresswoman Nydia M. Velázquez
Housing and Community Opportunity Hearing
"Title Insurance: Cost and Competition"
April 26, 2006

First, I want to thank Chairman Ney for holding this hearing today on title insurance and the role it plays in the housing market. This issue has relevance today as a result of the GAO report commissioned by Chairman Oxley and other recent and ongoing state and Federal investigations about practices within the industry. So, I am hopeful that today's hearing will provide this subcommittee with insight into these and other issues regarding title insurance -- as well as suggestions on how the industry can eliminate bad players and become more transparent for consumers.

Title insurance is a valuable tool for homebuyers. For many, it is just another box to check when closing on a home, but if something goes awry -- and it sometimes does-- it is critical in protecting consumers and lenders from losses. It also helps guarantee the efficient and safe transfer of property.

Recent investigations and GAO's preliminary findings identify possible areas that could be improved within the title insurance industry. It is important to address these concerns in order to ensure that title insurance continues to perform its vital role, which allows consumers to acquire real estate free of worry that someone will contest their right of ownership.

Title insurance allows homebuyers to accept ownership of real estate on terms they are comfortable with. Property ownership interests often go beyond the seller and the buyer -- extending to prior owners that have created contracts or suffered liens against the property. Title insurers work to uncover these liens and encumbrances, giving buyers the chance to make informed decisions about the property they are purchasing.

It is necessary, however, to ensure that consumers are receiving a fair deal and accurate information when they purchase title insurance.
In order to guarantee that this occurs, there should be adequate regulation, both from within and outside of the industry. This public-private partnership will make sure that questionable title insurance transactions, such as those that have been the impetuous for today's hearing, do not take place.

We will likely be hearing from witnesses about state and Federal investigation that have recently identified potential illegal activities in the sale of title insurance. These investigations have centered on alleged kickbacks received by real estate agents, lenders, mortgage brokers, and attorneys in return for steering business to title insurers or agents. The creation of captive reinsurance arrangements has also been the subject of investigations. Such arrangements have been alleged to be a method to pay for referrals which is illegal in many states and under RESPA.

The bad players engaging in these activities severely undermine the title insurance industry as a whole and harm consumers. Action should be taken and a framework put in place to stop illegal practices that undercut the integrity of title insurers and subsequently cause consumers to suffer.

Again, I would like to say that I am happy to be here today to hear all sides of the story. Title insurance is an important and necessary component of the real estate marketplace. In most cases, it allows for the smooth and secure transferal of property from seller to buyer. And in rare cases, when a party comes forward to make an ownership claim on a property, title insurance protects buyers and lenders from suffering losses. However, the benefit of title insurance to consumers depends on fair play within the industry and we must make sure that the marketplace is structured in a manner that promotes these objectives.

STATEMENT OF GARY M. CUNNINGHAM

Deputy Assistant Secretary for Regulatory Affairs
and Manufactured Housing
U.S. Department of Housing and Urban Development

Hearing before the United States House Committee on Financial Services, Subcommittee on Housing and Community Opportunity

United States House of Representatives

"Title Insurance: Cost and Competition"

April 26, 2006

Chairman Ney, Ranking Member Waters and distinguished Members of the Subcommittee, I appreciate the opportunity to be here today to discuss the important issues related to title insurance under the Real Estate Settlement Procedures Act (RESPA), and to highlight aspects of RESPA enforcement that provide examples of improper schemes by title companies and other settlement service providers to avoid the prohibitions of RESPA. At your pleasure, I would like to submit my written testimony for the record.

Enforcement of the Real Estate Settlement Procedures Act (RESPA) is a high priority of Secretary Jackson, and Brian Montgomery, the Assistant Secretary for Housing and Federal Housing Commissioner. We view RESPA enforcement as a very important part of HUD's mission to increase homeownership and help provide affordable housing opportunities. Let me also say that while the focus of the hearing today is on title insurance, we certainly recognize that RESPA enforcement is an industry-wide issue with respect to settlement service providers, and that most providers across the industry desire a level playing field on which to compete, and take their obligations under RESPA seriously.

RESPA Coverage and Prohibitions

Prior to enacting RESPA in 1974, Congress found that consumers needed more timely information on the nature and costs of the settlement process, and that abusive practices, including the payment of referral fees and kickbacks among settlement service providers, had developed in the process of buying a home. Congress also found that these payments artificially drove up the cost of settlement because consumers indirectly paid the referral fees. It sought to end these kinds of payments as one way of lowering costs to consumers when buying a home.

RESPA, therefore, was enacted to provide consumers protection during the homebuying and mortgage process by: (1) requiring that consumers receive certain information in the form of disclosures during the process; and (2) prohibiting certain practices that unnecessarily increase the costs of settlement. The statute was later amended several times, primarily to allow affiliated business arrangements and to address loan servicing and escrow account issues. More than 30 years later, it is still against the law for "any thing of value" to change hands merely for the referral of business related to a settlement service.

RESPA covers millions of transactions every year, as its coverage extends to virtually all loans secured by one-to-four family residential properties. RESPA's jurisdiction extends to all providers of settlement services required to close the loan. Among these services are the provision of title and closing services, including title examinations, and the issuance of title commitments and title insurance policies.

Disclosures required by RESPA include the Settlement Costs Booklet, the Good Faith Estimate, and the HUD-1. The Good Faith Estimate is given by the lender or mortgage broker and itemizes charges it is anticipated the borrower will have to pay to close the transaction. This disclosure is intended, in part, to be a shopping tool to help borrowers compare costs among various settlement service providers. The HUD-1 itemizes the charges actually imposed upon both the buyer and seller in connection with the settlement. All charges by the lender and other settlement service providers must be reported on the form.

Another key purpose of RESPA is to eliminate practices such as kickbacks, referral fees, and unearned fees in the settlement process. Specifically, Section 8(a) of RESPA provides that "no person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to, or part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person."

Section 8(b) prohibits the giving or acceptance of "any portion, split or percentage of any charge made or received for the rendering of a real estate settlement service ...other than for services actually performed." By regulation, HUD has established that the prohibitions include a charge for which "no or nominal services are performed." 24 C.F.R. § 3500.14(c).

Section 8(c) of RESPA sets forth various exclusions from these prohibitions. In particular, Section 8(c) provides that nothing in Section 8 shall be construed as prohibiting: (1) the payment of a fee by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance; and (2) the payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or for services actually performed.

Affiliated Business Arrangements, Required Use and the Provision of Settlement Services

Affiliated business arrangements are arrangements in which a person who is in a position to refer business to a real estate settlement service provider has an ownership interest in or affiliate relationship with a provider of settlement services, and directly or indirectly refers business to that provider.

Section 8(c)(4) permits affiliated business arrangements so long as: (1) a disclosure is made of the existence of such an arrangement to the person being referred, which includes a written estimate of the charge or range of charges generally made by the provider to which the person is referred; (2) such person is not required to use any particular provider of settlement services; and (3) the only thing of value received from the arrangement, other than the payments permitted under other exemptions in Section 8(c), is a return on the ownership interest or franchise relationship.

Another provision of RESPA that relates to title insurance is Section 9, which provides that "no seller of property that will be purchased with the assistance of a federally related mortgage loan shall require directly or indirectly, as a condition to selling the property, that title insurance covering the property be purchased by the buyer from any particular title company."

A study of the title industry conducted for HUD by Peat, Marwick and Mitchell in 1980 examined title insurance and settlement practices and pricing in eight metropolitan areas. The study was designed to determine if consumers were served well in the provision of title insurance and other settlement services. It concluded that such services and products were not provided to consumers "at a price which approximates the cost of efficiently providing those services."[1] The study also found that the title insurance industry followed a pattern of reverse competition, in that there is competition for "referral by providers rather than competition for customers themselves."[2] Later studies substantiated the Peat, Marwick findings.[3] Current anecdotal evidence and case investigations discussed below indicate that these practices still exist in the title insurance market environment.

HUD has sought to clarify certain provisions of RESPA and address specific abuses in the marketplace through its regulations and policy statements. In its regulations, HUD sets forth some criteria that address whether payment is made for a "bona fide" settlement service. One provision states that "[w]hen a person in a position to refer settlement service business, such as an attorney, mortgage lender, real estate broker or agent, or developer or builder, receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are **actual, necessary and distinct from the primary services provided by such person."** 24 C.F.R. § 3500.14(g) (3) (emphasis added). Other provisions make it clear that a charge "for which no or nominal services are performed or for which duplicative fees are charged" violates Section 8 and HUD's regulations. 24 C.F.R. § 3500.14(a) and (c).

HUD addressed the statutory exemption for payments from a title insurance company to its duly appointed agents in its Statement of Policy 1996-4, Title Insurance Practices in Florida (61 Fed.Reg. 49398, Sept. 19, 1996). This policy statement sets forth the work a title agent must perform to share in the title insurance premium. HUD addressed abuses in affiliated business arrangements through Statement of Policy 1996-2, Sham Controlled Business Arrangements (61 Fed.Reg. 29258, June 7, 1996). This policy statement set forth factors that HUD uses to determine whether the payments made by a settlement service provider to its affiliated entities are for *bona fide* settlement services.

As provided by RESPA, HUD takes enforcement actions against those who accept kickbacks or other things of value, as well as those who give them. Other service providers are often in a position to refer settlement service business to specific providers,

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[1] Chapter XII: "The Title Assurance and Conveyance Industries" of *Real Estate Closing Costs, RESPA, Section 14a, Vol. II Settlement Performance Evaluation* prepared by Peat, Marwick, Mitchell and Co. for U.S. Department of Housing and Urban Development, Oct. 1980, as quoted and discussed in "An Analysis of Competition in the California Title Insurance and Escrow Industry," Birnbaum, B., Dec. 2005, at p.32.
[2] *Birnbaum Study* at p. 32.
[3] See *Birnbaum Study* at sec. 5.1 for a discussion of economic studies conducted between 1980-2005 regarding competition in title insurance markets.

and they may demand things of value in return for referring that business. The things of value (such as money, payment of advertising costs, or provision of gift certificates and prizes) may be paid directly. In some cases, the parties may enter into elaborate affiliated business arrangements, such as joint venture companies, that have no business purpose other than to act as a conduit for distributing referral fee payments.

Captive Title Reinsurance Investigations

One affiliated business practice HUD has been investigating in cooperation with several states and the National Association of Insurance Commissioners (NAIC), is captive title reinsurance. Briefly, in the cases we have looked at, the practice of captive title reinsurance operates as follows. A settlement service provider, frequently a lender, builder, or real estate broker refers business to the primary title insurer. The title insurer in turn reinsures a portion of the risk of the title insurance policy with the lender, builder, or real estate broker-affiliated reinsurance company for a significant portion of the premium. Typically, the affiliated reinsurance companies do not operate as independent business entities offering reinsurance in the market place.

It is HUD's position that it is a violation of Section 8(a) of RESPA to accept a thing of value in the form of participation in money-making captive title reinsurance arrangements in return for the referral of settlement service business without valuable services being performed. It is further HUD's position that any captive title reinsurance arrangement in which payments to the reinsurer are not *bona fide* compensation and exceed the value of the reinsurance, violate Section 8 of RESPA.

In HUD's view, there is almost never any *bona fide* business purpose for title reinsurance on a single-family residence, and such an arrangement between an entity or an affiliate of an entity that is in a position to refer business to the primary title insurer and the primary insurer are deserving of close scrutiny. Further, when there is a history of little or no claims being paid, or the premium payments to the captive reinsurer far exceed the risk borne by the reinsurer, there is strong evidence that there is an arrangement constructed for the purpose of payment of referral fees or other things of value in violation of Section 8 of RESPA.

Recent Case Examples

Captive Title Reinsurance Arrangement: HUD investigated a reinsurance arrangement between a primary title insurance underwriter and a homebuilder. The homebuilder created an affiliated title reinsurance company and referred title insurance business to the primary title insurer, who in turn reinsured a portion of the risk with the builder's affiliated title reinsurance company. The homebuilder agreed to make a payment to the U.S. Treasury in the amount of $675,000, and to refrain from entering into any such captive title reinsurance arrangements in the future.

In Memphis, Tennessee, a title company established eight affiliated title companies with various builders, real estate agents and mortgage brokers. HUD found that the newly formed affiliated companies were paid for certain title and settlement work they did not perform, and that the affiliated companies were businesses created to make referral payments to the builders, real estate agents and mortgage brokers who owned the affiliated companies with the title company, in violation of RESPA. The title insurance company agreed to make a $680,000 payment to the U.S. Treasury and cease any further business operations involving the affiliated companies. HUD later reached a settlement for $226,000 with nine builders who were partners in the affiliated companies who received the unearned premiums. The settlements also provided that each title insurance entity will compete in the marketplace for title insurance business by actively seeking business from parties other than those that created the entity.

In Tulsa, Oklahoma, HUD determined that several area homebuilders, real estate companies and title companies violated Section 8 of RESPA by establishing middleman companies that distributed a portion of the profits earned by the title company that performed the core title services, to the members of the affiliated businesses in exchange for referring customers to the title company. HUD also alleged that one of the title companies violated RESPA by marking up charges for abstract services and recording fees. Together, the companies agreed to pay $450,000 and cease the business practices that triggered HUD's investigation. The real estate broker involved agreed that all of its agents would attend at least three hours of qualified training on the requirements of RESPA within six months of the settlement.

In Detroit, Michigan, a title company paid real estate brokers for the use of conference rooms at rates that were substantially higher than the fair market rent in violation of RESPA and HUD's Statement of Policy on the issue. The title company agreed to make a $150,000 payment to the U.S. Treasury, and that all future office lease agreements would conform to standard commercial lease terms. HUD later reached agreements with certain real estate brokers involved who received the above-market rent payments, and collectively paid $80,000 to the Treasury to settle the matter.

In Boston, Massachusetts, HUD and the Federal Deposit Insurance Corporation (FDIC) found that a mortgage company solicited and received sporting event tickets, restaurant gift certificates, and other things of value from attorneys, appraisers, title companies and others in exchange for the referral of business. The mortgage company agreed to stop accepting kickbacks from settlement service providers, to cooperate with the agencies' ongoing investigation of the settlement service providers who provided the tickets and other things of value to the mortgage company, and pay $150,000.

In Atlanta, Georgia, HUD found that a real estate broker offered its sales agents incentives including trips, Atlanta Braves baseball tickets, higher commission splits, and agent-of-the-month ads in local newspapers based on the number and volume of referrals to the broker's affiliated title company. The real estate broker agreed to make a $250,000 payment to the U.S. Treasury, to cease the business practices that triggered HUD's concern, and to notify all of its real estate agents that any compensation to them based on referring business to affiliated partners is a violation of RESPA.

In Houston, Texas, HUD, the Office of Thrift Supervision (OTS) and the Office of the Comptroller of the Currency (OCC) conducted a joint investigation that uncovered suspected acts of residential mortgage fraud that involved bank officers and a title company. The agencies claimed the title company engaged in a pattern of violating Section 4 of RESPA by providing inaccurate HUD-1 Settlement Statements to lenders and their borrowers. HUD further alleged that the title company's conduct was part of an agreement for the referral of business in violation of Section 8 of RESPA. The title company agreed to pay a $5 million civil penalty to the U.S. Treasury and to reform its settlement service practices nationwide. In a separate but related action, the Texas Insurance Commission also fined the title company.

In Lebanon, Pennsylvania, HUD's investigation of a title company revealed that it set up an affiliated title agency with real estate agents who referred business to the company, and made payments to the affiliated agency that had no employees, no office space, minimal capitalization, and performed no core title services. The title company agreed that it would receive at least 40% of its future business from real estate brokers or agents and mortgage brokers who were not affiliates, paid $15,000 to the U.S. Treasury, and agreed to abide by RESPA in the future.

Other Practices that Violate RESPA

Among its current cases, HUD is investigating other alleged practices that if true, would violate RESPA:

- A builder established affiliated mortgage and title companies. The builder requires the use of a large title insurer for closing and title insurance, however, the insurer splits the title insurance premium with the builder's affiliated title insurance company ostensibly for title services performed by the builder. In addition to the required use issue, the question is whether bona fide title services are being performed by the builder.

- To get title insurance referrals in a particular part of the country, title companies have established in-house marketing departments that employ full-time graphic artists and business development teams. The marketing department provides its services to real estate agents and builders, including producing open house flyers, "just listed" and "just sold" post cards and other advertising materials at no or below market costs.

- HUD has received complaints that allege builders are requiring buyers to purchase title insurance from the builders' affiliated title companies. In some instances, the builder may pay substantial closing costs or impact fees only if the affiliated company is used. In these examples, HUD questions whether a true discount is being offered or whether the discount is made up through the cost of the home. In a few instances, the buyer may be charged an extra fee if the affiliated title insurance company is not used.

- A title agent, who is an attorney, solicits business from a lender and is told that he must give the lender $50,000 to be a partner in its co-branded marketing in order to receive business.

- Real estate brokers writing in contracts that their affiliated title companies must be used for closing and title services.

Overview of HUD's RESPA Enforcement Efforts

HUD has recognized the need to devote more resources to RESPA enforcement. In the last several years, the Department created the Office of Regulatory Affairs and Manufactured Housing that directs the RESPA, Interstate Land Sales and manufactured housing programs. The Office of RESPA has substantially increased its staff and contracted with a private firm that includes former federal agents to provide nationwide investigative services. The Office coordinates with HUD's Office of General Counsel on policy issues and enforcement actions. This Office also has increased its staff. Additionally, HUD's Office of Inspector General (OIG) has assisted with some investigations. Last summer, the Department conducted training sessions for approximately 125 OIG agents.

Coordination with Federal and State Agencies

The Department has coordinated investigations with other federal agencies including the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, the Federal Trade Commission and the Department of Justice. We are currently working jointly on several investigations and anticipate others this year.

The Department has also worked closely with state regulators regarding RESPA. Over the last two years it has met with the National Association of Insurance Commissioners' Title Working Group, the Association of Real Estate License Law Officials, the primary association of state regulators of real estate brokers, and the American Association of Residential Mortgage Regulators. We will continue to foster relationships with state attorneys general and insurance commissioners, as well as with these important state regulatory associations, and will continue to share information with specific state regulators.

The Department is aggressively pursuing kickback schemes and affiliated business arrangements that do not comply with RESPA. Such schemes and arrangements unnecessarily increase the costs of settlement services by enabling the payment of fees and things of value without the performance of *bona fide* services. Of course settlement costs are of paramount importance to the homeowner, and it is in the interest of fairness to maintain a level playing field among settlement service providers.

Legislation to Enhance Enforcement

The success of HUD's regulatory efforts to implement RESPA for the benefit of both industry and consumers depends greatly on effective enforcement. Certain statutory amendments may advance the goals of RESPA. For example, RESPA does not currently include authority for regulators to enforce important sections of the statute: there are no remedies for violations of the requirements relating to the Good Faith Estimate, settlement costs booklet, or HUD-1 settlement statement. The effectiveness of RESPA could be enhanced by assuring that creative business structures do not defeat the purposes of Sections 8 and 9 of RESPA, and by providing the Secretary and State regulators with the necessary tools to enforce the statute.

Thank you for this opportunity to discuss these important issues regarding title insurance and the settlement services industry as they relate to RESPA.

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Testimony of

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

Title Insurance Cost and Competition

Also Delivered on Behalf of

Center for Economic Justice
Consumers Union
National Association of Consumer Advocates
National Consumer Law Center
U.S. Public Interest Research Group

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Introduction

Mr. Chairman and members of the Subcommittee, I appreciate the invitation to appear before you today to discuss current issues related to title insurance. I am J. Robert Hunter, Director of Insurance for the Consumer Federation of America (CFA).[1] I am a former Federal Insurance Administrator under Presidents Ford and Carter and have also served as Texas Insurance Commissioner. This testimony is presented on behalf of CFA, Center for Economic Justice,[2] Consumers Union,[3] National Association of Consumer Advocates,[4] National Consumer Law Center[5] (on behalf of its low-income clients) and U.S. Public Interest Research Group (U.S. PIRG).[6]

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

[1] **CFA** is a non-profit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy and education.
[2] The **Center for Economic Justice** is a non-profit organization that works to increase the availability, affordability and accessibility of insurance, credit, utilities, and other economic goods and services for low income and minority consumers.
[3] **Consumers Union**, the nonprofit publisher of Consumer Reports magazine, is an organization created to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. Consumers Union's publications carry no advertising and receive no commercial support.
[4] The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.
[5] The **National Consumer Law Center** (NCLC) is a non-profit organization specializing in consumer issues on behalf of low-income people. NCLC works with thousands of legal services, government and private attorneys, as well as organizations, who represent low income and elderly individuals on consumer issues.
[6] **U.S. PIRG** serves as the federal lobbying office for the state Public Interest Research Groups, which are non-profit, non-partisan public interest advocacy organizations.
[7] American Land Title Association, "Preliminary 2005 Market Share – Family-Company Summary at http://www.alta.org/industry/financial.cfm

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

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

The $17 billion in title insurance premiums paid by consumers in 2005 was roughly twice the amount paid in 2000 and four times the amount paid in 1995.[9] The increase in title insurance premiums was driven by an increase in the number of title insurance transactions – home sales and mortgage refinancings – and the increase in home values and mortgage amounts. Title insurance premiums are based on the amount of the sales price or mortgage loan. As home prices have soared in some parts of the country, title insurance premiums have jumped solely because of the increase in home price rather than legitimate increases in the cost of providing services. Clearly, revenue growth has far exceeded the reasonable costs of providing the title insurance service.

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

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

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

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

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

[10] American Land Title Association, "Preliminary 2005 Market Share – Family-Company Summary" at http://www.alta.org/industry/financial.cfm.
[11] *See* Birnbaum, Birny, Report to the California Insurance Commissioner, "An Analysis of Competition in the California Title Insurance and Escrow Industry," December 2005, at 28-37.
[12] "Reverse competition" is a feature of certain insurance transactions in which the buyer of the insurance is not shopping for insurance but for a large item such as a car or a home and insurance is required or suggested as part of that process. At that point a third party (such as a car dealer or a real estate broker) is in a position to steer the customer to a single insurer. The third party is influenced in making the selection of an insurer by legal or illegal financial inducements or "kickbacks." The inducements can take many forms including commissions, under priced services, captive reinsurance arrangements and other arrangements. The competition focuses on rewarding the third party for steering a buyer to the insurer. Since this increases the price of the insurance product, the competition is the reverse of normal competition where the ultimate buyer selects the insurer with a focus on lowering, not raising the premium charge. Insurance products with well-documented reverse competition effects include title insurance, credit insurance and lender forced-placed insurance.
[13] Cited in Birnbaum at 35.

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

I. The Title Insurance Market is Not Competitive

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

Under these circumstances, homebuyers are not positioned to be the most diligent consumers, but they are further hindered by the unique complexities of the title insurance marketplace. Title insurance is not sold in a competitive marketplace. Consumers lack information about title insurance and are poorly situated to exert pressure on terms or prices. Homebuyers are not even the "consumers" of title insurance; instead they are driven to title insurance policies by real estate intermediaries through referrals. Additionally, lenders require homebuyers to pay for both the lender's title insurance policy as well as their homeowner's title policy but do not help borrowers achieve similar savings that lenders receive on their policies through exerting economies of scale. Third, the market for title insurance demonstrates marked price inelasticity, meaning that even large increases in title insurance prices will not cause consumers to stop buying title insurance. This result occurs because title insurance is a required part of the real estate transaction.

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

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

[14] Birnbaum at 26.
[15] Stewart Information Services Corporation, Securities and Exchange Commission 10-K filing, Fiscal Year December 21, 2005, at 2.
[16] Gandel, Stephen, "Congressman Calls for Title-Insurance Investigation," *Money*, February 24, 2006.

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

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

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

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

[17] Consumers Union, "California Title Insurance Rates Remain High," April 3, 2003.
[18] Guttentag, Jack, "Title Insurance Fees Paid by Borrowers Include Referral Costs," March 21, 2005.

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

II. Product Costs are Excessive

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

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

[19] Boyer, M. Martin and Charles M. Nyce, "Banks as Insurance Referral Agents? The Convergence of Financial Services: Evidence from the Title Insurance Industry,"*Scientific Series*, Centre Interuniversitaire de Recherche en Analyse des Organisations, 2002s-78, September 2002, at 9.
[20] Birnbaum at 28.
[21] DasGupta, Neil and Richard McCarthy, "Clouds on Horizon After Title Industry's Bright Year," A.M. Best Special Report, October 2005 at 7.
[22] DasGupta, Neil and Richard McCarthy, "Clouds on Horizon After Title Industry's Bright Year," A.M. Best Special Report, October 2005 at 13.
[23] "Exclusive Report: Integrated Title Technology (Part 2 of 3)," *The Title Report*, October 3, 2003, at 6.

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

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

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

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[24] "Iowa's title alternative lifts its game," *The Title Report*, February 20, 2006 at www.thetitlereport.com.

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

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

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

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

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

[26] Demotech, "Title Insurance Industry Information and Economic Data," 2005 at 65.
[27] The First American Corporation, Securities and Exchange Commission 10-K filing, Fiscal Year December 31, 2005 at 26.
[28] *Ibid.*
[29] Arrunada, Benito, "A Transaction-Cost View of Title Insurance and its Role in Different Legal Systems," *The Geneva Papers of Risk and Insurance*, Vol. 27, No. 4, October 2002.
[30] Treaster, Joseph B., "Iowa Cuts Added Costs in Title Insurance Policies," *New York Times*, July 6, 2005.
[31] DasGupta, Neil and Richard McCarthy, "Clouds on Horizon After Title Industry's Bright Year," A.M. Best Special Report, October 2005 at 13.
[32] Brown, Wendy, "Suit Calls for Reform, Refund," *The New Mexican*, March 30, 2006.

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

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

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

Commission Split of Top Four Title Companies

	2003	2004	2005
Fidelity	78.4%	78.0%	77.5%
First American	80.9%	81.3%	80.5%
LandAmerica	80.2%	80.1%	78.2%
Stewart	82.0%	81.6%	81.2%
Average	80.4%	80.3%	79.3%

Source: 2005 SEC 10-K Filings

[33] Birnbaum at 27.
[34] Gandel, Stephen, "Congressman Calls for Title-Insurance Investigation," *Money*, February 24, 2006.
[35] Consumer Federation of America analysis of Securities and Exchange Commission 10-K filings for Fidelity National Title, First American Corporation, LandAmerica Financial Group and Stewart Information Services Corporation, fiscal year 2005.
[36] Birnbaum, Birny, Report to the California Insurance Commissioner, *An Analysis of Competition in the California Title Insurance and Escrow Industry*, December 2005 at 17.

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

The real costs for creating the title insurance policy are very low, a few hundred dollars for the title search and taxes and 5 percent of the premium price for losses, but consumers are being charged considerably more than the cost of the product plus a reasonable amount for profits. For a $500,000 home in the Washington, D.C. metropolitan area, title insurers are charging about $1,775.[37] The direct cost of the policy to the underwriter is about $200 to perform the associated administrative title services and 5 percent of the "market" premium, about $90, for a total of under $300 – about a sixth of the price being charged by title carriers. The remainder may be the split the underwriter pays the real estate agent, mortgage broker or title agent. The title industry maintains that title insurance can't be compared to other insurance products because of much higher operating expenses (i.e., maintenance and records search expenses) than other lines of insurance, but the overwhelming majority of these costs are related to the commission split that is paid to the title agents.

III. Factors Contributing to Excessive Cost

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

[37] First American Title Fee Calculator, Basic ALTA Coverage Premium Quote, accessed April 18, 2006, www.titlefees.firstam.com/titlefees.asp.
Calculation based on previously having title insurance valued at $250,000.
[38] Boyer, M. Martin and Charles M. Nyce, "Banks as Insurance Referral Agents? The Convergence of Financial Services: Evidence from the Title Insurance Industry," *Scientific Series*, Centre Interuniversitaire de Recherche en Analyse des Organisations, 2002s-78, September 2002, at 3; A.M. Best Aggregates and Averages, 2005 edition, 2004 data.

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

TITLE INSURANCE REVENUE BREAKDOWN

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

Figures in Billions of Dollars

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

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

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

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

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

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

Title insurance is a highly concentrated industry with the overwhelming majority of the market controlled by only five firms. Five title insurance firms control 92 percent of the national market. Between 1988 and 1996, the number of title insurance firms declined by about a fifth (18.4 percent) while the volume of premiums increased by nearly half (47.3 percent).[42] Since 1996, the industry has consolidated further. In 1998, LandAmerica was created from a merger between Lawyers Title Insurance and Commonwealth Land Title Insurance. In 2000, Fidelity National Financial (parent of Fidelity National Title) acquired Chicago Title.[43]

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

According to the American Land Title Association, the primary title insurance trade association, the top five title insurance firms (affiliated companies known as "families") have increased their market share from 90.2 percent in 2003 to 91.9 percent in 2005.[44] Although the increase is slight, the current title insurance market concentration precludes large increases because there is only 8.1 percent of the market that is not controlled by the five largest firms. Moreover, the five

[41] Fitch Ratings, "Review and Outlook 2005-2006: U.S. Title Insurance," December 7, 2005 at 3.
[42] Walker, Teresa, "Title Insurance: An Overview," *NAIC Research Quarterly*, October 1997, Vol. III, Iss. 4 at 5.
[43] Fidelity National Title Group, Inc., Securities and Exchange Commission 10-K filing, Fiscal Year, December 31, 2005 at 4.
[44] American Land Title Association, Market Share Family-Company Reports 2003, 2004 and 2005. Available at www.alta.org.

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

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

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

Recent State and Federal Enforcement Actions Suggest Title Costs are Inflated

[45] Fitch Ratings, "Review and Outlook 2005-2006: U.S. Title Insurance," December 7, 2005 at 6.
[46] *See* U.S. Department of Justice, Antitrust Division Manual, Chapter 2: Statutory Provisions and Guidelines of the Antitrust Division, 1.5 Concentration and Market Shares; U.S. Department of Justice and Federal Trade Commission, "Commentary on the Horizontal Merger Guidelines," March 2006 at 15.

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

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

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[47] Johansen, Erin, "Insurance Division Alleges Kickbacks," *Denver Business Journal*, January 14, 2005.
[48] McIntyre Law Firm, PLLC, "Summary of NAIC Spring 2005 Meeting," April 4, 2005.
[49] DasGupta, Neil and Richard McCarthy, "Clouds on Horizon After Title Industry's Bright Year," A.M. Best Special Report, October 2005 at 2.

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

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

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

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

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

The state of Iowa uses a form of Torrens title system. This system provides a useful benchmark for examination by Congress of just how much homeowners might save through a more pro-consumer approach. Iowa does not permit private title insurance; instead, the state operates a guaranty fund, which insures property titles essentially identically to private title insurers.[50] In 1947, Iowa banned title insurance after a spate of insurance bankruptcies in Sioux City and created a statewide title guaranty program. In 1985, Iowa developed Title Guaranty, the state sponsored title guaranty, to ensure that mortgages could be sold on the secondary market.[51]

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

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

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[50] Lavelle, Karen, "Title Insurance: Is it Wanted Here?" *Law Society Journal*, New South Wales, Australia, November 2002.
[51] Iowa Finance Authority, Title Guarantee, *On the Move*, Fall 2005.
[52] Treaster, Joseph B., "Iowa Cuts Added Costs in Title Insurance Policies," *New York Times*, July 6, 2005.
[53] Iowa Finance Authority, Title Guarantee, Residential Certificate Premium Rates, March 1, 2006; First American Title Fee Calculator, Basic ALTA Coverage Premium Quote, accessed April 18, 2006, www.titlefees.firstam.com/titlefees.asp.
[54] *Ibid.* Calculation based on previously having title insurance valued at $250,000.
[55] Iowa State Bar Association, "Title Insurance: A Fleecing of America," 2003 at 11.

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

2. Make Lenders Pay for Title Insurance

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

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

Conclusion

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

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

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

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

1. Move away from the old-fashioned and inefficient title insurance legal system toward a Torrens system similar to that used in many parts of the world. Take a good look at the Iowa system as one example of a more efficient system.

2. Make the lenders pay for their own title insurance, eliminating the opportunity for kickbacks on that title insurance sold in America. Lenders will seek to lower the cost and are sophisticated buyers of title insurance who have no incentive to drive costs down today (lenders do not pay the premium today). The incentive to get title insurance at reasonable cost will be there when lenders have to pay for it themselves and build it into their cost of doing business.

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

APPENDIX A

RECENT STATE ACTIONS AGAINST KICKBACK SCHEMES

- **Colorado:** A 2005 investigation in Colorado closed 11 title insurance agencies that were created to receive kickbacks from title insurers.[57] In 2006, the Colorado Insurance Department pledged to close 180 "sham" affiliated real estate businesses that received kickbacks from title insurers.[58]

- **California:** California settled claims of kickbacks to lenders, real estate agents and developers' captive reinsurance firms in exchange for referring business to title insurers that would refund $37.8 million to consumers.[59]

- **Michigan:** In 2006, four title insurers refunded $27.5 million to Michigan home buyers to settle a 2000 class action suit representing 60,000 households.[60]

- **Arizona:** Arizona settled an anti-kickback case with one title insurer in exchange for a $1 million donation to the state American Red Cross because the insurer insisted on litigating the case if any refunds were made to actual consumers.[61]

- **New York:** Attorney General Eliot Spitzer is investigating whether national title insurance firms have been illegally paying rebates and referrals to real estate intermediaries that have increased title insurance premiums for homeowners.[62]

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[57] Prerault, Michael, "State Probe Propels Federal Inquiry," *Denver Business Journal*, March 5, 2006.
[58] "Colorado Targets 180 'Sham' Affiliated Businesses," *Insurance Journal*, April 6, 2006.
[59] California Department of Insurance press release, "Insurance Commissioner John Garamendi Announces Major Settlement Agreements with Title Insurers – More than $37 Million to be Paid for Illegal Kickback Schemes," July 20, 2005.
[60] Gandel, Stephen, "Congressman Calls for Title-Insurance Investigation, *Money*, February 24, 2006.
[61] Harris, Craig, "LandAmerica Title Insurance Firm Settles Kickback Case with $1 Million Gift," *Arizona Republic*, September 9, 2005.
[62] "Spitzer Said to Eye Title Insurers," *CNNMoney.com*, March 2, 2006.

APPENDIX B

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

- **Tennessee:** HUD reached a settlement with a builder in Tennessee that, along with 7 other builders, created an affiliate with a national title insurance company that provided "little or no title work" for the title company, was not an independent company according to RESPA requirements, and received "substantial financial benefits from the referral of business."[63] The investigation was settled for $225,000.[64]

- **Michigan:** HUD investigated whether real estate firms in Michigan were being over-reimbursed for providing office and conference room services to title companies. Four firms settled the investigations for a combined total of $80,000 in the fall of 2005. HUD reached a settlement with two affiliates of a national real estate chain for receiving conference room rental reimbursements from a title company that exceeded the market rental rates. The real estate affiliates settled the investigation for a combined $20,000.[65] A second affiliate of a national real estate firm settled similar charges for $45,000.[66]Another real estate brokerage firm settled a similar allegation in Michigan for $15,000.[67] Earlier in the year, HUD settled a case against a regional title insurer for making above market conference room rent payments to real estate agents for $150,000.[68]

- **Georgia:** HUD investigated a national real estate firm operating in and around Atlanta for providing inducements for sales agents that made referrals to a title company including higher sales commission splits and prizes and other benefits. In some cases, it

[63] Downing Homes, LLC, U.S. Department of Housing and Urban Development, December 15, 2005; Title Group Builders, HUD, December 15, 2005.
[64] Title Group Builders, HUD, December 15, 2005 at 4.
[65] RE/MAX Masters, HUD, October 20, 2005; RE/MAX in the Hills, HUD, September 12, 2005.
[66] Schweitzer Real Estate, Inc., d/b/a Coldwell Banker Schweitzer Real Estate, HUD, September 12, 2005.
[67] Hometown One Associates, Inc., d/b/a Remerica, HUD, September 12, 2005.
[68] Metropolitan Title Company, HUD, May 27, 2005.

appears that sales agents would forgo their commissions if they did not refer homebuyers to the title company. The real estate firm settled the investigation for $250,000.[69]

- **Tennessee 2:** A national title insurance company's Memphis-based affiliate was investigated for providing two employees and office space for an allegedly independent group which was a partnership between real estate agents, builders and the title insurer. The real estate agencies and builders provided "little or no work" to the partnership which was basically provided by the title insurer. The partnership was determined to be a "sham controlled business arrangement" that provided substantial referral fees to the builders and real estate agents. The title insurer agreed to pay a $680,000 settlement to HUD, which was the value of title business referred by the real estate agents and builders.[70]

- **Oklahoma:** HUD investigated a limited liability real estate services firm which was established by 40 Tulsa-area residential construction firms to establish a separate title agency "solely for the purpose of [...] distributing funds" from the title agency to the builders.[71] A series of real estate shell companies owned the title agency (including the real estate services firm formed by the builders, and another escrow firm and the closing firm which owned the escrow firm) received regular disbursements of profits from the title agency for referring clients to it. The related companies agreed to terminate their referral payment or allocation arrangements and pay HUD $125,000.[72]

[69] Prudential Locations, LLC, HUD, August 22, 2005.
[70] First American Title, HUD, July 8, 2005.
[71] Closing and Escrow of Tulsa, Inc., Closings of Tulsa, LLC, 2003 Builders Services, LLC, and Builders Title and Escrow, LLC, HUD, March 21, 2005 at 3.
[72] Closing and Escrow of Tulsa, Inc., Closings of Tulsa, LLC, 2003 Builders Services, LLC, and Builders Title and Escrow, LLC, HUD, March 21, 2005 at 6-7.

Testimony
Douglas R. Miller, President and CEO
Title One, Inc., Minneapolis, Minnesota
Before the House Financial Services Committee
Subcommittee on Housing and Community Opportunity

April 26, 2006

Introduction

Good afternoon and thank you for this opportunity to discuss the problems in the title insurance and closing services industry. My name is Douglas Miller, and I am the President and CEO of one of the last remaining competitive title companies in Minnesota. I am also an attorney and a Real Property Law Specialist, certified by the Minnesota State Bar Association.

My company may not be big at 55 employees, but we are the epitome' of the American success story. My business partner and I started Title One out of my house fourteen years ago and grew the company to eight offices. When we started the business we recognized that real estate consumers did not know how to shop and compare title companies and we felt that real estate consumers were being overcharged for title and closing services. For that reason, we took the position that we had a duty to set our fees at a reasonable amount. We felt that a consumer's lack of knowledge and naivety about title insurance and closing services was not an asset to exploit, but rather it was a responsibility with which to take great care. Apparently we were alone in our philosophy.

My company has the lowest fees in the Minneapolis-St Paul metropolitan area by hundreds of dollars on average. See Exhibit 1 (Price comparison chart showing fees of Title One and other major title companies in Minnesota). We have some of the nicest facilities in Minnesota, we have the best technology available, and with attractive salaries and benefits, we attract highly qualified and skilled personnel to work for us. You won't find our company's fees on any rate comparisons of any of my competitors. And, unlike our competitors, we have to advertise for our business. We spent over $500,000 on sales and marketing last year and our competition is still approximately 40% more expensive than us.

So why is my company having a hard time competing in Minnesota?

Because in Minnesota, the playing field is not level as the title insurance industry and the real estate industry have locked-up almost the entire marketplace through controlled business schemes. The culprit goes by many names: Affiliated Business Arrangements, Controlled Business Arrangements, One Stop Shopping, Ancillary Services, and Bundled Services are a few. The terms all mean the same thing – steering real estate consumers into over-priced ancillary services for secret profits. Controlled business is now estimated to be involved in over 90% of all residential real estate transactions in my area. It would appear that most real estate firms in the Twin Cities are now involved in controlled business. The huge infusion of hundreds of "title companies" that has occurred in our area has actually reduced the choices of title companies down to only one choice – the controlled business arrangement.

No where in the United States are there more controlled business arrangements than in Minnesota. The problem is so deep that we are finding it to be a rare case when a real estate professional is not involved in controlled business. What better way to lock-in business, destroy competition and raise prices without consequences than to incentivize fiduciaries to manipulate their clients about choosing a title company? It should come as no surprise then that a recent investigation by MONEY magazine concluded that the widespread existence of controlled business relationships in the Minneapolis/St. Paul metropolitan area was the main reason we now have the highest closing costs in the nation. See Exhibit 2 (March, 2006 Money Magazine Article, "Snow Job"). Recently the Federal Housing Finance Board conducted a survey of mortgage closing costs in U.S. cities and concluded that Minneapolis-St. Paul metropolitan area closing costs were ***more than twice the national average***. See Exhibit 3 - Table, Averages by Metropolitan Area, 2004, Federal Housing Finance Board.

The title and real estate industry know that consumers don't shop and compare title insurance. In fact, most controlled business models acknowledge that their success is based upon the consumer's ignorance and their reliance upon real estate professionals to make a recommendation. First American Title and its subsidiary Universal Title Company ("Universal") have explained their business model to prospective real estate professionals in their Private Placement Memorandum (See Exhibit 4, Page 6) as follows:

> "The title insurance business is highly competitive. ***However, unlike many industries, where consumers have a wealth of information to make choices among service providers, the title insurance industry competes by obtaining client recommendations from different sources in the real estate industry. Home buyers and sellers often use a particular title company because of a recommendation from their real estate agent or mortgage loan officer, and they typically follow this recommendation. Relatively few consumers actively comparison shop for a title company based upon price and service.*** As a result, the Partnership's success is highly dependent upon generating recommendations from sources in the real estate industry."

In my opinion, the above statement is the model for all real estate related controlled business arrangements. It is true for an in-house full-service title company and it is true for a sham title company that exists for no other purpose but to pay referral incentives to its partner members. The success and profit of a controlled business arrangement is dependent upon tainting the advice that real estate fiduciaries provide to their principals when selecting a title company.

Even if my company were interested in setting up controlled business arrangements, we don't charge enough to be successful at it. We would have to ***raise*** our fees to be competitive. In order to be successful at controlled business, you must charge a lot to make it attractive for the "investors." In a controlled business model, the consumer savings for shopping and comparing title companies are pocketed by real estate professionals. Because real estate professionals have a captured audience who will pay whatever they are told, the incentive is to constantly raise prices. These controlled business arrangements have become so popular among real estate professionals in Minnesota that our State is literally littered with hundreds of them. That is why title fees are rising. The success of controlled business is measured by "capture rates" which has nothing to do with providing good service, but everything to do with exacting more money from consumers through the misuse of fiduciary responsibilities.

Service excellence and price are now meaningless in my market. Instead, we have a system that rewards real estate professionals for manipulating their clients into selecting the highest priced title companies. We are stopped at the door at most real estate brokerage houses in town. They have their own "affiliated" title company and don't want to hear about us. Loan Officers who are loyal to our cause are powerless to risk making a title company recommendation to their clients that is contrary to the Realtor's recommendation for fear of losing a referral source. Consumers are carefully guarded from information about competing title companies and agents are chastised if they recommend a title company other than their in-house company.

I am here today because I am being unfairly forced out of my marketplace and consumers are being manipulated into overpaying for title services and being prevented from shopping and comparing title services. Controlled business arrangements continue to spread across the U.S. with Minnesota in the lead. Please stop what is happening in Minnesota and don't let Minnesota's current situation become the standard for the rest of the U.S.

I need your help. I can't compete for business right now because the business is securely locked away in controlled business schemes with Realtors, Mortgage Companies and Builders. It is these real estate professionals who guide their clients in selecting a title company. And it is to these same real estate professionals to whom I would normally market our services. However, my competition is no longer with other title companies, but rather with the same people to whom I would normally market – the people who exert enormous controls over their clients' real estate decision making process – Realtors, Mortgage Companies and Builders. My company has now been forced to try and market directly to the real estate consumer, and because of the complexity of my industry it is proving to be an almost impossible task. See Exhibit 5 (Title One ad campaign). We should be the leading title company in our marketplace with our fee structure, convenient facilities and excellent service. But we're not. We simply do not have a level playing field in Minnesota.

Please put a stop to controlled business and force my competition to face me in a free and fair market again.

RESPA background

Section 8(a) of RESPA provides an absolute prohibition against the payment of referral fees to obtain real estate settlement services business. The prohibition is unambiguous in both its language and its intent. The purpose of the statute is to make merit, service, price, and other competitive factors decisive in the selection of service providers, and to eliminate cash incentives as the basis for referral decisions. The statute not only enhances the quality of available services for consumers by making excellence rather than kickbacks the key to purchasing decisions, it ensures that legitimate market forces, not institutionalized corruption, will determine success or failure for competing service providers. The prohibition could not be clearer: no payments to influence the selection of a particular settlement service provider to the exclusion of its competitors are permitted.

There are numerous participants in the title industry. It is a business, however, that the ultimate consumers of title services know virtually nothing about, and the selection of a title company is typically a matter of the choice of and referral by the consumer's real estate agent or loan officer. For title service providers, there is, therefore, an almost irresistible incentive to financially influence these referral sources, and thereby ensure that the real estate agents, whose referrals and recommendations to consumers are so vital, refer business to them rather than to their competitors. As a result, title insurers typically do not need to market their services directly to consumers: they only market themselves to participants in the real estate industry with an ability to refer them business.

Despite the fact that §8 of RESPA prohibits the payment of any money or any "thing of value" for the referral of that business, it has become big business to devise schemes to attempt to bypass that prohibition and attract business controlled by the real estate professionals by providing financial incentives for sending referrals. The variations in these controlled business arrangements, or better described as tying arrangements, that lock-in real estate professionals to title companies are too numerous to identify in this testimony. I can, however, identify two predominant "models" of controlled business arrangements which I have seen in Minnesota and believe clearly harm consumers.

1. Full Service Title Companies That Are Affiliated With Real Estate Brokerages: These ABA's, although they offer full title and closing services and could stand alone in a free market, skew the marketplace by manipulating real estate agents fiduciary obligations. By Minnesota law, real estate agents owe fiduciary duties to their clients (Minn. Stat. 82.22 subd. 4 footnotes).[1] Despite these duties to act in the best

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[1] The fiduciary duties mentioned above are listed below and have the following meanings: Loyalty-broker/salesperson will act only in client(s)' best interest. Obedience-broker/salesperson will carry out all client(s)' lawful instructions. Disclosure-broker/salesperson will disclose to client(s) all material facts of which broker/salesperson has knowledge which might reasonably affect the client's use and enjoyment of the property. Confidentiality-broker/salesperson will keep client(s)' confidences unless

interest of the consumer at all times, financial and other incentives are provided to agents to steer their consumer's title and closing business to the company's high priced affiliate. As the price comparison attached as Exhibit 1 shows, two of the largest title companies in Minnesota are affiliated with the two largest realty companies and have some of the highest fees in the Twin Cities marketplace. **Why would any fiduciary, truly acting in its clients' best interests, repeatedly send those clients to an affiliate that it knows will cost them hundreds of dollars more on average?**

2. Sham Title Companies Created To Filter Referral Fees Through. By far the most common form of controlled business arrangement, these companies are created for no other purpose but to pay referral incentives to real estate professionals. In Minnesota, over the past 10+ years I have seen the ***proliferation of <u>hundreds</u> of small sham "title companies"*** dilute and destroy our marketplace.

The way this scheme typically works (there are many variations) is that a competing title company (a legitimate full service title company or title insurance underwriter) will approach a group of real estate professionals with similar amounts of volume and offer them a partnership in a joint venture. The title company then sets up a separate joint venture with the real estate professionals to perform services already being performed as part of title company's routine package of services. The title company will be the General Partner and the real estate professional "investors" will be Silent Partners. The "investors" don't need to know anything about title insurance. They will call this joint venture a "title company."

The only requirement for success of these sham title companies is that the silent partners refer similar amounts of business so that the referral incentives are fair to each of the partners. The pressure from other "investors" to refer equal amounts of business to this sham joint venture is tremendous. The competitor does all the closings for the sham as well as providing many other services. By setting up a joint venture as described above, the competitor will essentially lock-in real estate professionals into using only them.

This scheme adds no value to an already complex and expensive process. In fact, by adding unnecessary "investors" into the mix, they are adding unnecessary costs to the transaction which must be recouped somewhere. Keep in mind, that most title companies don't need "investors" in joint ventures. They are already well capitalized. There is only one reason for the existence of sham title companies, to pay referral incentives.

As described above, these type of joint ventures have no valid reason to exist other than to try to bypass RESPA prohibitions. Instead of marketing service, product and price to real estate professionals (working on behalf of their clients), they market

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required by law to disclose specific information (such as disclosure of material facts to Buyers). Reasonable Care-broker/salesperson will use reasonable care in performing duties as an agent. Accounting-broker/salesperson will account to client(s) for all client(s)' money and property received as agent.

redundant services (many of these sham title companies office right next door to the legitimate title company, See Exhibit 6, photograph of directory of joint venture title companies affiliated with Universal Title) and RESPA approved "kickbacks" and then rationalize the decision with talk about their so-called excellent service. Most real estate professionals that are members of these joint ventures understand the blatant deceitfulness of these schemes and as a result they rarely advertise this "service" to their clients. The "service" is not explained for its true nature as a referral scheme almost 100% of the time.

My company has lost a huge amount of market share to these referral incentive schemes. We've had many real estate professionals who were perfectly satisfied with my company switch to the more expensive joint venture in order to obtain the referral incentives. I've had many real estate professionals who are involved in these schemes tell me that they miss my company because our service was better and our fees were lower, but that they are now locked-in to the partnership and feel that they have no choice but to continue to refer "their" business to these shams. Most of them recognize that it is a disservice to their clients, but state that the financial incentives and pressures to refer business are too great.

Consumers whose business flows through one of these companies are harmed because lower priced alternatives in the marketplace are not presented as an option.

Affiliated Business Arrangement is a Misleading Term

The term "Affiliated Business Arrangement" does not adequately define the processes at work in these tying arrangements. RESPRO was successful in lobbying for and having the "negatively charged" term "Controlled Business Arrangement" changed to "Affiliated Business Arrangement." See, Exhibit 7 paragraph 4 (RESPRO document). This was a mistake. Even the prior term "Controlled Business Arrangements" does not adequately describe the deceitful nature of these arrangements. These arrangements are not merely "affiliations." Rather, they are sophisticated tying arrangements that utilize the manipulation and perversion of fiduciary relationships in order to unfairly steer business for profit. These arrangements are designed to remove "competition" from the title industry and to drive up prices. These arrangements by design interfere with real estate agents' fiduciary responsibilities. In addition, they cause anti-competitive market results in that they eliminate legitimate competition and drive prices up.

These arrangements should be called **S**ophisticated **C**aptured **A**udience **M**anipulation **S**chemes or **SCAMS**. They are illegal and cause dramatic negative effects to consumers and the marketplace.

Controlled Business is Not Efficient and It Certainly Doesn't Cost Less

Controlled business proponents regularly argue that controlled business is good for America because it is efficient and those efficiencies translate into cost savings for consumers. That is not the case. If that were the case, then why are the highest volume controlled business title companies in the Twin Cities metropolitan area, who are affiliated with the area's largest realty companies, also the most expensive? See Exhibit

1 (Price Comparison). And it is not just them, it is every controlled business relationship out there – the entire basis of their existence is to control business so that their clients are prevented from making an informed decision. A vulnerable and trusting consumer will pay more, so controlled business charges them more.

Controlled business does not provide motivation to the service providers to provide excellent service. Why would it? Real estate professionals are locked-in to the controlled business arrangements and the real estate professionals are not likely to go somewhere else without suffering all kinds of consequences. The people who work at these controlled business service providers are very well aware that they are going to get the business for just a mediocre showing of service. This type of relationship does not promote efficiency or great service.

Is there Competition Among Controlled Business Arrangements?

There is no competition among controlled business arrangements in the normal sense of the term. For example, it would be a rare case for a Coldwell Banker Burnet Realty agent to use Edina Title for its closing services. Edina Realty is a competitor with its own affiliated title company.

Large title insurance underwriters and small title agents approach Realtors, mortgage companies and builders with Private Placement Memorandums like the one in Exhibit 6 to start their own sham title companies. They set up hundreds of these "title companies" for no other purpose but to pay referral incentives to their silent partner real estate professional members. This strange scenario is caused by a loophole in RESPA. It makes no sense and has caused a perverted sort of competition in which the Underwriter or title agent is setting up companies to do services that they already perform. These companies are essentially competing with themselves. Bottom-line, they are not true stand alone businesses: they are referral incentive conduits. They offer financial incentives to real estate professionals to unfairly lock-in their customer's business.

Real Estate Professionals are Fiduciaries – It is Illegal to Self-Deal

A fiduciary is someone who has the power and obligation to act for another (often called the beneficiary or principal) under circumstances that require total trust, good faith and honesty. The most common is a trustee of a trust, but fiduciaries can include attorneys, accountants, guardians, administrators of estates, real estate agents, bankers or anyone who undertakes to assist someone who places complete confidence and trust in that person or company. Characteristically, the fiduciary has greater knowledge and expertise about the matters being handled. A fiduciary is held to a standard of conduct and trust above that of a casual business person. A fiduciary must avoid "self-dealing" or "conflicts of interests" in which the potential benefit to the fiduciary is in conflict with what is best for the principal.

Most real estate consumers put all their trust in a real estate professional when it comes time to select a title company. Real estate professionals recognize their higher level of knowledge and skill and happily assume the position of trustee of their clients' real estate affairs. They are fiduciaries. That is what they do. What they should never do is exploit that unique relationship of trust for profit, especially secret profit.

Real estate clients are often completely reliant on the broker for expertise and advice in all aspects of the real estate transaction, including finding a title company. In addition, the client's only contact for advice throughout the transaction process is the agent, so there is a sort of "captive audience" situation. To represent a client fully all the way up to the point of choosing a title company, and then steer them into an in-house title company at a time when the client is often under a lot of pressure regarding other housing issues is abandonment and self-dealing at its worst. The agent knowingly places their client in a position of complete vulnerability and then takes financial advantage of them by sending them to an in-house title company.

The typical disclosures that brokers initially provide to their clients are in the form of two choices: 1. Pick our title company; or 2. Go look for your own title company. The choice is usually presented at a time when the client is overwhelmed with other decisions. Some of the largest brokers even put this choice right in the Purchase Agreement as part of the negotiations. There are other additional disclosures that are given to the client, but they are often presented in a flurry of papers and come no where near obtaining the informed consent of their clients.

Does the real estate professional owe a duty to the client to make a diligent effort to comparative shop title companies for their client? If the real estate professional creates a situation of reliance in which the client is reasonably led to believe that a title company is being selected with the client's best interests at heart, then yes the broker owes the client a duty to make a skillful recommendation based upon service, product and price. In addition, as a fiduciary, the professional has a duty to avoid conflicts of interests. They shouldn't be out there creating them. After all, most consumers don't know the first thing about selecting a title company, and many consumers go into a relationship with an agent thinking that the agent will guide them through all the real estate related questions, including selecting a title company.

Once a client relies on the fiduciary for expertise, it is the fiduciary's responsibility to navigate very carefully and make sure that the client's interests are best served. It is of course not a time to become opportunistic. That would be self-dealing and would be illegal. Unfortunately, that is exactly the type of "opportunity" for which the controlled business model is aiming.

And groups like RESPRO that have made these abuses of fiduciary relationships common place have also managed to somehow convince some real estate education authorities that classes for continuing education credit on the subject are also a good thing. Classes on how to start controlled business arrangements for credit are being given all over the country.

Luckily there are some organizations that believe fiduciary relationships in real estate are something to be respected. One such organization is NAEBA, the National

Association of Exclusive Buyer Agents. That organization takes the very practical and responsible position that dual agency is to be avoided in all circumstances. They believe that is impossible to make the necessary disclosures to adequately represent a client in a dual agency scenario. In addition, they also take a strong position against controlled business. See Exhibit 8, Letter from President of NAEBA.

Is a RESPA Analysis Really Enough?

Currently, in order to engage in controlled business, real estate professionals rely upon client signed Affiliated Business Arrangement Disclosure forms. The forms are designed only to satisfy RESPA disclosure requirements. They are not designed to satisfy common law fiduciary disclosure requirements regarding a conflict of interest. Disclosure of the affiliated business relationship is not the primary issue. Rather, the question is, was there ***full*** disclosure of all the material ramifications of controlled business. Considering that the disclosure typically starts out with a misleading name by calling the arrangement "affiliated business" and then omits some of the key disclosures that a consumer would really want to know, I believe the answer is that the current disclosures are terribly inadequate.

In 1993, Edina Realty, a Minnesota company, made national news and settled a lawsuit alleging undisclosed dual agency after losing on Summary Judgment.[2] In ruling on Edina's summary judgment motion, the state district court held that, while the disclosure statement appeared to comply with the state's statutory requirements, the statute did not eliminate common law disclosure requirements. The state court judge granted summary judgment to the plaintiffs holding that Edina breached its fiduciary duty to disclose to the class members the consequences and effect of dual representation.

The Affiliated Business Disclosure forms being used today do not protect real estate professionals from Edina Realty type lawsuits and those forms certainly do not adequately disclose to consumers the nature of the controlled business scheme being thrust upon them and its ramifications. In fact, if a full disclosure were to be made to consumers about using an in-house title company, consumers would not select the in-house title company almost 100% of the time.

Imagine what would need to be said in order to fully disclose a real estate agent's and real estate brokerage's conflict of interest in referring their client to an in-house title company with significantly higher fees. Timing is everything. Disclosure of the conflict of interest needs to be made at first substantive contact, before the client begins to rely upon the agent for their expertise. The fiduciary must disclose if their in-house title company is more expensive than others and by how much. They must disclose the names of other title companies that they know are less money and if they provide similar services and products. They may not omit information because it is not favorable. In fact, if the agent is being pressured by a manager to use the in-house title company, then that information must also be disclosed. The broker must disclose if managers are getting

2 See, Dismuke v. Edina Realty, 1993 WL 327771 (Minn.Dist.Ct.,1993). See also, Bokusky v. Edina Realty, 1993 WL 515827 (D.Minn.1993)

compensated based upon the "capture rate" of the agents in the office. If the broker uses the "capture rate" of the agent to determine commission splits, then that should also be disclosed.

The list of disclosures is almost endless and specific to each situation. It would probably require a lawyer trained in conflict management on every file to properly obtain the client's informed consent to engage in self-dealing. It is for exactly this reason that you see other fiduciary professions like accountants and attorneys avoiding conflicts, not creating them.

Bottom line, controlled business is self-dealing and not legally possible in a fiduciary relationship.

The Elderly, First Time Home Buyers and Protected Classes are Most Vulnerable

Most of the consumers that have been subject to these controlled business schemes probably will never know that they were harmed. Although the elderly, first time home buyers and some protected classes may be victimized the most, these schemes cross over all racial and demographic borders. Practically every consumer that has bought a house through a controlled business arrangement overpaid for their services and didn't give their informed consent to the atrocities to which they were subjected.

Enormous Legal Consequences

There are numerous legal theories that could generate massive lawsuits surrounding controlled business. Self-dealing, unfair business practices, anti-competitive business practices, conspiracy to defraud, unjust enrichment, interference with a fiduciary relationship are just a few.

It has become routine for real estate fiduciaries to regularly engage in conduct that exploits their client's trust and reliance upon them: They direct clients to controlled business relationships without obtaining their clients' informed consent. This conduct amounts to self-dealing and violates the fiduciary duty of loyalty as well as other duties. The substantial omissions involved in directing business may be considered to be fraud by some Courts. As far as I know, I believe the only legal analysis done prior to setting up a controlled business arrangement is a RESPA analysis. I don't believe anyone is looking to the common law of agency, the anti-trust implications, theories of fraud or other sources of law for additional legal requirements. That oversight may be putting the entire real estate industry in jeopardy.

The written disclosures being used do not secure the informed consent of clients almost 100% of the time. It is almost impossible to adequately disclose self-dealing, its' inherent conflict of interests and obtain the informed consent of the principal. The fact that fiduciaries have used these controlled business arrangements to unfairly exact higher fees from consumers does not make the case any better for real estate professionals. This is a huge liability risk for all the real estate professionals involved in controlled business.

Misrepresentation by omission is considered to be fraud in many jurisdictions.

Think about the intentional omissions that are kept from consumers when they are directed into a controlled business. Add to this the fact that the potential defrauder is also a fiduciary and now you have a situation where real estate transactions utilizing controlled business may be considered to be fraudulent… Could this be reason enough to unravel a real estate transaction? Many transactions involving dual agency have been nullified. The potential ramifications are enormous.

Title underwriters and agents are probably also at risk for the act of enticing agents with financial rewards to breach their fiduciary duties to their clients. Although there may not be a lot of law on the subject, it would not be a huge stretch to devise a tort called, "interference with a fiduciary relationship." I imagine the financial consequences would not be small.

The typical remedy in a breach of fiduciary duty case that involves self-dealing or a serious breach of loyalty is disgorgement of all fees earned. In the Edina Realty lawsuit the plaintiffs were seeking one hundred million dollars in damages. And that was just one firm in Minnesota. The kicker is that in a fiduciary duty lawsuit, you don't even need to prove up damages. Once it is proven that there was a fiduciary relationship and that self-serving conduct took place, the burden of proof is often switched to the Defendants to prove that they obtained the informed consent of their principal before engaging in the conduct. In order to obtain the informed consent of their principal it is necessary to make a full disclosure of ALL the ramifications of the conduct and you have to prove that the client understood the disclosure and agreed to it.

The potential damages could be all the real estate commissions, title fees and other fees charged where there was any kind of controlled business relationship. I believe the damages could be in the hundreds of billions of dollars nationwide. A case of this magnitude would likely bankrupt many mortgage lenders, title insurers and real estate companies. Most of the large companies that are involved in controlled business are publicly held. This could be a disaster for their shareholders.

Controlled business in not good for the consumer, it is not good for a free market and although it might generate a lot of revenue in the short term, it is not good for controlled business owners as the legal consequences could be devastating.

Recommendation

Make a strong statement that controlled business in real estate is illegal.

Force all forms of controlled business to disband including in-house title and mortgage companies and make them compete for the right to do business.

Conclusion

You have the power to resolve this problem. If you do nothing, then you will be sanctioning anti-competitive business practices, the practice of fiduciaries preying upon their clients and the destruction of a free market. Controlled business needs to be eliminated. Controlled business is an exploitation of a fiduciary relationship and does not belong in any fiduciary based industry. If you do nothing, companies like mine will cease to exist and prices will continue to artificially rise. Title One may be appropriately named, as we may be the only truly independent title company left in the Minneapolis area.

Unfortunately, because of extensive budget cuts, the Minnesota Attorney General's Office has taken the position that they cannot afford to investigate this matter. See Exhibit 9, Letter from Mike Hatch.

Give me a chance to compete and I will outperform my competitors in service and price and earn the right to do business. Stop controlled business and you will force my competitors to compete on the merits of their work again, not the influence they place over their clients. We develop loyal customers the old fashioned way, we earn them. We don't buy them. When business is locked away and consumers are getting ripped off to preserve a "diversified revenue stream," there is a serious problem. Please have the courage to stand up to ALTA, NAR, and RESPRO. These organizations are deeply entrenched in the anti-competitive and manipulative business practice schemes called controlled business and it needs to stop. Let me take them on in a normal marketplace. If you need the support of other organizations I suggest that you enlist AARP and other organizations whose members have been victimized the worst.

Eliminate controlled business in real estate and you will have a free market with healthy competition based upon service and price. Fees will go down. Realtors will divest themselves of conflicts of interest and be better suited to represent their clients and title companies won't be tempted to offer Realtors financial incentives in exchange for referral business.

Thank you for your attention to this important problem.

Exhibit 1

TITLE-1

Title One, Inc., has been a key player in the industry since 1992, when we were founded upon the simple premise that title insurance did not have to be expensive and high quality customer service should be the standard. We have built a loyal following of Loan Officers and Realtors who seek the best service and price for their clients. Below is a price comparison, showing you how much you save your clients, in respect to other title companies in town. Our settlement fee drops to $165 on most transactions involving new financing in which Title One, Inc. performs both the mortgage and real estate closings.

The following example is a typical transaction with a purchase price of $250,000 and new financing in the amount of $200,000.

	Closing Fee	Exam Fee	Name Search	Plat Drawing	Recording Service Fee	Title Insurance Lender	Title Insurance Owners	Adjustable Rate Rider	Totals	Total Savings
TITLE-1	195.00	135.00	25.00	55.00	31.00	400.00	225.00	0.00	1066.00	
Burnet Title	280.00	145.00	35.00	60.00	50.00	577.50	330.00	50.00	1527.50	$462.00
Dakota Abstract & Title	250.00	125.00	25.00	50.00	40.00	812.50		50.00	1352.50	$286.50
Edina Realty Title	290.00	140.00	30.00	50.00	40.00	562.50	300.00	50.00	1462.50	$396.50
Stewart Title	250.00	130.00	30.00	60.00	50.00	575.00	287.50	50.00	1432.50	$366.50
Walsh Title	275.00	140.00	30.00	60.00	30.00	562.50	300.00	50.00	1447.50	$381.50
Chicago Title	275.00	130.00	30.00	60.00	60.00	575.00	287.50	0.00	1417.50	$351.50
GAC	250.00	200.00	30.00	60.00	30.00	687.50	175.00	50.00	1482.50	$416.50
Excel Title	275.00	125.00	50.00	60.00	60.00	575.00	287.50	0.00	1,432.50	$366.50
1st American Title	270.00	160.00	36.00	60.00	30.00	508.75	306.75	0.00	1371.50	$305.50

* Our competitors' figures were obtained from verbal quotes in March/ April 2006 and are well documented. However, verbal quotes may be inaccurate and they are not guaranteed. The purpose of this rate comparison is to demonstrate the substantial savings at Title One, Inc.

Exhibit 3

Metropolitan Areas

Terms on Conventional Home Mortgages -- 2004
Table VIII - Averages by Metropolitan Area

Metropolitan Area - *Consolidated MSA	Contract Interest Rate (%)	Initial Fees and Charges (%)	Effective Rate (%)	Term to Maturity (Years)	Purchase Price ($thou.)	Loan to Price Ratio (%)	% of Loans LTV 70 0 Less	% of Loans LTV 70.1 - 80.0	% of Loans LTV 80.1 - 90.0	% of Loans LTV Over 90.0	Percent of Number with Adjustable Rates	Number of Loans
Albany-Schenectady-Amsterdam, NY*	5.74	0.40	5.80	26.8	189.9	75.9	25	47	9	18	17	341
Atlanta-Sandy Springs-Gainesville, GA-AL*	5.62	0.35	5.67	28.0	235.2	75.4	19	55	7	19	44	6,752
Austin-Round Rock, TX	5.91	0.17	5.94	26.6	217.5	71.0	27	46	6	21	22	1,463
Birmingham-Hoover-Cullman, AL*	5.95	0.74	6.06	28.6	179.3	79.4	15	56	9	21	37	608
Boston-Worcester-Manchester, MA-NH*	5.42	0.29	5.46	28.5	379.6	71.2	33	49	7	11	45	4,140
Buffalo-Niagara Falls, NY	5.91	0.15	5.93	28.4	188.1	78.0	25	31	15	30	4	440
Charlotte-Gastonia-Salisbury, NC-SC*	5.78	0.43	5.84	27.5	220.6	74.1	22	51	7	20	22	2,115
Chicago-Naperville-Michigan City, IL-IN-WI*	5.57	0.20	5.60	28.6	271.9	75.6	24	50	10	15	50	11,830
Cincinnati-Middletown-Wilmington, OH-KY-IN*	5.59	0.32	5.63	28.9	197.7	80.7	14	48	11	28	38	1,883
Cleveland-Akron-Elyria, OH*	5.75	0.70	5.85	28.7	216.7	80.6	17	43	11	30	21	1,967
Columbus-Marion-Chillicothe, OH*	5.39	0.61	5.48	29.0	213.5	79.3	13	62	9	16	50	1,630
Dallas-Fort Worth, TX*	5.94	0.25	5.98	26.2	179.9	73.5	24	35	6	35	18	5,443
Dayton-Springfield-Greenville, OH*	5.85	0.64	5.95	28.5	195.5	80.9	15	47	9	30	17	787
Denver-Aurora-Boulder, CO*	5.50	0.53	5.57	29.1	297.4	74.6	23	62	7	8	59	3,411
Detroit-Warren-Flint, MI*	5.59	0.21	5.62	28.4	186.9	77.5	21	48	9	22	32	3,307
Fresno-Madera, CA*	5.83	0.24	5.86	27.8	260.1	72.0	29	49	8	13	38	944
Grand Rapids-Muskegon-Holland, MI*	5.77	0.37	5.82	29.0	190.0	79.9	13	57	12	18	45	453
Greensboro--Winston-Salem--High Point, NC*	5.61	0.49	5.68	27.2	180.2	75.8	21	48	7	23	27	1,062
Greenville-Anderson-Seneca, SC*	5.66	0.55	5.74	28.1	178.2	79.6	16	45	13	26	19	703
Hartford-West Hartford-Willimantic, CT*	5.72	0.33	5.77	28.3	277.4	74.4	28	51	9	13	27	872
Honolulu, HI	5.41	0.83	5.53	28.7	368.5	74.3	23	64	7	6	28	707
Houston-Baytown-Huntsville, TX*	5.85	0.43	5.91	26.5	178.0	77.5	19	44	6	31	20	4,170
Indianapolis-Anderson-Columbus, IN*	5.77	0.20	5.80	28.1	157.0	80.2	14	51	5	30	26	807
Jacksonville, FL	5.71	0.33	5.75	27.9	223.7	76.4	21	49	9	21	40	1,587
Kansas City-Overland Park-Kansas City, MO-KS*	5.73	0.36	5.78	27.7	185.5	79.0	17	45	8	30	30	2,553
Knoxville-Sevierville-La Follette, TN*	5.62	0.75	5.73	27.0	170.7	77.4	19	54	9	18	27	758
Las Vegas-Paradise-Pahrump, NV*	5.63	0.38	5.68	28.2	288.3	72.5	27	52	9	12	50	2,131
Little Rock-North Little Rock-Pine Bluff, AR*	6.00	0.41	6.06	27.7	143.1	81.3	15	38	14	33	27	391
Los Angeles-Long Beach-Riverside, CA*	5.46	0.20	5.49	28.0	425.8	68.0	40	48	5	6	54	17,120
Louisville-Elizabethtown-Scottsburg, KY-IN*	5.81	0.52	5.89	28.0	168.1	78.4	19	54	6	21	35	1,039
Memphis, TN-MS-AR	5.95	0.49	6.02	28.2	164.1	81.0	13	47	11	29	32	899
Miami-Fort Lauderdale-Miami Beach, FL	5.73	0.43	5.80	28.5	266.9	76.1	25	44	12	19	43	7,970
Milwaukee-Racine-Waukesha, WI*	5.74	0.25	5.78	29.1	203.6	78.0	16	59	8	18	38	881
Minneapolis-St. Paul-St. Cloud, MN-WI*	5.38	0.94	5.51	29.1	272.9	77.3	20	58	6	16	47	6,253
Nashville-Davidson--Murfreesboro--Columbia, TN*	5.80	0.30	5.85	27.0	212.8	75.3	20	52	9	19	20	1,350
New Orleans-Metairie-Bogalusa, LA*	5.74	0.27	5.78	28.4	205.3	79.6	18	49	11	22	21	1,056
New York-Newark-Bridgeport, NY-NJ-CT-PA*	5.63	0.32	5.68	28.2	397.5	69.6	39	46	8	8	32	15,812
Oklahoma City-Shawnee, OK*	5.97	0.32	6.02	27.2	146.7	79.3	16	45	14	24	21	655
Omaha-Council Bluffs-Fremont, NE-IA*	5.78	0.67	5.88	28.8	177.5	78.4	13	68	6	13	36	965
Orlando-The Villages, FL*	5.76	0.37	5.81	28.3	212.7	76.7	20	51	11	18	37	2,873
Philadelphia-Camden-Vineland, PA-NJ-DE-MD*	5.83	0.33	5.87	28.7	274.6	76.3	25	45	12	18	20	7,059
Phoenix-Mesa-Scottsdale, AZ	5.67	0.57	5.76	28.0	217.4	75.9	21	49	7	23	39	4,907
Pittsburgh-New Castle, PA*	5.85	0.52	5.93	28.1	211.2	79.0	21	40	11	28	12	1,957
Portland-Vancouver-Beaverton, OR-WA	5.64	0.31	5.68	27.7	255.4	71.5	28	58	5	9	43	3,084
Providence-New Bedford-Fall River, RI-MA	5.57	0.32	5.61	28.6	325.1	70.7	36	45	9	11	39	860
Raleigh-Durham-Cary, NC*	5.66	0.44	5.73	27.0	221.1	70.9	25	58	4	12	42	1,236
Richmond, VA	5.78	0.65	5.87	27.9	231.6	75.2	22	49	8	21	27	1,953
Rochester-Batavia-Seneca Falls, NY*	5.79	0.22	5.82	27.6	203.4	80.5	19	34	13	35	7	426
Sacramento--Arden-Arcade--Truckee, CA-NV*	5.49	0.28	5.53	28.3	375.5	70.0	32	55	7	7	62	3,261
Salt Lake City-Ogden-Clearfield, UT*	5.56	0.52	5.64	27.7	231.3	75.6	22	55	9	13	44	1,115
San Antonio, TX	5.95	0.37	6.01	26.7	161.3	77.5	20	45	10	25	22	1,334
San Diego-Carlsbad-San Marcos, CA	5.22	0.26	5.26	28.7	512.3	66.4	42	52	3	3	67	3,254
San Jose-San Francisco-Oakland, CA*	5.41	0.12	5.42	28.1	552.3	67.7	34	56	5	5	67	10,044
Seattle-Tacoma-Olympia, WA*	5.48	0.35	5.53	27.9	304.7	72.6	27	56	5	12	47	7,629
St. Louis-St. Charles-Farmington, MO-IL*	5.95	0.25	5.99	27.1	188.9	75.2	23	45	7	25	27	1,696
Tampa-St. Petersburg-Clearwater, FL	5.79	0.37	5.84	27.8	204.6	75.2	22	50	11	18	33	4,210
Tucson, AZ	5.76	0.36	5.81	27.2	204.2	73.0	27	49	7	17	29	934
Tulsa-Bartlesville, OK*	5.95	0.41	6.01	27.4	156.6	78.5	18	46	9	27	27	335
Virginia Beach-Norfolk-Newport News, VA-NC	5.74	0.55	5.82	27.8	247.1	73.2	23	54	9	14	37	1,875
Washington-Baltimore-Northern Virginia, DC-MD-VA-WV*	5.75	0.57	5.84	28.1	372.2	70.6	29	53	6	12	33	14,158

Taken from the Federal Housing Finance Board

Exhibit 4

CONFIDENTIAL PRIVATE PLACEMENT MEMORANDUM

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DIAMOND TITLE SERVICES, LIMITED PARTNERSHIP
A MINNESOTA LIMITED PARTNERSHIP

("DIAMOND" OR THE "PARTNERSHIP")

7777 Washington Avenue South
Edina, Minnesota 55439
(612) 829-0899

35 LIMITED PARTNERSHIP INTERESTS
$500.00 PER INTEREST

Number: 2

Offeree: ____________________

The Date Of This Memorandum Is January 25, 1999.

CONFIDENTIAL PRIVATE PLACEMENT MEMORANDUM
DIAMOND TITLE SERVICES, LIMITED PARTNERSHIP

All limited partnership interests (the "Interests"), offered hereby are being offered by Diamond Title Services, Limited Partnership, a Minnesota limited partnership ("Diamond" or the "Partnership") solely to Minnesota residents who are full-time professional real estate service providers with at least two years experience ("Qualified Investors"). There is no public market for the Interests. The capital contribution for the interests was determined by Diamond and is not based upon the net worth or earnings of the Partnership.

The Interests offered by this Prospectus are speculative and involve a degree of risk and should be purchased only by Qualified Investors who can afford the loss of their entire Capital Contribution. Qualified Investors should be particularly aware of the following risks:

- The Partnership has no operating history.
- The Partnership may experience losses from errors and omissions and there may not be adequate insurance to cover these losses.
- The Partnership and its members must comply strictly with the Real Estate Settlement Procedures Act and other federal and state laws. These laws and applicable regulations promulgated thereunder are subject to legislative modification and to interpretation by enforcing agencies.
- The title insurance business is highly competitive.
- Limited Partners do not have a role in managing the Partnership.
- Restriction on transfer of Partnership Interests.

Also see "Risk Factors" beginning on page 5.

THESE SECURITIES HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSIONS, BUT ARE OFFERED PURSUANT TO CLAIMED EXEMPTIONS FROM REGISTRATION PROVIDED BY THE ACT AND APPLICABLE STATE EXEMPTIONS. THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS MEMORANDUM. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Capital Contribution from Qualified Investors	General Partner's Capital Contribution(2)	Total Capital Contributions(4)
Per Interest(1)	$500	$125	$625
Total Interests (35 Interests)(3)	$17,500	$4,375	$21,875

(1) The Interests are being offered solely to Minnesota Residents who are full-time professional real estate service providers with at least two years experience. ("Qualified Investor"). The Partnership is not offering to sell any Interests hereunder to any party other than Qualified Investors.

(2) The General Partner shall make a contribution equal to 20% of all contributions by Qualified Investors.

(3) The Partnership will accept subscriptions until the maximum number of subscriptions offered hereby has been accepted or until this offering is terminated, whichever is earlier.

(4) Before deducting offering expenses payable by the Partnership, estimated at approximately $1,000 including legal and filing fees and printing and related expenses.

The date of this Prospectus is January 25, 1999

THE INTERESTS MAY BE PURCHASED BY AN UNLIMITED NUMBER OF "ACCREDITED INVESTORS" WITHIN THE MEANING OF THE ACT, SUBJECT TO PRIOR SALE, WITHDRAWAL, CANCELLATION OR MODIFICATION OF THE OFFER WITHOUT NOTICE, AND ACCEPTANCE OF THE SUBSCRIPTIONS, DELIVERY OF THE CERTIFICATES AND CERTAIN FURTHER CONDITIONS. THE COMPANY RESERVES THE RIGHT TO WITHDRAW, CANCEL OR MODIFY SUCH OFFER AND TO REJECT SUBSCRIPTIONS IN WHOLE OR IN PART FOR THE PURCHASE OF ANY OF THE INTERESTS OFFERED. IN ADDITION, THE RIGHT IS RESERVED TO CANCEL ANY SALE IF SUCH SALE, IN THE OPINION OF THE COMPANY, WOULD VIOLATE FEDERAL OR STATE SECURITIES LAWS.

OFFEREES AND SUBSCRIBERS ARE URGED TO READ THIS MEMORANDUM CAREFULLY. ALL OFFEREES AND SUBSCRIBERS WILL BE OFFERED AN OPPORTUNITY TO TALK WITH OFFICERS OF THE COMPANY TO VERIFY ANY OF THE INFORMATION INCLUDED HEREIN AND TO OBTAIN ADDITIONAL INFORMATION REGARDING THE COMPANY. THIS MEMORANDUM CONTAINS SUMMARIES OF CERTAIN DOCUMENTS. ADDITIONAL MATERIALS WILL BE MADE AVAILABLE TO PROSPECTIVE INVESTORS FOR INSPECTION DURING NORMAL BUSINESS HOURS UPON REASONABLE REQUEST TO THE COMPANY.

THE DELIVERY OF THIS MEMORANDUM, ATTACHMENTS OR MATERIALS AVAILABLE ON REQUEST AT ANY TIME DOES NOT IMPLY THAT THERE HAS BEEN NO CHANGE IN THE INFORMATION SINCE THE DATE HEREOF.

THE OFFEREE, BY ACCEPTING DELIVERY OF THIS MEMORANDUM, AGREES TO RETURN THIS MEMORANDUM AND ALL ENCLOSED DOCUMENTS TO THE COMPANY IF THE OFFEREE DOES NOT UNDERTAKE TO PURCHASE ANY OF THE INTERESTS OFFERED HEREBY.

ANY REPRODUCTION OR DISTRIBUTION OF THIS CONFIDENTIAL PRIVATE PLACEMENT MEMORANDUM, IN WHOLE OR IN PART, OR THE DIVULGENCE OF ANY OF ITS CONTENTS WITHOUT THE PRIOR WRITTEN PERMISSION OF THE COMPANY IS PROHIBITED. THIS CONFIDENTIAL PRIVATE PLACEMENT MEMORANDUM IS FURNISHED FOR THE SOLE USE OF THE OFFEREE AND FOR THE SOLE PURPOSE OF PROVIDING INFORMATION REGARDING THE SECURITIES PROPOSED TO BE SOLD BY THE COMPANY. NO OTHER USE OF THIS INFORMATION IS AUTHORIZED.

EXCEPT AS HEREIN DISCUSSED, NO PERSON HAS BEEN AUTHORIZED BY THE COMPANY TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATION CONCERNING THE COMPANY OTHER THAN THOSE CONTAINED IN THIS OFFERING MEMORANDUM IN CONNECTION WITH THE OFFERING DESCRIBED HEREIN AND, IF GIVEN OR MADE, SUCH OTHER INFORMATION OR REPRESENTATION MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY THE COMPANY. IN MAKING AN INVESTMENT DECISION INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE ISSUER AND THE TERMS OF THE OFFERING, INCLUDING THE MERITS AND RISKS INVOLVED.

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SUMMARY OF THE OFFERING

The following summary is qualified in its entirety by reference to the more detailed information appearing elsewhere in the Prospectus. Each Qualified Investor is urged to read this Prospectus in its entirety.

Qualified Investors

Qualified Investors are Minnesota residents who are experienced full-time professionals with at least two years of experience in the real estate services business, such as licensed real estate brokers or agents, mortgage loan brokers, real estate builders and developers, and title service professionals.

Diamond Title Services; Limited Partnership

Diamond Title Services, LP was established on January 25, 1999, as a Limited Partnership under Minnesota law. Universal Partnerships, Inc. ("Universal" or the "General Partner") is the sole general partner of the Partnership. The General Partner is organized in Minnesota and is a wholly owned subsidiary of Universal Title Company. Universal Title Company is a title insurance underwriter licensed to do business in Minnesota.

Diamond is a title insurance agency that provides title and real estate closing services primarily to Diamond home buyers and sellers in the Minneapolis and St. Paul metropolitan area and surrounding counties. In its capacity as a title insurance agent, Diamond performs all the functions and services necessary to obtain an underwritten commitment for a title policy. Diamond conducts the title exam, determines the insurability of title to particular parcels of property, prepares title commitments, resolves any underwriting obligations or conditions prior to issuance of the policy and issues the final policy. If necessary, Diamond orders abstracts from a number of different vendors. The title premium is paid by the insured for the title insurance policy and Diamond retains a portion of the premium as a fee for its services. The remaining portion of the premium is paid to the title insurance underwriter. Diamond currently serves as an agent for First American under the terms of an Agency Contract which is terminable by either party on 30 days written notice.

Diamond contracts with Universal Title Company, a wholly owned subsidiary of First American Title Insurance Company, a national title insurance company ("First American"), for closing services pursuant to a Title and Closing Services Agreement. Diamond also contracts with other contractors to provide a variety of other ancillary real estate services, including abstracting, name searches, plat drawings and real estate assessments. Diamond passes the outside contractor's invoice for these services rendered to Universal Title Company, who collects the fees at closing and without mark-up, forwards such fees to the outside contractors for their services.

The General Partner is currently serving as the general partner in approximately 18 other limited partnerships. These limited partnerships have been established to serve as vehicles for delivering title services to home buyers, who often rely on a recommendation from a real estate agent or mortgage loan officer to select a provider of title and related real estate services. The General Partner believes that title agencies such as the Partnership can deliver quality title services to the clients of real estate agents and mortgage loan officers and other real estate professionals and that such persons are the best means of educating the consumers of such services and about the services to be offered by the Partnership.

The Partnership's offices currently are located at 7777 Washington Avenue South, Edina, Minnesota 55439 and its telephone number is (612) 829-0899.

The Limited Partnership Agreement

Diamond Title Services, Limited Partnership is governed by the Limited Partnership Agreement substantially in the form attached as Attachment A hereto (the "Partnership Agreement").

The General Partner

The General Partner is a wholly-owned subsidiary of Universal Title Company. Commencing upon the sale of the Interests offered hereby, and at all times thereafter, the General Partner will own a twenty percent (20%) interest in Diamond based on an initial and subsequent capital contributions which at all times will represent 20% of all capital contributions made to Diamond. See "Dilution." The Partnership Agreement provided that the General Partner shall manage the Partnership. See "Organization, Structure and Operation of the Partnership." The Balance Sheet of the General Partner is attached to this Prospectus as Attachment B.

Universal Title Company serves as a general partner in approximately 18 other limited partnerships that operate as title agencies in Minnesota, including the Minneapolis and St. Paul metropolitan area, St. Cloud and Duluth. See "Relationships Among Certain Parties."

The Limited Partners

Qualified Investors who purchase limited partnership interests in the Partnership ("Interests") will become Limited Partners under the Partnership Agreement. Limited Partners will collectively own an 80% interest in the Partnership, which will be shared among all Limited Partners pro rata in accordance with the amount of their capital contributions. Limited Partners will not participate in the management or control of the Partnership and do not have the right or authority to act for or bind the Partnership. See "Organization, Structure and Operation of the Partnership." Limited Partners may, but are not required to, refer potential clients to the Partnership for title and closing services. PARTNERS ARE REQUIRED AT ALL TIMES TO STRICTLY COMPLY WITH THE RULES AND REGULATIONS OF THE U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT ("HUD") AND THE REAL ESTATE SETTLEMENT PROCEDURES ACT ("RESPA"), INCLUDING PROPER AND TIMELY DISCLOSURE OF THE PARTNERS' OWNERSHIP INTEREST IN THE PARTNERSHIP.

Number of Limited Partnership Interests Offered; Duration of the Offering

A maximum of 35 Interests are being offered to Qualified Investors. Payment for Interests purchased must be made in full at the time of subscriptions. Qualified Investors must complete and sign the Subscription Agreement enclosed herein as Attachment C, and make a check payable to "Diamond Title Services, Limited Partnership" for the subscription amount and mail the Subscription Agreement and check to: Diamond Title Services, Limited Partnership, 7777 Washington Avenue South, Edina, Minnesota 55439.

The offering of Interests will terminate on the earlier of the following: (a) the sale of the maximum number of Interests; or (b) on any date prior to completion of the offering as the General Partner deems appropriate.

Capital Contribution

The Partnership is offering Interests for a $500 capital contribution per Interest. The General Partner will not, under any circumstances, accept subscriptions for a fraction of an Interest.

Use of Proceeds

The Partnership plans to use the proceeds from this offering for working capital. The maximum offering is expected to provide sufficient initial working capital to operate the business of the Partnership.

Investor Qualification Requirements

Investors must be residents of the state of Minnesota and must not have a present intention to be a resident of any other state.

Investors must be Qualified Investors, as defined on Page 1 "Prospectus Summary" and as further set forth in paragraphs 2 through 5 of the Subscription Agreement.

Compliance with RESPA

The Partnership is subject to RESPA, administered by HUD.

Although RESPA does not apply to all real estate transactions, it is the Partnership's policy to require that all Limited Partners adhere strictly to the requirements of RESPA. "See Business - Federal Regulation."

Reports to Partners

Limited Partners have the right to inspect, examine and copy certain books and records of the Partnership. Annual reports prepared by the General Partner will be delivered to each Limited Partner at the end of the Partnership's fiscal year. In addition, the Partnership will provide Limited Partners with monthly profit and loss statements and Partnership minutes each quarter.

Allocation of Income, Losses and Distributions Among Partners

Income and losses of the Partnership each year will be allocated among all the Partners in proportion to such Partners' respective ownership interests in the Partnership. The Partnership will distribute each year an amount estimated by the General Partner to be sufficient to pay federal and state income taxes on each Partner's share of Partnership income which will be included in the Partner's income for income tax purposes for such fiscal year. UNDER NO CIRCUMSTANCES WILL THE PARTNERSHIP DIRECTLY OR INDIRECTLY COMPENSATE OR OTHERWISE REWARD INDIVIDUAL LIMITED PARTNERS BASED ON THE VOLUME OF THEIR REFERRALS TO THE PARTNERSHIP.

Generation of Passive Income and Losses

Under the Tax Reform Act of 1986 (the "1986 Act") investors generally may not offset losses from passive activities (i.e., activities in which the investor does not materially participate) against nonpassive income of the investor. Material participation (generally defined by the IRS as 500 hours of participation in a year) would cause net income and net loss to be nonpassive. However, significant participation (defined by the IRS as 100 hours of participation in a year) by an investor would cause net income to be nonpassive, but net loss to be passive.

If the Partnership generates losses, such losses should be passive losses to Limited Partners since the Limited Partners will materially participate in the Partnership's business. For years in which the Partnership produces net income, such income should generally be passive income unless the Limited Partner materially or significantly participates in the Partnership's business.

RISK FACTORS

Purchasing an Interest in the Partnership is speculative, involves a high degree of risk and is not an appropriate use of funds for persons who cannot afford the loss of their entire Capital Contribution. Qualified Investors should be particularly aware of the following risk factors and should review carefully the information contained elsewhere in this Prospectus.

A. Limited Operating History and No Assurance that Partnership will be Profitable. The Partnership was recently formed for the purpose of providing title services. However, the General Partner's parent company, Universal Title Company, has many years of experience in the title services business and the General Partner has formed and currently manages other limited partnerships similar to this Partnership. There is no assurance that the Partnership will be profitable and continue to operate as a going concern. Two limited partnerships similar to this Partnership were not profitable and as a result were dissolved.

The Partnership has entered into an Agency Contract with First American and a Title and Closing Services Agreement with Universal Title Company. The Partnership believes such agreements will provide the Partnership with all of the necessary support to conduct its operations. However, both agreements may be terminated by either party upon 30 and 90 days' notice respectively, and such termination could have a material adverse effect on the Partnership and its operations.

B. Errors and Omissions Insurance. The Partnership has purchased errors and omissions insurance to protect the Partnership against mistakes in examining title which could render the Partnership liable to the beneficiaries for whom the Partnership has procured the insurance policies. However, this errors and omissions insurance does not protect the Partnership against willful or dishonest conduct by its employees. The Partnership believes it has minimized this risk by hiring a competent, qualified and experienced title examiner. However, there is no assurance that the errors and omissions coverage will be adequate to cover any and all claims or that insurance premiums will not increase in the future as a consequence of conditions in the market.

C. RESPA Requirements. The U.S. Department of Housing and Urban Development ("HUD") published final regulations under the Real Estate Settlement Procedures Act ("RESPA") on November 2, 1992 and published certain revisions on March 26 and June 7, 1996. RESPA is a federal law designed to reduce inflated and unwarranted title insurance and settlement costs, to give consumers a better understanding of the home purchase and settlement process; and to allow the consumer adequate opportunity to shop for real estate services, including title services. In addition, this law is designed to prevent kickbacks and fee splitting by the parties which are involved in providing services relating to home purchases and the settlement process. RESPA is enforced by HUD, which has the power (i) to seek an injunction against violators; (ii) to seek a $10,000 fine against any entity or individual involved in a violation of RESPA; (iii) to seek criminal penalties of up to one year imprisonment against violators; (iv) to seek restitution for the home buyer of an amount up to three times the settlement charge resulting from the unlawful activity; (v) to recover all profits made as a result of the illegal activity; (vi) to ban any person involved in any illegal activity under RESPA from further participation in any FHA program; (vii) to impose civil penalties of double damages, plus $5,000 for false statements or claims in connection with any FHA mortgage insurance issued in violation of RESPA; and (viii) to withdraw FHA approved mortgagee status for any mortgage brokers or other lenders who violate RESPA.

Although RESPA does not apply to all real estate transactions, it is the Partnership's policy to require that all Limited Partners adhere strictly to the requirements of RESPA because the situations in which RESPA will not apply are expected to be rare and difficult to ascertain with any certainty.

The Partnership intends to comply with the applicable requirements of RESPA by, inter alia, (1) requiring Qualified Investors to provide the requisite controlled business disclosure statement to clients referred to the Partnership, a current form of which is attached to this Prospectus as Attachment D, (2) prohibiting Qualified Investors from requiring that clients use any particular provider of settlement services, including the Partnership, and (3) providing that the only financial benefits which Qualified Investors will receive from the Partnership are profits to be distributed pro rata, strictly in accordance with the Partners' respective ownership interests outstanding from time to time, regardless of how much business has been referred by each partner receiving a distribution. In addition, the Partnership will not adjust a partnership interest in any fashion to reflect the amount of business referred by a partner. The Partnership's policy regarding the Limited Partners' compliance with RESPA is that Limited Partners are not required to refer clients to the Partnership for title services, and that in the event a Limited Partner refers a client to the Partnership, the Limited Partner is required first to disclose his/her interest in the Partnership in the manner required by RESPA.

Although the Partnership believes it is in compliance with applicable RESPA rules, there is no assurance that it in fact is in total compliance with such rules or that it will continue to be in compliance in the future. See "Business -- Federal Regulations."

D. Competition. The title insurance business is highly competitive. However, unlike many industries, where consumers have a wealth of information to make choices among services providers, the title insurance industry competes by obtaining client recommendations from different sources in the real estate industry. Home buyers and sellers often use a particular title company because of a recommendation from their real estate agent or mortgage loan officer, and they typically follow this recommendation. Relatively few consumers actively comparison shop for a title company based upon price and service. As a result, the Partnership's success is highly dependent upon generating recommendations from sources in the real estate industry. There is no assurance that the Partnership will be able to generate sufficient recommendations to be profitable.

The title closing and insurance underwriting services offered by First American and Universal Title Company, which companies are the Partnership's sole vendors of such products and services, will compete with many other title insurance underwriters and service providers in the Minneapolis-St. Paul metropolitan area. Many of these companies are affiliated with local real estate companies that are able to refer customers to such title companies for title services. The Partnership's major competitors in the Twin Cities include Burnett Title, Edina Title, Chicago Title Insurance Company, Old Republic Title Insurance Company and ATI Title Company. These competitive providers may be successful in attracting business from the clients of the Partnership's members notwithstanding the member's referral of their clients to the Partnership.

E. <u>Factors Which May Affect Limited Partners' Limited Liability; Control by General Partner</u>. A Limited Partner of the Partnership will not be liable for debts or obligations of the Partnership in excess of his or her capital contribution. A Limited Partner may, however, be liable for the full amount of his or her capital contribution even if part of that contribution has been returned by way of distributions. Distributions to Limited Partners may be subject to return to the Partnership upon action by creditors if after such distributions the Partnership's liabilities exceed its assets.

The Limited Partners of the Partnership are prohibited by the Partnership Agreement from participating in the management of the Partnership (and under Minnesota law such participation, with certain exceptions, would eliminate the limitations on the liability of such Limited Partners for Partnership obligations), and thus must rely exclusively on the management abilities and decisions of the General Partner.

F. <u>Restrictions on Transfer of the Interests</u>. The Interests offered hereby have not been registered under the Securities Act of 1933, as amended (the "Act") or any state securities or Blue Sky laws (the "Laws") and may be sold only pursuant to registration or exemption from such registration under the Act and Laws. The Partnership Agreement restricts the transfer of the Interests and gives the Partnership an option to purchase the Interests at book value in the event of any attempted transfer. Book value is the Partnership's net worth (as determined in accordance with generally accepted accounting principles, multiplied by the percentage interest to be purchased from a Limited Partner. See "Organization, Structure and Operation of the Partnership" and "Description of Interests Offered -- Limitations on Resale."

There was no market for the Interests prior to this offering and there will be no market for the Interests subsequent to this offering. The purchase of the Interests should therefore be viewed as a long-term, illiquid investment.

G. <u>Tax Risks</u>. The Partnership was formed as a limited partnership under Minnesota law in order to eliminate "double taxation" of the Partnership's income to its Partners. See "Summary of Certain Federal Income Tax Matters." The Partnership will not apply for a ruling from the Internal Revenue Service ("IRS") to the effect that it will be classified as a limited partnership rather than as an organization taxable as a corporation for federal income tax purposes. If the Partnership were to be taxed as a corporation, the overall profits available for distribution to its partners would be diminished by the extent of the corporate tax applied to such profits. It is not the Partnership's purpose to create losses or other deductions for its partners, but to operate profitably so that partners will realize a share in such profits. However, there is no assurance that the Partnership will be able to operate profitably, and any losses which are passed through to the partners will most likely be deemed to be "passive losses" under the Internal Revenue Code. The deductibility of passive losses is severely limited. Each respective partner is urged to consult with his or her own tax advisor with respect to the federal, state, and local tax consequences arising from acquisition of a partnership interest in the Partnership.

H. Possible Conflicts of Interests of the General Partner; Contracts with General Partner and Affiliates.

Other Limited Partnerships. The General Partner serves as a general partner for approximately 18 other limited partnerships, all of which conduct the same business as proposed to be conducted by Diamond. The General Partner expects to facilitate formation of other such limited partnerships in the future. Investors in this offering are not eligible to participate in any other limited partnership in which the General Partner participates. The General Partner endeavors to provide the same assistance to all the limited partnerships which it serves as general partner, but there is no assurance that all limited partnerships will actually receive the same assistance or that all limited partnerships will actually incur the same benefits from such assistance.

Contracts With General Partner. Universal Title Company, the General Partner's parent company, has entered into a Title and Closing Services Agreement with the Partnership to provide real estate and mortgage closing services for the Partnership at the same market rate as provided to others. This agreement may be terminated at any time by either party upon 90 days written notice. The Partnership has entered into an Agency Contract with First American, whereby the Partnership agrees to prepare and issue title insurance commitments and final policies on behalf of the General Partner for properties located in Minnesota, including the Minneapolis and St. Paul metropolitan area and surrounding counties. The Partnership receives a commission equal to 75% of the rate charged for policies issued on behalf of the General Partner. The Agency Contract is terminable upon 30 days' written notice by either party. The rates for title insurance policies to be quoted and charged are the rates currently approved by the State of Minnesota. In the event that a special risk endorsement is issued, the commission on the rate is negotiated by the Partnership and the General Partner. The General Partner receives no fees, or other compensation directly or indirectly for its role as a General Partner, other than its 20% ownership interest in the Partnership, the market rate fees charged under the Agency Agreement, and the market rate fees received by Universal Title Company under the Title and Closing Services Agreement. The termination of one or both of these agreements would have a material adverse effect on the Partnership and its operations.

I. State Licensing Requirements. In the State of Minnesota each title agency is required to be licensed to issue title insurance. In addition, the State of Minnesota through the Department of Commerce (the "Department") requires that an individual acting for each agency be licensed. The underwriter appoints an individual as an authorized agent able to conduct business on behalf of the underwriter. The Partnership is a licensed title agency by the State of Minnesota and also employs a properly licensed staff person. The failure to maintain such licenses would have a material adverse effect on the Partnership.

J. Limitation on Liability of the General Partner to the Limited Partnership; Indemnification of General Partner. While the General Partner of the Partnership is required to act in good faith and with integrity in managing the affairs of the Partnership, the Partnership Agreement provides that the General Partner will not be liable to the Limited Partners for any act or omission, except in the event of fraud, intentional wrongdoing, or gross negligence. The Partnership Agreement requires the Partnership to indemnify the General Partner against any expenses (including reasonable attorneys' fees), claims or liability incurred by the General Partner in connection with the business of the Partnership.

K. Dependence of the Partnership on General Partner. The General Partner will have responsibility for the oversight of the Partnership. The loss of the services of General Partner, for whatever reason, would adversely affect the business operation conducted by the partnership.

L. Capital Contribution. The capital contribution required for the Interests has been established by the General Partner based on its estimate of Partnership capital requirements. There is no assurance that the Partnership will not need additional capital to conduct its operations.

M. Government Regulation. The title services industry in which the Partnership conducts its operations, is subject to extensive and rigorous government regulation. The Partnership is subject to the laws of the United States and Minnesota and the rules and regulations promulgated and enforced by various government departments and agencies, including HUD.

There is no assurance that the Congress of the United States will not enact amendments to RESPA that would adversely affect the Partnership and its operations. Similarly, there is no assurance that HUD, which has the authority to promulgate administrative rules and regulations interpreting RESPA, will not adopt rules and regulations or interpretations of RESPA that would adversely affect the Partnership and its operations. In addition, a court of law or administrative judge may interpret RESPA, and the administrative rules and regulations governing RESPA, in a way that may adversely affect the Partnership and its operations.

USE OF PROCEEDS

The proceeds to the Partnership from the sale of the Maximum number of Interests offered hereby, including the General Partner's capital contribution, will be approximately $21,875, less approximately $1,000 in expenses. The Partnership intends to use the proceeds from this Offering as initial working capital to operate the Partnership. Based on the experience of the General Partner and the General Partner's parent Company, Universal Title Company, the General Partner believes that the maximum proceeds are sufficient to allow the Partnership to operate its business.

	Maximum	
	Amount	Percentage of Gross Proceeds
Gross Offering Proceeds	$21,875	100%
Less Expenses:		
Organizational and offering expenses	$1,000	4.5%
Net Offering Proceeds	$20,875	95.5%
Less fees paid to General Partner or others to set up business (1)	—	—
Reserves	—	—
Amount Available for Investment	$20,875	95.5%

(1) The General Partner pays certain fees and expenses for services rendered to organize the Partnership. Such fees and expenses are recovered by the General Partner from its 20% interest in the profits of the Partnership, but are not paid from the capital of the Partnership or from proceeds of this Offering.

The General Partner will have authority to vary such expenditures without approval of the variances from the Partners. Pending utilization of the proceeds of this Offering, the General Partner may invest such proceeds on behalf of the Partnership in short-term investment grade securities.

GENERAL PARTNER
COMPENSATION TABLE

This table discloses all the compensation the General Partner or its affiliates may be paid directly or indirectly.

Name of Entity Receiving Compensation	Amount of Compensation and Services Provided
General Partner	Reimbursement for organization and offering expenses $1,000
General Partner	20% of distributions based on 20% ownership interest in Partnership.
Universal Title Company	Market rate fees charged for providing closing services pursuant to the Title and Closing Services Agreement. Universal Title Company charges the same rates as it charges to others, including other limited partnerships.
First American	First American receives 25% of underwriting commissions charged for issuing title insurance commitments and policies. The commissions charged are rates authorized and approved by the State of Minnesota. The 75% balance of such commissions is retained by the Partnership.

CAPITALIZATION

The following table summarizes the Partnership's General Partners and Limited Partners' Interests currently outstanding and as adjusted for the sale of all of the Interests offered hereby:

		As adjusted for Offering(1)
	Actual	Maximum
General Partner's Capital Contribution	$4,375	$ 4,375
Limited Partners' Capital Contributions ($500 per Interest)	-0-	17,500
Total Capitalization	$4,375	$21,875

(1) Does not include expenses the Partnership may incur in conducting the offering, including attorney fees, printing expenses and registration fees estimated to be approximately $1,000.

DILUTION

The Partnership Agreement provides that the General Partner shall maintain a 20% ownership interest in the Partnership. The General Partner will make an additional capital contribution to the Partnership each time a new Limited Partner is admitted, equal to 20% of the capital contribution from the new Limited Partner. In like manner, the General Partner will receive a distribution of 20% of the redemption payment to each limited partner who withdraws from the Partnership, in order to maintain a 20% interest in the Partnership at all times. Limited Partners are not obligated to make additional contributions to the Partnership, except as the General Partner and Limited Partners agree in writing.

BUSINESS OF THE LIMITED PARTNERSHIP

General

Diamond Title Services, Limited Partnership was established on January 25, 1999, as a Limited Partnership under Minnesota law. Universal Partnerships, Inc. ("Universal" or the "General Partner") is the sole general partner of the Partnership. The General Partner is incorporated in Minnesota and is a wholly owned subsidiary of Universal Title Company. Universal Title Company is a title insurance underwriter licensed to do business in Minnesota.

Diamond is a title insurance agency that provides title and real estate closing services primarily to residential home buyers and sellers in the Minneapolis and St. Paul metropolitan area and surrounding counties. In its capacity as a title insurance agent, Diamond performs all the functions and services necessary to obtain an underwritten commitment for a title policy. Diamond conducts the title exam, determines the insurability of title to particular parcels of property, prepares title commitments, resolves any underwriting obligations or conditions prior to issuance of the policy and issues the final policy. If necessary, Diamond orders abstracts from a number of different vendors. The title premium paid by the insured for the title insurance policy and Diamond retains a portion of the premium as a fee for its services. The remaining portion of the premium is paid to the title insurance underwriter. Diamond currently serves as an agent for First American under the terms of an Agency Contract which is terminable by either party on 30 days written notice.

Diamond contracts with Universal Title Company, a wholly owned subsidiary of First American Title Insurance Company, a national title insurance company ("First American") for closing services pursuant to a Title and Closing Services Agreement. Diamond also contracts with other contractors to provide a variety of other ancillary real estate services, including abstracting, name searches, plat drawings and real estate assessments. Diamond passes the outside contractor's invoice for these services rendered to Universal Title Company, who collects the fees at closing and without mark-up, forwards such fees to the outside contractors for their services.

The General Partner is currently serving as the general partner in approximately 18 other limited partnerships. These limited partnerships serve as vehicles for delivering title services to home buyers, who often rely on a recommendation from a real estate agent or mortgage loan officer to select a provider of title and related real estate services. The General Partner believes that title agencies such as the Partnership, can deliver quality title services to the clients of real estate agents and mortgage loan officers and other real estate professionals and that such persons are the best means of educating the consumers of such services and about the services to be offered by the Partnership.

Overview of Title Insurance Industry

Title insurance has become increasingly accepted as the most efficient means of determining title to, and the priority of interests in, real estate in nearly all parts of the United

States. Today, most real property mortgage lenders require their borrowers to obtain a title insurance policy at the time a mortgage loan is made.

Title Policies

Title insurance policies are insured statements of the condition of title to real property, showing priority of ownership as indicated by public records, as well as outstanding liens, encumbrances and other matters of record, and certain other matters not of public record. Title insurance policies are issued on the basis of a title report, which is prepared after a search of the public records, maps, documents and prior title policies to ascertain the existence of easements, restrictions, rights of way, conditions, encumbrances or other matters affecting the title to, or use of, real property. In certain instances, a visual inspection of the property is also made. To facilitate the preparation of title reports, copies of public records, maps, documents and prior title policies may be compiled and indexed to specific properties in an area. This compilation is known as a "title plant."

The beneficiaries of title insurance policies are generally real estate buyers and mortgage lenders. A title insurance policy indemnifies the named insured and certain successors in interest against title defects, liens and encumbrances existing as of the date of the policy and not specifically excepted from its provisions. The policy typically provides coverage for the real property mortgage lender in the amount of its outstanding mortgage loan balance and for the buyer in the amount of the purchase price. Coverage under a title insurance policy issued to a real property mortgage lender generally terminates when the mortgage loan is repaid. Coverage under a title insurance policy issued to an owner generally terminates upon the sale of the insured property unless the owner carries back a mortgage or makes certain warranties as to the title.

Unlike other types of insurance policies, title insurance policies do not insure against future risk. Before issuing title policies, title insurers seek to limit their risk of loss by accurately performing title searches and examinations. The major expenses of a title company relate to such searches and examinations, the preparation of preliminary reports or commitments and the maintenance of title plants, and not from claim losses as in the case of property and casualty insurers.

The Closing Process

Title insurance is essential to the real estate closing process in most transactions involving real property mortgage lenders. In a typical residential real estate sale transaction, title insurance is generally ordered on behalf of an insured by a real estate broker, lawyer, developer, lender or closer involved in the transaction. Once the order has been placed, a title insurance company or an agent conducts a title search to determine the current status of the title to the property. When the search is complete, the title company or agent prepares, issues and circulates a commitment or preliminary title report ("commitment") to the parties to the transaction. The commitment summarizes the current status of the title to the property, identifies the conditions, exceptions and/or limitations that the title insurer intends to attach to the policy and identifies items appearing on the title that must be eliminated prior to closing.

- The closing function is often performed by an independent real estate closer, an attorney or by a title insurance company or agent (such person or entity, the "closer"). Once documentation has been prepared and signed, and mortgage lender payoff demands are in hand, the transaction is "closed." The closer records the appropriate title documents and arranges the transfer of funds to pay off prior loans and extinguish the liens securing such loans. Title policies are then issued insuring the priority of the mortgage of the real property mortgage lender in the amount of its mortgage loan and the buyer in the amount of the purchase price. The time lag between the opening of the title order and the issuance of the title policy is usually between 60 and 90 days.

Issuing the Policy: Direct vs. Agency

A title policy can be issued directly by a title insurance underwriter or indirectly on behalf of a title insurance underwriter through agents which are not themselves licensed as insurers. Where the policy is issued by a title insurance underwriter, the search is performed by or at the direction of the underwriter, and the entire premium is collected and retained by the underwriter. Where the policy is issued by an agent, the agent performs the search, examines the title, issues the final policy, collects the premium and retains a portion of the premium. The remainder of the premium is remitted to the underwriter as compensation for bearing the risk of loss in the event a claim is made under the policy. The percentage of the premium retained by an agent varies from region to region. A title insurance underwriter is obligated to pay title claims in accordance with the terms of its policies, regardless of whether it issues its policy directly or indirectly through an agent.

Premiums

The premium for title insurance is due and earned in full when the real estate transaction is closed. Premiums are generally calculated with reference to the policy amount. The premium charged by a title insurance underwriter or an agent is subject to regulation in most areas. Such regulations vary from state to state.

Because the policy insures against matters that have occurred prior to its issuance (rather than future occurrences, as with most other types of insurance), the major portion of the premium is related to the service performed in ascertaining the current status of title to the property.

<u>Business of the Partnership</u>

Diamond is a title insurance agency that provides title and real estate closing services primarily to residential home buyers and sellers in the Minneapolis and St. Paul metropolitan area and surrounding counties and St. Cloud and Duluth. In its capacity as an agent for a title insurance underwriter, the Partnership provides the following services for customers who select the Partnership as their title insurance agency:

- Diamond opens an order for the title policy and requests the necessary abstract or search information. It orders these services from a variety of licensed independent contractors.

- Diamond examines the abstract and other title information furnished by the contractor and any other title information available to the Partnership's examiner.

- Diamond examines title according to customary practices and procedures and in compliance with First American's instructions concerning safe underwriting practices.

- Diamond issues title commitments and final policies of title insurance based on its examinations.

- Diamond contracts with Universal Title Company to furnish necessary closing services.

Diamond collects the title premium paid by the insured for the title insurance policy and retains a portion of the premium as a fee for its services. The remaining portion of the premium is paid to the title insurance underwriter. Diamond currently serves as an agent to First American under the terms of an Agency Contract which may be terminated by either party on 30 days written notice. In addition to the Title Insurance premium, Diamond charges the customer an examination fee for performing the title exam.

Diamond contracts with Universal Title Company for closing services pursuant to a Title and Closing Services Agreement. Diamond also contracts with other contractors to provide a variety of other ancillary real estate services, including abstracting, name searches, plat drawings and real estate assessments. Diamond passes the outside contractor's invoice for title services rendered to Universal Title Company, who collects the fees at closing and without mark-up, passes such fees to the outside contractors for their services.

Operating Experience of the General Partner

First American formed the first title services limited partnership in 1994. Universal Title Company, a wholly owned subsidiary of First American, formed and served as the general partner in subsequent limited partnerships. The General Partner, a wholly owned subsidiary of Universal Title Company, has assumed Universal Title Company's position as the general partner in all the other limited partnerships and currently serves as general partner in approximately 18 other limited partnerships. These limited partnerships have been established to serve as vehicles for delivering title services to home buyers, who often rely on a recommendation from a real estate agent or mortgage loan officer to select a provider of title and related real estate services. The General Partner believes that title agencies, such as the Partnership, can deliver quality title services to the clients of real estate agents and mortgage loan officers and other real estate professionals and that such persons are the best means of educating the consumers of such services and about the services to be offered by the Partnership.

Employees

The Limited Partnership employs a full-time title examiner. The title examiner performs the core title services and is responsible for managing the daily operations of the Partnership. If needed, additional staff will be hired as appropriate, including a title agency production assistant and title agency clerk.

Competition

The title insurance business is highly competitive. However, unlike many industries, where consumers have a wealth of information to make choices among services providers, the title insurance industry competes by obtaining client recommendations from different sources in the real estate industry. Home buyers and sellers often use a particular title company because of a recommendation from their real estate agent or mortgage loan officer, and they typically follow this recommendation. Relatively few consumers actively comparison shop for a title company based upon price and service. As a result, the Partnership's success is highly dependent upon generating recommendations from sources in the real estate industry. There is no assurance that the Partnership will be able to generate sufficient recommendations to be profitable.

The Partnership will compete with many other title insurance companies in the Minneapolis, St. Paul metropolitan area. Many of these companies are affiliated with local real estate companies that are able to refer customers to such title companies for title services. The Partnership's major competitors in the Twin Cities include Burnett Title, Edina Title, Chicago Title Insurance Company, Old Republic Title Insurance Company and ATI Title Company.

Federal Regulation

The Department of Housing and Urban Development published final regulations under the Real Estate Settlement Procedures Act ("RESPA") on November 2, 1992 and published certain revisions on March 26 and June 7, 1996. RESPA is a federal law designed to reduce inflated and unwarranted title insurance and settlement costs, to give consumers a better understanding of the home purchase and settlement process; and to allow the consumer adequate opportunity to shop for real estate services, including title services. In addition, this law is designed to prevent kickbacks and fee splitting by the parties which are involved in providing services relating to home purchases and the settlement process. RESPA is enforced by the Department of Housing and Urban Development, which has the power (i) to seek an injunction against violators; (ii) to seek a $10,000 fine against any entity or individual involved in a violation of RESPA; (iii) to seek criminal penalties of up to one year imprisonment against violators; (iv) to seek restitution for the home buyer of an amount up to three times the settlement charge resulting from the unlawful activity; (v) to recover all profits made as a result of the illegal activity; (vi) to ban any person involved in any illegal activity under RESPA from further participation in any FHA program; (vii) to impose civil penalties of double damages, plus $5,000 for false statements or claims in connection with any FHA mortgage insurance issued in violation of RESPA; and (viii) to withdraw FHA approved mortgagee status for any mortgage brokers or other lenders who violate RESPA.

Although RESPA does not apply to all real estate transactions, it is the Partnership's policy to require that all Limited Partners must adhere strictly to the requirements of RESPA because the situations in which RESPA will not apply are expected to be rare and difficult to ascertain with any certainty.

The basic prohibition contained in RESPA is very broad:

> "No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or part of real estate settlement services involving a federally related mortgage loan shall be referred to any person . . . . a payment or thing of value includes any payment, advance, fund, loan, service or other consideration [and may] take many forms, including, but not limited to monies, things, discounts, salaries, commissions, fees, duplicate payments of a charge, stock, dividends, distributions of partnership profits, franchise royalties, credits representing monies that may be paid at a future date, the opportunity to participate in a money-making program, retained or increased earnings, increased equity in a parent or subsidiary entity, special bank deposits or accounts, special or unusual banking terms, services of all types at special or free rates, sales or rentals at special prices or rates, lease or rental payments or reduction in credit against an existing obligation".

Notwithstanding the foregoing prohibitions, RESPA establishes a permitted form of "controlled business arrangement" under which service providers may own an equity interest in an entity which furnishes title, settlement or other services to a customer if the following requirements are satisfied:

1. Any person who makes a recommendation to a company in which the person has an equity ownership interest must disclose that relationship in writing.
2. The customer cannot be required to use any particular provider of insurance or other settlement services.
3. The only value that may be received from the entity is bona fide dividends or other equity distributions related to the ownership interests. No payments may be made to such equity owners if there is no apparent business motive for such payment other than distinguishing among recipients on the basis of the amount of their actual, estimated or anticipated recommendations, or if such payments vary according to the relative amount of recommendations by the different recipient, or if the payment is based on any adjustment in the ownership interest which has occurred based on previous relative recommendations by the recipients.

The Partnership believes it has complied with applicable RESPA requirements by providing that the only financial benefits which Qualified Investors will receive from the Partnership are profits to be distributed pro rata, strictly in accordance with the Partners' respective ownership interests outstanding from time to time, regardless of how much business has been referred by each partner receiving a distribution. In addition, under no circumstances will the Partnership directly or indirectly adjust a partnership interest or otherwise reward or compensate a Limited Partners in any fashion to reflect the amount of business referred by a Limited Partner.

State Regulations

In the State of Minnesota each title agency is required to be licensed to issue title insurance. In addition, the Department requires that an individual for each agency be licensed. This permits the title agent to sell title insurance. The underwriter appoints an individual as an authorized agent able to conduct business on behalf of the underwriter. The Partnership is a licensed title agency by the State of Minnesota. The Partnership also employs a properly licensed staff person.

The premium rates for First American title insurance policies must be filed with and approved with the State of Minnesota's title insurance regulatory authority from time to time. After approval, only then can the Partnership charge the approved premium rates.

Marketing

The Partnership does not conduct any form of advertising. Since it primarily relies on recommendations from real estate agents, mortgage loan officers and other real estate professionals, the Partnership focuses its attention on developing and maintaining relationships with such persons.

Facilities

Based upon the General Partner's experience as the general partner of 17 other limited partnerships, the General Partner anticipates that the Partnership will lease approximately 800 square feet of office space at a cost no greater than $1,000 per month, including expenses. The office space will be strategically located to be accessible to its limited partners and clients and will be large enough to accommodate up to three staff persons.

Litigation

There are no legal proceedings pending or, to the best of the General Partner's knowledge, threatened to which the Partnership is or may be a party. See "Risk Factors - Government Regulations."

MANAGEMENT

General Partner

The General Partner of the Partnership is Universal Partnerships, Inc., a wholly owned subsidiary of Universal Title Company, which is a wholly-owned subsidiary of First American. First American believes it is one of the largest title insurance underwriters in the United States based on gross title fees. Universal Title Company traces its title services business in Minnesota to the late 1970s. Universal Title Company has long established relationships with many lending institutions, law firms, real estate companies, home builders, and real estate developers, as well as other independent closing companies.

Duties of the General Partner

The General Partner's duties include: (i) coordinating this Offering; (ii) executing the Partnership Agreement and filing the Partnership Agreement with the State of Minnesota; (iii) locating suitable office space in the community for lease by the Partnership (which is separate from the space utilized by the General Partner for its own business; (iv) securing the necessary licensing and errors and omissions insurance; (v) obtaining necessary outside accounting services (which are different from the services utilized by the General Partner for its own business); and (vi) interviewing and causing the Partnership to hire its initial staff. The General Partner supervises the Partnership's staff to maintain an efficient, well-managed operation and acts as a liaison between the Partnership and its vendors, including the underwriter. The General Partner also facilitates the monthly profit distributions; convenes quarterly Limited Partner meetings; and provides examiner training and continuing education sessions to the Partnership's staff.

Although the General Partner performs the foregoing management functions, the day-to-day operations of the Partnership and all core title services functions are conducted by the Partnership's employed staff.

Fiduciary Responsibility of the General Partner

The General Partner is accountable to each Limited Partner as a fiduciary, which means that the General Partner is required to exercise good faith and integrity in dealings with respect to Partnership affairs. This is in addition to the several duties and obligations of the General Partner set forth in the Partnership Agreement. See "Relationships Among Certain Parties." Each Limited Partner may inspect the Partnership books and records at any time during normal business hours upon notice to the General Partner.

The General Partner may not be liable to the Partnership or the Limited Partners for certain acts and omissions to act, since provision has been made for such liability in the Partnership Agreement only to the extent of fraud, intentional wrongdoing and gross negligence. With respect to acts and omissions which do not amount to fraud, intentional wrongdoing or gross negligence, the Partnership Agreement provides for indemnification of the General Partner (and its officers and directors). Insofar as indemnification for liabilities arising under the

Securities Act of 1933, as amended (the "Act") may be provided to the General Partner pursuant to the language of the Partnership Agreement, or otherwise, the General Partner has been advised that in the opinion of the U.S. Securities Exchange Commission (the "Commission") such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable.

It should be noted that the matter of remedies available under state and federal law to limited partners for breach of fiduciary duty by general partners is a rapidly developing and changing area of law. Any Limited Partner who believes that a breach of fiduciary duty by the General Partner has occurred should consult counsel as to the status of the law at such time.

Notwithstanding the fiduciary relationship between the General and Limited Partners, the General Partner has broad discretion and power under the terms of the Partnership Agreement and Minnesota law to manage exclusively the affairs of the Partnership. Generally, the Partnership Agreement provides that the General Partner shall manage the affairs of the Partnership, which are not subject to vote or review by the Limited Partners, except to the limited extent provided in the Partnership Agreement and under Minnesota or other applicable law. An attempt on the part of one or more Limited Partners to exercise substantial influence over the management of the business of the Partnership (other than as permitted under Minnesota law) may result in the loss of that Partner's limited liability. A loss of limited liability would make a Limited Partner jointly and severally liable for the liabilities of the Partnership with the General Partner. See "Organization, Structure and Operation of the Partnership."

CONFLICTS OF INTEREST

Possible Conflicts of Interests

Multiple Interests of the General Partner

The General Partner serves as a general partner for approximately 18 other limited partnerships, all of which conduct the same business as proposed to be conducted by Diamond. The General Partner expects to facilitate formation of other limited partnerships in the future. Investors in this offering are not eligible to participate in any other limited partnership in which the General Partner or its affiliates participates. The General Partner endeavors to provide the same assistance and advice to all the limited partnerships. There is no assurance that all limited partnerships will actually receive the same assistance or that all limited partnerships will actually incur the same benefits from such assistance.

Contracts with General Partner and Affiliates

The General Partner's parent company, Universal Title Company, has entered into a Title and Closing Services Agreement with the Partnership to provide real estate and mortgage closing services for the Partnership at the same market rate as provided to others. This agreement may be terminated at any time by either party upon 90 days written notice. The Partnership has entered into an Agency Contract with First American, whereby the Partnership agrees to prepare and issue title insurance commitments and final policies on behalf of First American for properties located in Minnesota, including the Minneapolis and St. Paul metropolitan area and surrounding counties. The Partnership receives a commission equal to 75% of the rate charged for policies issued on behalf of First American. The Agency Contract is terminable upon 30 days' written notice by either party. The rates for title insurance policies to be quoted and charged are the rates currently approved by the State of Minnesota. In the event that a special risk endorsement is issued, the commission on the rate is negotiated by the Partnership and First American. The General Partner receives no fees, or other compensation for its role as a General Partner, other than its 20% ownership interest in the Partnership and market rate fees charged under the Title and Closing Services Agreement. The termination of one or both of these agreements would have a material adverse effect on the Partnership and its operations.

ORGANIZATION, STRUCTURE AND OPERATION OF THE PARTNERSHIP

Summary of Limited Partnership Agreement

The following is a summary of certain provisions of the Limited Partnership Agreement, the form of which is included as Attachment A. In the event of a conflict or apparent conflict between such description and the full text of the Limited Partnership Agreement, the full text will control. References are to Articles of the full Limited Partnership Agreement.

(a) Partnership Interests. The General Partnership Interest of the Partnership shall represent a 20% Percentage interest in the Partnership at all times. The Limited Partnership Interests of the Partnership shall represent a 80% Percentage interest in the Partnership. See Article 2.1(a).

(b) Capital Contributions. The General Partner has made a capital contribution to the Partnership in exchange for a 20% General Partner Interest. A Limited Partner's capital contribution is made in exchange for a Limited Partnership Interest. The General Partner shall contribute additional capital to the Partnership from time to time as may be necessary to maintain a minimum balance in its capital account at least equal to 20% of the sum of the total positive capital account balances of all Partners of the Partnership. See Article 2.3(b). The Limited Partners shall never be obligated to make additional contributions to the Partnership except as the General Partner and all the Limited Partners may agree in writing. See Article 2.3(c).

(c) Distributions. The Partnership will make distributions at such times and amount as determined from time to time by the General Partner. The General Partner will distribute each year an amount estimated by the General Partner to be sufficient to pay federal and state income taxes on each Partner's share of the Partnership income which will be included in the Partner's income for income taxes for such fiscal year. See Article 2.4.

(d) Allocation and Distribution of Cash, Profits, Income and Losses. For income tax purposes and financial accounting purposes all items of income, gain, receipt, loss, deduction, and credit of the Partnership for each fiscal year shall be allocated among all the Partners in proportion to such Partners' respective Percentage Interests. See Article 3.1(a). Any economic losses sustained by the Partnership shall be borne by the Partners, to the extent of their respective Percentage Interests. See Article 3.4.

(e) Limited Partners' Liability. Under no circumstances shall any Limited Partner be required to make any additional capital contributions to the Partnership or be personally liable for any liabilities of the Partnership, except to the extent of their respective capital contributions. See Article 3.4.

(f) General Partner's Liability. The General Partner has a fiduciary responsibility to the Partnership for the safekeeping and use of all funds and assets of the Partnership. The General Partner shall not be liable to a Limited Partner for any act or omission performed or omitted, except only in the event of fraud, intentional wrongdoing, or negligence by the General Partner. If certain conditions are met, the Partnership shall indemnify the General Partner against any expenses (including reasonable attorney's fees), claims or liabilities incurred by the General Partner in connection with its duties as the General Partner. See Article 5.12.

(g) Books, Records, and Financial Statements. The General Partner shall maintain accurate and complete books and records of the Partnership at the Partnership's specified office. The Limited Partners shall have the right to inspect, examine, and copy such books and records at any reasonable time. Accurate and complete financial statements shall be prepared promptly as of the end of each fiscal year and copies shall be delivered to the Limited Partners. See Article 4.

(h) Partnership Management. The general management of the Partnership business shall be conducted by the General Partner. See Article 5.1. The Limited Partners have no authority or power to interfere in any manner with the management, conduct or control of the Partnership and have no right or authority to act for or bind the Partnership in any transaction or agreement. Each Limited Partner irrevocably appoints the General Partner such Partner's true and lawful attorney-in-fact with the power of substitution to execute, deliver and file (i) any new amended or restated certificate of limited partnership; (ii) any fictitious names or assumed name certificate; (iii) instruments required to qualify the Partnership to do business in any state other than Minnesota; (iv) any documents necessary to effectuate continuation of the business of the Partnership; and (v) any cancellation of any certificate, instrument or amendment required to be filed. See Article 5.11.

(i) Restrictions on Transferability of Interests. Except as provided in Article 7 of the Limited Partnership Agreement, a Limited Partner may not assign, transfer, or otherwise dispose of any Partnership Interest in the Partnership without prior consent of the General Partner. Article 7.1 provides for the transfer of a Partnership Interest upon the death of a partner. Article 7.4 allows a Partner to transfer his interest, without obtaining prior written consent of the General Partner to such disposition, provided that such transferring Partner shall first give notice to the General Partner of the transferring Partner's intention. The Partnership shall then have an option to purchase all of the transferring Partner's interest in the capital, income, profits, and assets of the Partnership at book value. Book value means the Partnership's net worth (as determined by generally accepted principles) multiplied by the percentage interest to be purchased from a Limited Partner. The decision of whether this option is to be exercised shall be made by the General Partner. If the Partnership does not exercise this option during the period ending 60 days after the General Partner shall have received such notice, the transferring Partner may, at any time within 90 days after the expiration of the 60-day period following delivery of such notice, transfer such interest in the manner and on the terms set forth in the notice given to the General Partner, subject to the federal and state securities laws. Article 7.5 provides for the transfer of a Partnership interest in the event of (i) the insolvency of a Partner, (ii) a Partner's interest in the Partnership is foreclosed upon or sold pursuant to any collateral agreement or otherwise, or (iii) any Partnership interest owned by a Partner is transferred to the Partner's spouse as a part of a divorce settlement agreement. In such event the Partnership shall have the option to purchase the Partnership's interest.

(j) Partnership Option to Purchase Limited Partner's Interests. The Partnership has a continuing option to purchase all, but not part, of a Limited Partner's Interests at book value. Book value means the Partnership's net worth (as determined by generally accepted principles) multiplied by the percentage interest to be purchased from a Limited Partner. The decision as to whether the option is to be exercised is made by the General Partner, in its sole discretion, and no reason need be given or cause shown for exercise of the option. Without limiting the generality of the foregoing, the General Partner may exercise the option if the General Partner determines that a Limited Partner has violated the rules and regulations of RESPA, that the Limited Partner is not a resident of the state of Minnesota; that a Limited Partner is not engaged full-time as a real estate professional; or that the Limited Partner has a conflict of interest with the Partnership. See Article 7.3.

(k) Withdrawal by a Limited Partner. A Partner shall have a continuing right to withdraw from the Partnership. Upon notice of withdrawal, the Partnership shall purchase all of the withdrawing Partner's interest in the capital, income, profits, and assets of the Partnership for book value, unless the General Partner, within 90 days of notice, determines that the Partnership shall dissolve and immediately thereafter elects to wind up and liquidate the Partnership. Book value means the Partnership's net worth (as determined by generally accepted principles) multiplied by the percentage interest to be purchased from a Limited Partner. If the General Partner elects to dissolve the Partnership, settlement shall be made as if the withdrawing Partner had remained a Partner. See Article 7.2.

(l) Dissolution, Winding Up, and Settlement. The Partnership shall not dissolve until December 31, 2047, unless (i) the Agreement specifically directs such result; (ii) the General Partner so determines; (iii) all of the Partners agree to dissolve and wind up and terminate the Partnership; or (iii) an event of withdrawal occurs with respect to a General Partner and there are no remaining General Partners and no replacement General Partner is appointed to serve. See Article 9.1.

Upon an event of dissolution, the Partnership shall expeditiously wind up its affairs. . The Partners shall continue to share income and losses during dissolution, including any gain or loss on disposition of Partnership properties in the process of liquidation. Partnership assets, including proceeds from liquidation, shall be applied in the following order of priority:

(i) To Partnership liabilities owed to creditors other than Partners;

(ii) To Partnership liabilities owed to Partners other than for their interests in capital and income;

(iii) To the distribution to the Partners to the extent of any credit balance in the accounts (other than the capital accounts), if any, being maintained for financial accounting purposes for the Partners;

(iv) To the distribution to the Partners to the extent of any credit balance of the capital accounts, if any, being maintained for financial accounting purposes for the Partners;

(v) To the distribution to the Partners in proportion to their respective Percentage Interests in the Partnership. See Article 9.3.

(m) Amendment of Partnership Agreement. A majority in interest of all of the General Partners of the Partnership shall have the authority to amend the Agreement in any and all respects from time to time by amendment to the Agreement duly executed by them. See Article 10.2.

DESCRIPTION OF INTERESTS OFFERED

The Interests

The Interests being offered constitute limited partnership interests in the Partnership. Investors will have all the rights and obligations of a limited partner as described in the Minnesota Uniform Limited Partnership Act and the provisions of the Partnership Agreement. Investors will have no right to participate in the management or conduct of the Partnership's business and they will have no right to cause the dissolution of the Partnership or to force its liquidation.

Each investor will be entitled to his or her share of profits and income of the Partnership and to his or her allocable share of all items of Partnership income, loss, deduction or credit as determined for income tax purposes as provided in the Partnership Agreement. Limited Partners are not liable to creditors of the Partnership beyond the amount of capital contributed to the Partnership. Investors are not required to make capital contributions in addition to their original subscription amounts.

Limitations on Resale

The Interests are subject to substantial restrictions on transfer or sale as more fully described elsewhere in this Prospectus and the Partnership Agreement. See "Organization, Structure and Operation of the Partnership - Restrictions on Transferability of Interests."

In addition, persons acquiring Interests may not resell or transfer their Interests without registration or exemption from registration under the Act and Laws.

There has been no public market for the Interests prior to this Offering. Accordingly, the required capital contribution for the Interests offered hereby has been determined by the Partnership and should not be considered an indication of the actual value of the Interests. Further, no public market for the Interests will develop. Investors must either hold their Interests for an indefinite period of time or exercise the right of withdrawal as more fully described in this Prospectus and the Partnership Agreement. See "Organization, Structure and Operation of the Partnership - Withdrawal of Limited Partner."

Record of Interests

The Partnership will maintain a register of the Interests at its offices, and will record all transfers of Interests thereon. The Limited Partners will be responsible for paying all costs incurred in connection with the transfer of their respective Interests.

OFFERING AND SALE OF INTERESTS

Plan of Distribution

The Partnership, through the General Partner, is offering to sell a maximum of 35 Limited Partnership Interests at a price of $500 per Interest solely to Qualified Investors. See "Offering and Sale of Interests - Investor Qualification Requirements." Each subscriber's per Interest subscription will be due and payable at the time of delivery to the Partnership of an executed Subscription Agreement.

The General Partner is not licensed as a securities broker or dealer under state or federal law. The Partnership has not engaged in prior sales of the Partnership's securities other than the Interests. The General Partner will not receive commissions in connection with the sale of the Interests offered hereby. Persons authorized to solicit Qualified Investors for the Company must be licensed title insurance agents who (i) offer memberships only to persons who satisfy the Qualified Investors standard in this Prospectus and (ii) refrain from giving investment advice relative to any matter other than acquiring a membership interest in the Company.

The offering of Interests will terminate on the earlier of the following: (i) the sale of the maximum number of Interests; or (ii) on any date prior to completion of the offering as the General Partner deems appropriate.

The Partnership shall indemnify the General Partner against any expenses (including reasonable attorneys' fees), claims or liabilities incurred by the General Partner in performing its duties as General Partner, or in connection with the business of the Partnership; provided however, that such indemnification shall not apply in the event of fraud, intentional wrongdoing, or gross negligence by the General Partner.

Investor Qualification Requirements

The Interests are being offered only to persons who are experienced full-time professional real estate services providers with at least two years of experience, such as licensed real estate brokers or agents, mortgage loan officers, real estate builders and developers, and title services professionals ("Qualified Investors"). The Interests are offered to Qualified Investors pursuant to an exemption from the registration provisions of the Act. Qualified Investors must be residents of the state of Minnesota and must not have a present intention to be a resident of any other state.

The Partnership may consider other criteria from time to time in determining eligibility for investing in the Partnership. The Partnership has no obligation to accept any particular person or persons into Partnership and may remove a Partner at any time subject to certain repurchase obligations. See "Organization, Structure and Operation of the Partnership – Summary of Limited Partnership Agreement."

Limited Partners must strictly adhere to the Partnership's policy with respect to RESPA, including disclosing his/her equity position in the Partnership when referring a client to the Partnership for title services.

Subscription for the Interests

Qualified Investors who meet all the qualifications described above and desire to purchase any Interests, must do the following:

(i) complete and sign the Subscription Agreement including Investment Representations (the "Subscription Agreement");

(ii) make a check payable to Diamond Title Services, Limited Partnership in the subscribed amount;

(iii) send the check and executed Subscription Agreement to Diamond Title Services, Limited Partnership, c/o Universal Title Company, 7777 Washington Avenue South, Edina, Minnesota 55439.

The Interests offered hereby are offered by the Partnership, when, as, and if subscriptions are received and accepted by the Partnership and subject to certain other conditions. The General Partner reserves the right to withdraw, cancel or modify this offering and to reject any offer or order in whole or in part, in its sole discretion. In the event a Subscription Agreement is rejected by the General Partner, all funds delivered to the Partnership with such Subscription shall be returned to the subscriber as soon as practicable following rejection, without interest.

Right to Rescind

Investors have the right to rescind their investment in the Partnership, without costs within three business days from the date the Subscription Agreement is executed. See "Attachment E."

SUMMARY OF CERTAIN FEDERAL INCOME TAX MATTERS

It is impractical to comment in detail on all aspects of tax laws affecting the tax consequences of an investment in the Partnership and, consequently, each prospective investor should consult with such investor's tax advisor.

Classification as a Partnership

The General Partner believes that the Partnership will be classified as a partnership for tax purposes because it lacks at least two of the four corporate attributes set forth in applicable IRS regulations. However, the Partnership will not qualify for an IRS ruling as to its partnership classification. See "Risk Factors."

Use of Deductions

Deductions allocated from the Partnership to a Partner may or may not be deductible on such Partner's individual tax return depending upon a number of circumstances, some relating to the Partnership and some relating to the individual Partner. For example, operations of the Partnership may produce portfolio-type income or passive activity-type income/loss depending upon the characterization by the IRS of the Partnership's activities and the relationship of the individual Partner to those activities. Furthermore, the individual circumstances of the Partners will determine whether they are better able to take tax advantage from a portfolio designation or from a passive activity designation.

The impact of a number of tax rules (including the passive activity rules described above, investment interest limitations, basis limitations and at-risk limitations) will severely limit deductible losses. Investors should assume, that during operation of the Partnership, they will be unable to deduct losses in excess of current Partnership income and, in virtually all events, deductible losses will never exceed an investor's cash investment in the Partnership. Furthermore, if any Limited Partner borrows to finance the purchase of a Limited Interest, interest expense incurred in connection with those borrowings will be subject to severe limitations on deductibility.

Taxation of Income

Income of the Partnership will be taxed to the Partners without regard to whether cash is distributed. Accordingly, in certain circumstances, Partners may have tax liability without cash distributions. Investors should assume that all income arising from the activities of the Partnership will be taxed as ordinary income.

Audit and Administrative Matters

The IRS has been giving increasing attention to the audit of limited partnerships. If the Partnership's returns are audited, the individual returns of the Partners are more likely to be audited and, thus, investment in the Partnership may increase the chance of audit of non-partnership items on the individual tax returns of Partners. With respect to Partnership items, audits are conducted at the Partnership level, for which the General Partner will have primary responsibility, although individual Partners will have certain rights to participate or seek review. A variety of penalties under the Code may apply to investment in the Interests if positions taken by the Partnership are successfully challenged by the IRS; these penalties, along with interest on any unpaid tax liability, may aggregate well in excess of 100% of the actual tax owed.

ATTACHMENTS

The Attachments to this Confidential Offering Memorandum are deemed to be a part hereof. See "Additional Materials Available on Request" below for a summary of additional materials which will be made available to offerees, if they so desire, during the course of this offering.

ADDITIONAL MATERIALS AVAILABLE ON REQUEST

The following items are considered material or informative with respect to the Interests being offered hereby, and, upon request made to the General Partner, specifying the items desired, will be made available to offerees during the course of this offering:

1. Form of Agency Contract, between the Partnership and First American Title Insurance Company.

2. Form of Title and Closing Services Agreement, between the Partnership and Universal Title Company.

2221247-1
(1blxb01!.doc)

Exhibit 5

You have a right to

BE MAD!

Given the astonishing number of controlled business relationships that currently exist between real estate companies and title companies, many real estate professionals are profiting unfairly from consumers' lack of knowledge of how much their closing should really cost.

If your real estate professional directs you to an affiliated title company, he or she (or their firm) is likely to be financially rewarded. You will lose the benefit of open market service and pricing. You are also likely to pay $200 – $400* more for your closing than you would with Title One.

Ask your real estate professional to help you shop and compare title companies. You'll find that Title One, the largest independent title company in the Twin Cities, provides the lowest prices, the best title insurance, the most attentive service and the most convenient and attractive offices — without any of the bad stuff. Quite honestly, we can't imagine doing business any other way.

TITLE-1

TITLE INSURANCE & REAL ESTATE CLOSINGS

We make closing a real pleasure!

**on average*

Visit

title-1.com

for a Free Quote

You have a right to

BE MAD!

Given the astonishing number of controlled business relationships that currently exist between real estate companies and title companies, many real estate professionals are profiting unfairly from consumers' lack of knowledge of how much their closing should really cost.

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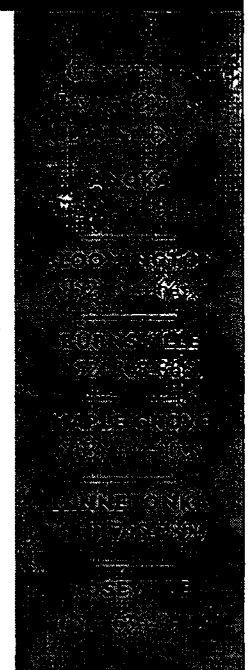


TITLE-1

TITLE INSURANCE & REAL ESTATE CLOSINGS

We make closing a real pleasure!

Visit

title-1.com

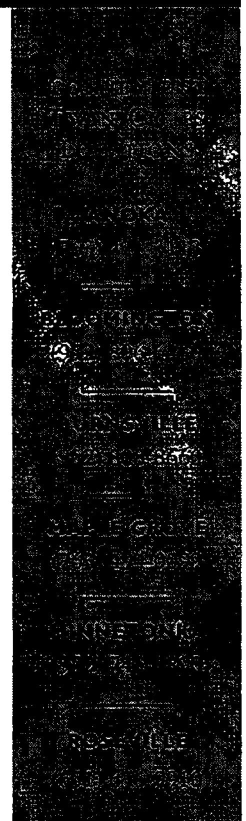
for a Free Quote

**on average*


If your title company didn't
match Title One's *low fees*,
call them and request a refund!
Burnet Title HUD-1 Settlement Statement, 5/05.
But if they did *match our low fees*,
we want to know! Fax your HUD-1 Settlement Statement
to *952-837-0712 today!*
ANOKA
(763) 421-3113
BURNSVILLE
(952) 808-8660
MINNETONKA
(952) 745-7890
BLOOMINGTON
(952) 806-6430
MAPLE GROVE
(763) 494-0099
ROSEVILLE
(651) 636-9910
TITLE 1
TITLE INSURANCE AND REAL ESTATE CLOSINGS
We make closing a real pleasure!

[TOUGH QUESTIONS TO ASK YOUR REAL ESTATE PROFESSIONAL]

"Do you *receive* referral incentives from *your* title company?"



If you're buying or selling a home, be sure to ask your loan officer and real estate agent if they receive referral incentives from their title company.

From there, it's your choice whether you want to pay the high cost of working with people who offer financial rewards for directing clients to their title company. As one of the Twin Cities' only independent title companies, we choose not to pay any kind of referral incentives to real estate professionals, so that we can keep our relationships honest and our prices low. At Title One, we can't imagine doing business any other way.

TITLE-1

TITLE INSURANCE & REAL ESTATE CLOSINGS

We make closing a real pleasure!

Visit
title-1.com
for a Price Comparison and Free Quote

[TOUGH QUESTIONS TO ASK YOUR REAL ESTATE PROFESSIONAL]

"What does the *Affiliated Business Disclosure* form really mean?"

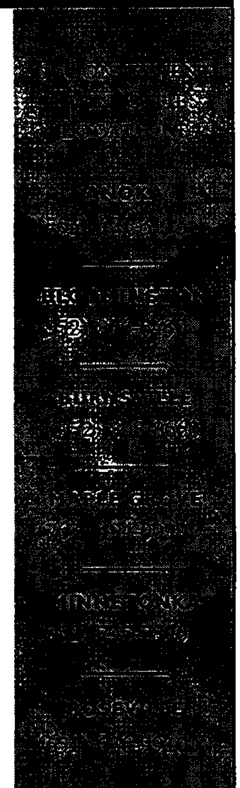
If your loan officer or real estate agent presents you with an Affiliated Business Disclosure form, be sure to ask for an explanation before you sign it.

As you'll discover, this form is used to notify consumers of a business relationship between a real estate professional and a title company that may result in financial or other benefits. At Title One, we believe this also results in higher prices for the consumer. As one of the Twin Cities' only independent title companies, we choose not to pay any kind of referral fees so that we can keep our relationships honest and our prices low. At Title One, we can't imagine doing business any other way.

TITLE-1

TITLE INSURANCE & REAL ESTATE CLOSINGS

We make closing a real pleasure!



Visit title-1.com *for a Price Comparison and Free Quote*

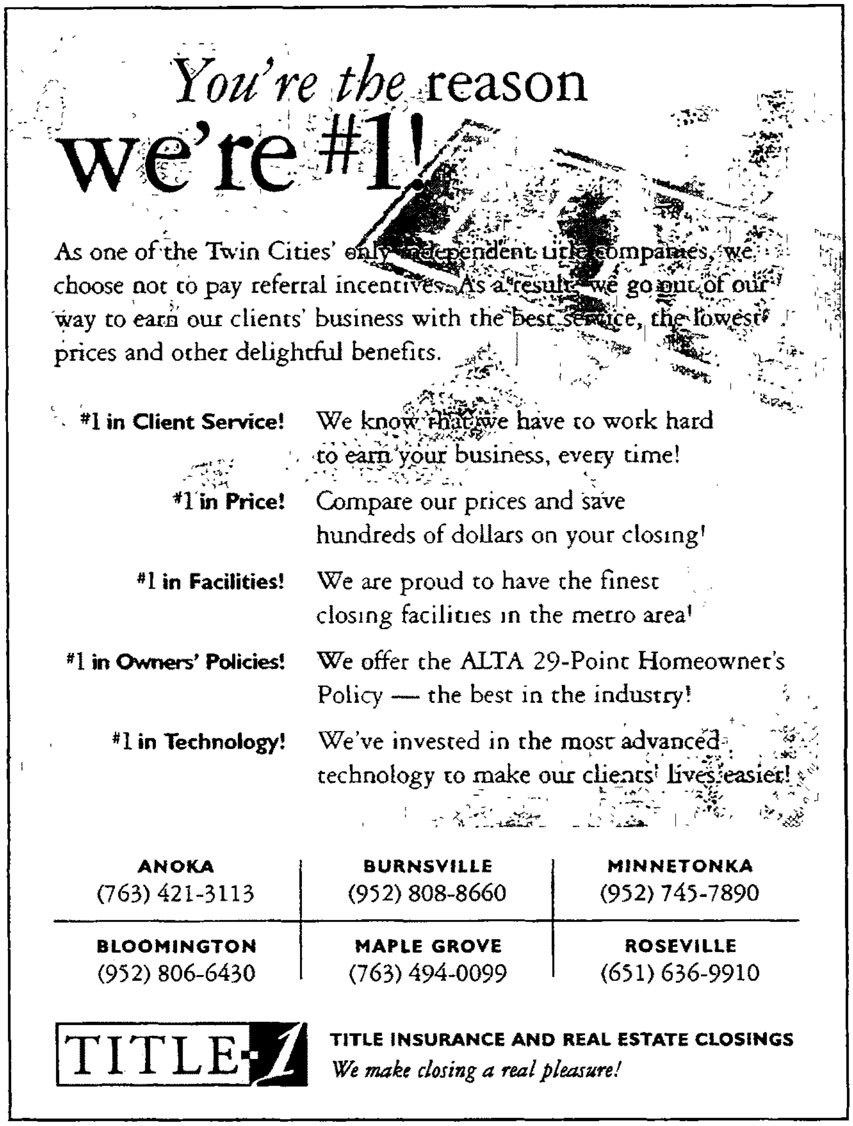

You're the reason
we're #1!
As one of the Twin Cities' only independent title companies, we choose not to pay referral incentives. As a result, we go out of our way to earn our clients' business with the best service, the lowest prices and other delightful benefits.
#1 in Client Service! We know that we have to work hard to earn your business, every time!
#1 in Price! Compare our prices and save hundreds of dollars on your closing!
#1 in Facilities! We are proud to have the finest closing facilities in the metro area!
#1 in Owners' Policies! We offer the ALTA 29-Point Homeowner's Policy — the best in the industry!
#1 in Technology! We've invested in the most advanced technology to make our clients' lives easier!
ANOKA (763) 421-3113
BURNSVILLE (952) 808-8660
MINNETONKA (952) 745-7890
BLOOMINGTON (952) 806-6430
MAPLE GROVE (763) 494-0099
ROSEVILLE (651) 636-9910
TITLE 1
TITLE INSURANCE AND REAL ESTATE CLOSINGS
We make closing a real pleasure!

Exhibit 6

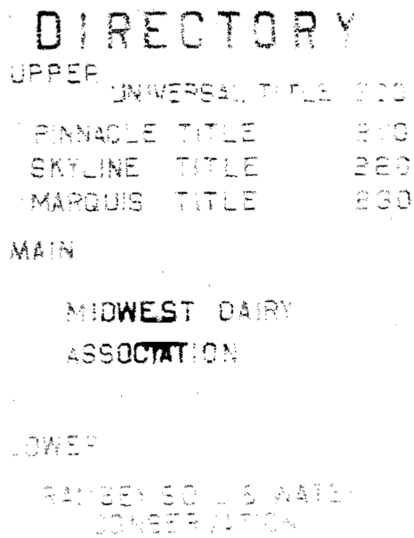

DIRECTORY
UPPER
PINNACLE TITLE
SKYLINE TITLE 220
MARQUIS TITLE 230
MAIN
MIDWEST DAIRY
ASSOCIATION

Exhibit 7

RESPRO®

REAL ESTATE SERVICES PROVIDERS COUNCIL, INC.

Legislative/Regulatory Record On Behalf of Affiliated Businesses

- ***Employee Compensation:*** Successfully supported a 1992 HUD RESPA rule to allow employers to compensate their own employees for cross-marketing performance with affiliated companies, and obtained a moratorium (still in effect) on the implementation of a 1996 HUD rule to overturn the 1992 regulation.
- ***"Safe Harbor" for Affiliated Businesses:*** Successfully supported a HUD RESPA rule to create a "safe harbor" for "affiliated businesses" under RESPA, as opposed to a "rebuttable presumption" that they are illegal.
- ***Consumer Discounts:*** Successfully advocated a HUD RESPA rule to allow settlement service providers to offer consumers discounts when they purchase affiliated services.
- ***Eliminate "Controlled Business" Terminology:*** Successfully advocated 1996 legislation to replace the negatively-charged RESPA term "controlled business" with the term "affiliated business".
- ***"Affiliated Business" Disclosures:*** Successfully advocated legislation enabling affiliated businesses to more efficiently provide the RESPA-required "affiliated business" disclosure by mail, telephone, and electronic means.
- ***Affinity Marketing Legislation:*** Successfully opposed federal legislation to allow payments to affinity marketers for referrals of settlement service business, while leaving all other providers and marketing strategies subject to RESPA's referral fee prohibition.
- ***Consensus Position on "Packaged Services" Legislation:*** The only trade association to develop a cross-industry consensus position on "packaged services" legislation, which is based on the premise that all settlement service providers (i.e., real estate broker-owners, mortgage lenders, home builders, title companies) should be able to offer packaged services directly to the consumer, regardless of their industry or affiliation.
- ***Mortgage Broker Compensation:*** Convinced HUD to drop its longstanding policy of discriminating against "affiliated" mortgage brokers (those affiliated with real estate, home building, or other settlement service providers) in its regulatory treatment of lender-paid mortgage broker compensation.

REAL ESTATE • MORTGAGE • TITLE • HOME BUILDING • INSURANCE • HOME WARRANTY

1090 Vermont Avenue, Suite 800, Washington, D.C. 20005 • Tel: (202) 408-7038 • Fax: (202) 408-0948 • E-mail: respro@erols.com

Please visit our web site at www.respro.org

- ***"Percentage Caps" on Affiliated Title Business Referrals:*** Convinced the National Association of Insurance Commissioners (NAIC) to eliminate a recommended "percentage cap" on the amount of business a title agency can receive from an affiliated real estate, mortgage, or home builder in its State Model Title Agency Code, in favor of an NAIC optional approach toward state affiliated title business regulation.

- ***High Cost Mortgage Legislation:*** Convinced drafters of 2000 federal legislation to lower "high cost" thresholds in the Home Equity Ownership Protection Act (HOEPA) to drop discriminatory language that would not count title and other closing fees towards the "high cost" threshold *unless* the fees are paid to an affiliate. The original language would have made it easier for mortgage originators who use affiliated companies for closing services to meet the "high cost" threshold and be subject to federal term restrictions.

- ***FHA Rehabilitation Loans:*** Convinced the U.S. House of Representatives to amend legislation that would have prevented any mortgage originator from making an FHA rehabilitation loan if an affiliated real estate agaent, property inspector, or appraiser is involved in the transaction.

- ***Resource For State "Affiliated Business" Battles:*** Developed and maintain a comprehensive library of empirical studies, favorable statements by public policymakers, and model state testimony on the consumer benefits of affiliated businesses (one-stop shopping) in the home buying industry for use by RESPRO® members in their state battles against affiliated business restrictions.

Exhibit 8

eba

NATIONAL ASSOCIATION OF
EXCLUSIVE BUYER AGENTS

The Buyer's Voice. The Buyer's Choice.

To: House Financial Services Committee
Sub Committee on Housing and Community Opportunity

The National Association of Exclusive Buyer Agents (NAEBA) joins those who oppose controlled business arrangements (CBA) when promoted by many of the mega Broker as an additional choice for consumers.

Regardless of the service provided by the CBA weather it be Title Insurance, Mortgage Brokerage, Home Inspection, Home Warranty, or any one of the ancillary services provide by those involved in the real estate transaction, providing more choice is not the reason for its existence. The CBA is created as a profit center – PERIOD.

In the past Title Insurance representatives and other service providers have been allowed full access to the sales staff of most brokerages. That meant the representative could stop into any office and speak freely to any agent within the brokerage. This put into play the natural forces projected on an open market place. These representatives were forced to be competitive in both pricing and the level of service provided.

Once a CBA is put in place by a brokerage, the outside unaffiliated service provider, no matter what service they are providing or the cost of such service, is stopped at the reception desk and told they can no longer visit with the agents of the brokerage. This has the effect of narrowing the choices and in fact declaring the service provider which is approved by the brokerage owner for use by the agents within the brokerage.

This happens with every CBA put in place no matter what the service is. Incentives, in one way or another, are in place to make sure the CBA is in fact used by the majority of the agents working for the brokerage as independent contractors. Agents with long tenure and high production levels do not see the pressure to use the CBA in the same way a new agent will feel it. Most new agents are told that if they are going to support the Brokerage they work for, they will use the CBA companies' services. For a brokerage owner who has set up a CBA to say differently stares in the face of reality.

If an agent is in fact acting as a fiduciary, it would be self dealing and an obvious breach of fiduciary duty to accept pressure or incentives in the selection of a Title Company or any other service provider.

These CBA's are set up as profit centers and do NOT encourage competition when in fact the policy adopted by the brokerage cuts off the competition at the front door.

Thomas A. Early
President, NAEBA

Exhibit 9

OFFICE OF THE ATTORNEY GENERAL

State of Minnesota

MIKE HATCH
ATTORNEY GENERAL

ST. PAUL 55155

May 12, 2004

Mr. Douglas R. Miller
President
Title One, Inc.
601 Carlson Parkway, Suite 1140
Minnetonka, MN 55305

Dear Mr. Miller:

I thank you for your e-mail correspondence to Assistant Attorney General Prentiss Cox dated April 21, 2004.

You are the President of Title One, Inc. ("Title One"), an independent title insurance company and residential closer. You believe that various title companies have formed "sham" partnerships with independent real estate agents and loan officers as a means to pay those persons a referral fee in violation of the Real Estate Settlement Procedures Act ("RESPA"). You also believe that various corporations which own both title companies and real estate and/or mortgage affiliates pressure their employees to refer business to the in-house title company and/or provide compensation which essentially amounts to a referral fee for such business.

In your February 13 letter to me on these topics, you asked to have a "round table discussion" with this Office. Mr. Cox and Solicitor General Lori Swanson thereafter met with you on March 10, 2004, and you subsequently spoke with Mr. Cox by telephone. I understand that Mr. Cox and Ms. Swanson encouraged you to pursue your concerns with the federal Housing and Urban Development agency ("HUD") and the state Commerce Department, the two primary regulators in this area. In your April 21 e-mail, you asked for an "official" explanation of why this Office made those recommendations.

This Office has undergone extensive budget cuts. Indeed, it was approximately fifty percent larger in 1999. The vast majority of the lawyers in this Office are required to provide legal assistance to State agencies, and the remaining lawyers (less than 20 percent of the complement) currently have very heavy caseloads trying to address lawsuits that don't relate to state agencies. Among other things, they are tied up trying to track down and civilly commit sexual predators who were erroneously released by the Department of Corrections. They are also attempting to recover money for senior citizens who have been defrauded by prescription drug companies, to save the homes of people who have been targeted by equity stripping schemes, to remove trustees who have pilfered charitable trusts of elderly citizens, to prosecute physical abuse of vulnerable adults, to enjoin the conduct of a manufacturer of defective bulletproof vests sold to police officers and to stop illegal pyramid schemes and other fraudulent sales. In addition, the Office is prosecuting approximately one dozen murder trials in rural Minnesota and about three dozen cases involving methamphetamine dealers. We are also involved in a variety of antitrust investigations on issues ranging from prescription drugs to software to timber sales.

As a result of our limited resources, this Office must prioritize its work. In doing so, we have encouraged constituents with industry grievances that are regulated by other agencies at the state or federal level to pursue them with those regulators. As you know, HUD is the federal agency which acts as the primary enforcer. I understand that you do not believe that HUD has been sufficiently zealous in its enforcement practices. I nevertheless encourage you to file a complaint with that agency as follows:

Minnesota Department of Housing and Urban Development
Stephen J. Gronewold, Chief Counsel
920 Second Avenue South
Minneapolis, MN 55402
Phone: (612) 370-3000
E-mail: www.hud.gov

In addition, the Minnesota Department of Commerce is the primary regulator of title and mortgage companies in Minnesota. You indicate that you have not been impressed with the Commerce Department. Unlike this Office, the Commerce Department is funded and structured to receive and investigate complaints involving the real estate industry. Accordingly, I strongly encourage you to file a complaint with the Commissioner of Commerce, who may be reached as follows:

Commissioner Glenn Wilson
Department of Commerce
85 Seventh Place East, Suite 500
St. Paul, MN 55101
(651) 296-4026

As you probably know, federal law does provide a private right of action for violations of RESPA's anti-referral fee provisions, and plaintiffs may receive damages of up to three times the amount of any improperly-paid amounts, together with costs and attorneys fees. I understand that you were represented at your meeting with Ms. Swanson and Mr. Cox by the law firm of Zimmerman and Reed, a well-known and capable class action litigation firm. At the meeting, your attorney indicated that he had commenced a private lawsuit in federal court involving some of the "sham" partnerships about which you complain, which lawsuit was apparently settled pursuant to a confidentiality order. In addition to filing complaints with the regulators identified above, you may wish to discuss with your attorney the feasibility of bringing another private lawsuit based upon the above allegations.

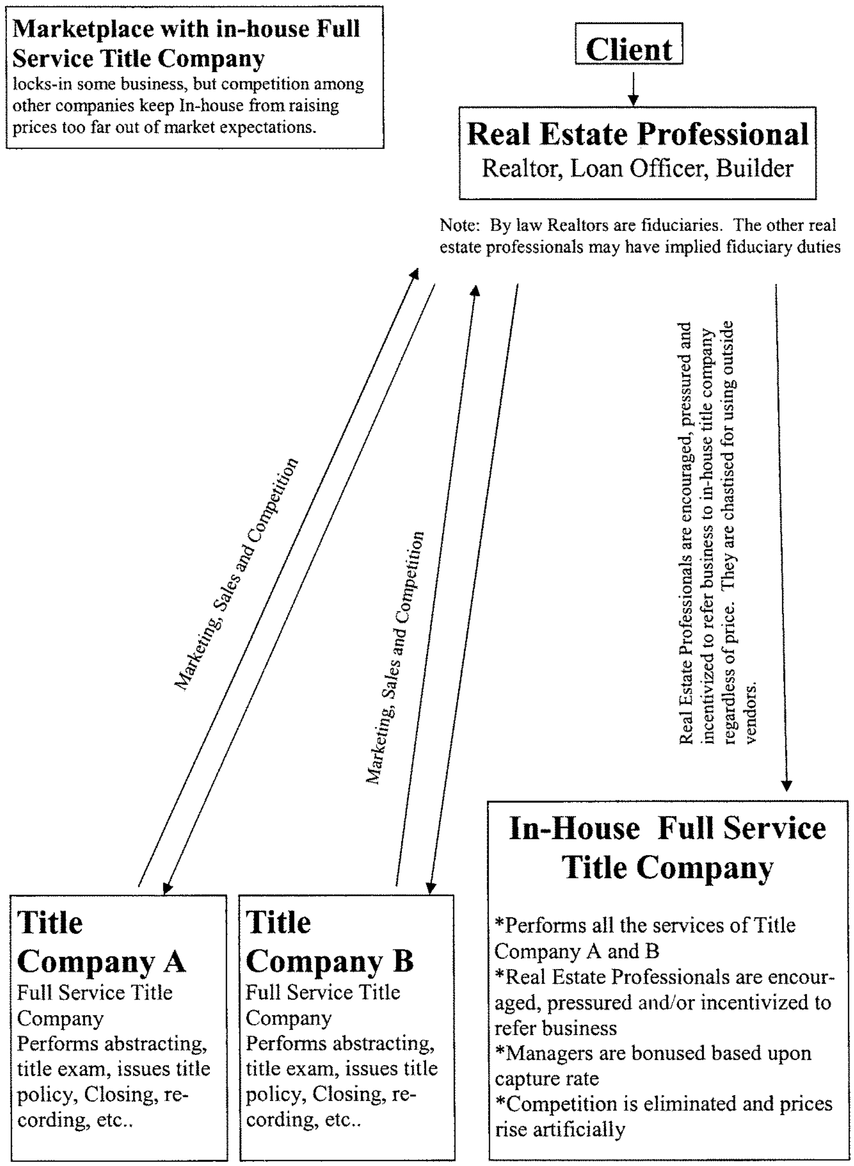
I thank you again for contacting this Office.

Very truly yours,

Mike Hatch

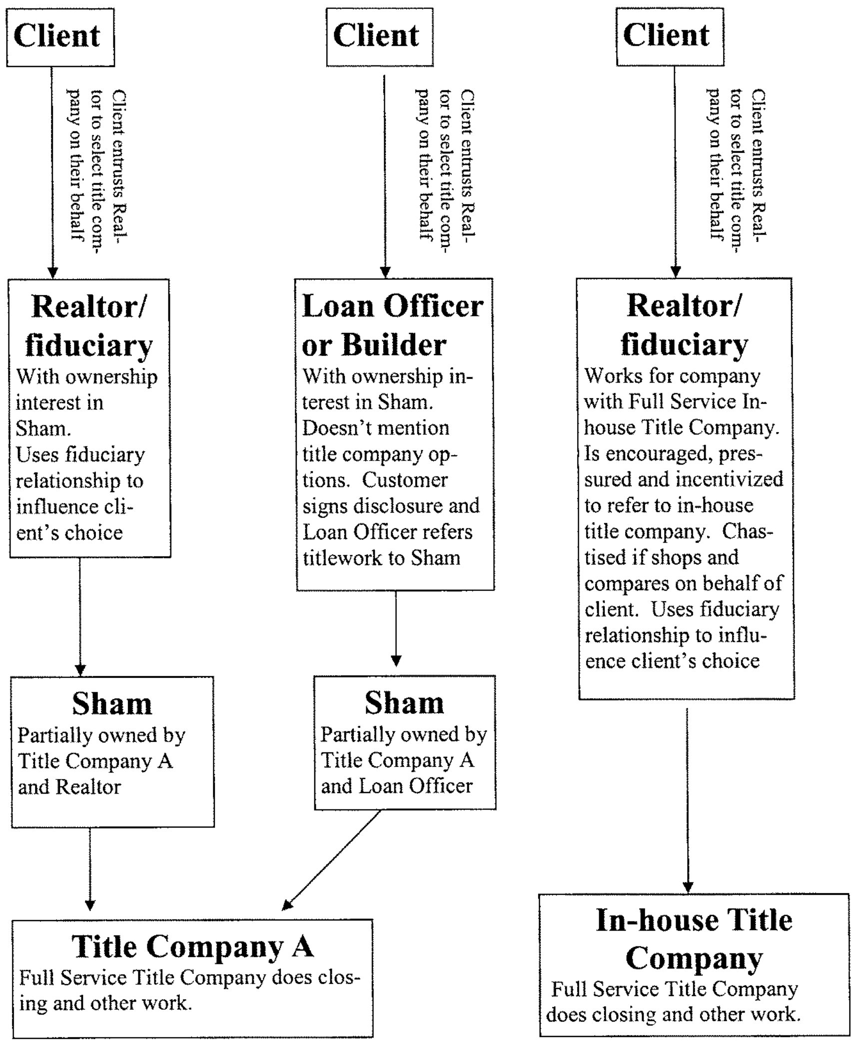
MIKE HATCH
Attorney General
State of Minnesota

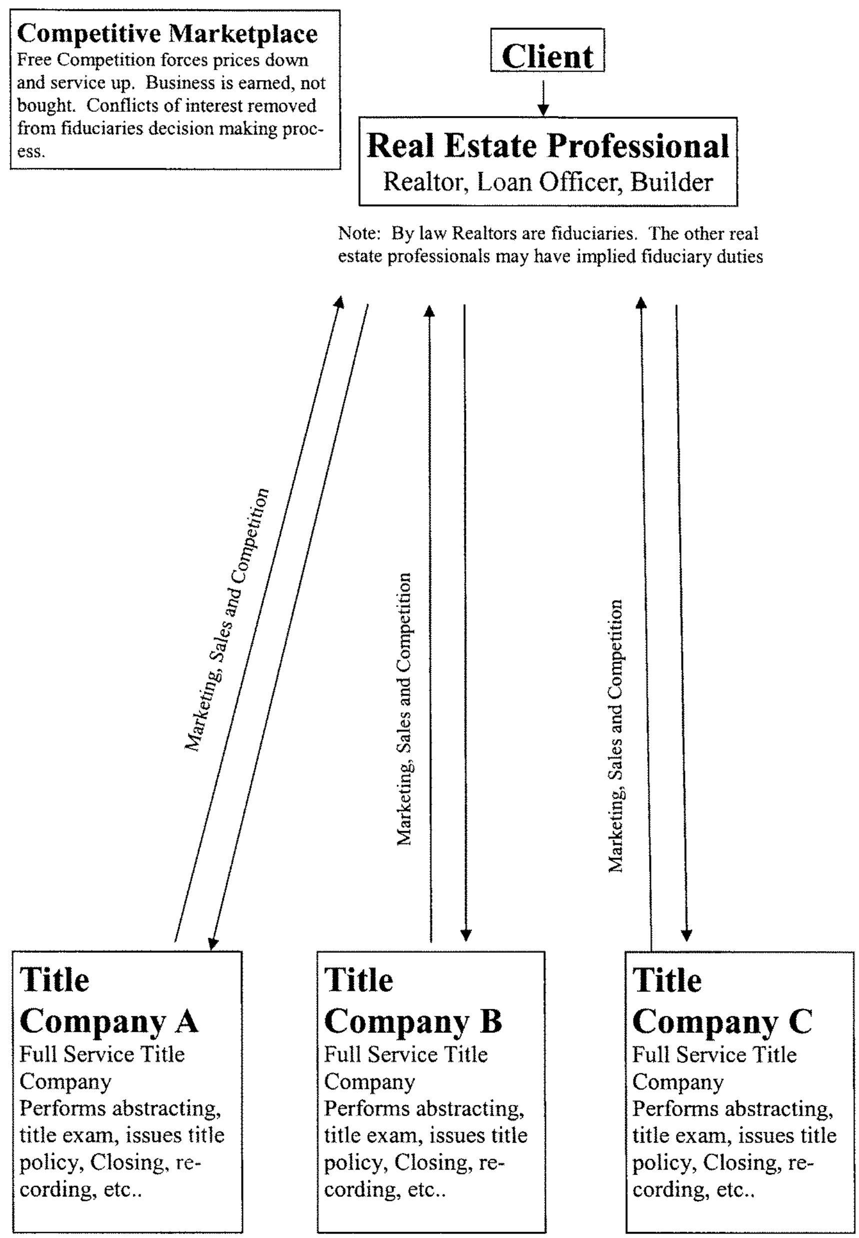
MAH/rlh
cc: Solicitor General Lori Swanson
Assistant Attorney General Prentiss Cox
AG: #1225496-v1

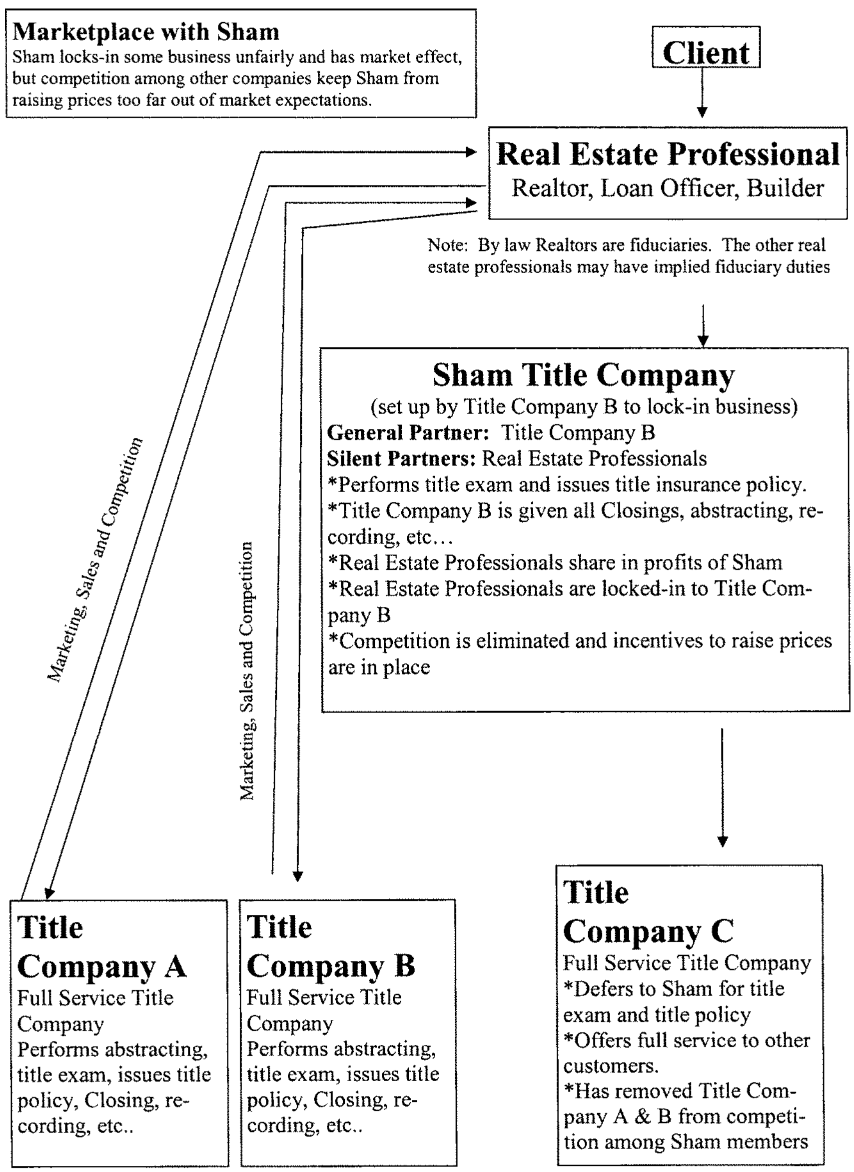

Marketplace with in-house Full Service Title Company
locks-in some business, but competition among other companies keep In-house from raising prices too far out of market expectations.
Client
Real Estate Professional
Realtor, Loan Officer, Builder
Note: By law Realtors are fiduciaries. The other real estate professionals may have implied fiduciary duties
Marketing, Sales and Competition
Marketing, Sales and Competition
Real Estate Professionals are encouraged, pressured and incentivized to refer business to in-house title company regardless of price. They are chastised for using outside vendors.
Title Company A
Full Service Title Company
Performs abstracting, title exam, issues title policy, Closing, re-cording, etc..
Title Company B
Full Service Title Company
Performs abstracting, title exam, issues title policy, Closing, re-cording, etc..
In-House Full Service Title Company
*Performs all the services of Title Company A and B
*Real Estate Professionals are encour-aged, pressured and/or incentivized to refer business
*Managers are bonused based upon capture rate
*Competition is eliminated and prices rise artificially

Marketplace Contaminated With Controlled Business / Minnesota Model

In this scenario competition has been completely removed from the title insurance marketplace. There are no market pressures to control prices and capture rates are near 100%. Incentives to real estate professionals drive entire title company selection process. Hundreds of title companies exist, one for every real estate firm.




Competitive Marketplace
Free Competition forces prices down and service up. Business is earned, not bought. Conflicts of interest removed from fiduciaries decision making process.
Client
Real Estate Professional
Realtor, Loan Officer, Builder
Note: By law Realtors are fiduciaries. The other real estate professionals may have implied fiduciary duties
Marketing, Sales and Competition
Marketing, Sales and Competition
Marketing, Sales and Competition
Title Company A
Full Service Title Company
Performs abstracting, title exam, issues title policy, Closing, recording, etc..
Title Company B
Full Service Title Company
Performs abstracting, title exam, issues title policy, Closing, recording, etc..
Title Company C
Full Service Title Company
Performs abstracting, title exam, issues title policy, Closing, recording, etc..


Marketplace with Sham
Sham locks-in some business unfairly and has market effect, but competition among other companies keep Sham from raising prices too far out of market expectations.
Client
Real Estate Professional
Realtor, Loan Officer, Builder
Note: By law Realtors are fiduciaries. The other real estate professionals may have implied fiduciary duties
Sham Title Company
(set up by Title Company B to lock-in business)
General Partner: Title Company B
Silent Partners: Real Estate Professionals
*Performs title exam and issues title insurance policy.
*Title Company B is given all Closings, abstracting, recording, etc…
*Real Estate Professionals share in profits of Sham
*Real Estate Professionals are locked-in to Title Company B
*Competition is eliminated and incentives to raise prices are in place
Marketing, Sales and Competition
Marketing, Sales and Competition
Title Company A
Full Service Title Company
Performs abstracting, title exam, issues title policy, Closing, recording, etc..
Title Company B
Full Service Title Company
Performs abstracting, title exam, issues title policy, Closing, recording, etc..
Title Company C
Full Service Title Company
*Defers to Sham for title exam and title policy
*Offers full service to other customers.
*Has removed Title Company A & B from competition among Sham members

Real Estate Services Providers Council, Inc.

Written Statement

Of

Arthur Sterbcow

President

Latter and Blum, Realtors

On behalf of

The Real Estate Services Providers Council, Inc. (RESPRO®)

Before the

U.S. House of Representatives

Subcommittee on Housing

On

The Title Insurance Industry: Cost and Competition

April 26, 2006

Good afternoon, Mr. Chairman and members of the Subcommittee. My name is Arthur Sterbcow and I am President of Latter and Blum Realtors, a full service real estate brokerage company headquartered in New Orleans, Louisiana.

Latter and Blum Realtors was founded in 1916 and is headquartered in New Orleans, Louisiana with 28 real estate brokerage offices that engage in real estate sales and leasing in Louisiana and Southern Mississippi. Our firm has over 1000 sales associates and 250 employees, and we closed over 13,000 transactions in 2005.

Latter and Blum offers a full array of mortgage services through our wholly-owned subsidiary, Essential Mortgage Company, which is known under the Real Estate Settlement Procedures Act (RESPA) as an "affiliated business arrangement". We have two other affiliated business arrangements as well – Latter and Blum Insurance Services, which is a joint venture jointly owned by Latter and Blum and Hartwig Moss Insurance Agency; and Essential Title, which is a wholly-owned subsidiary of Latter and Blum.

I. About RESPRO®

Today I am representing the Real Estate Services Providers Council, Inc. (RESPRO®) as a member of its Board of Directors and as its 2006 Vice Chair.

RESPRO® is a national non-profit trade association of approximately 275 residential real estate brokerage firms, mortgage lenders, home builders, title companies, and other settlement service companies (see attached membership list). The bond that unites this diverse membership is that we all offer one-stop shopping for home buyers and owners through affiliated businesses and other strategic alliances across industry lines.

The most common services offered by our members through their affiliated businesses are mortgage, title, and homeowners insurance. As with Latter and Blum, their services are offered either through either wholly-owned companies or through joint ventures that are jointly owned with mortgage lenders, title companies, or other firms that may be RESPRO® members as well.

RESPRO®'s members are not alone in providing one-stop shopping for home buyers and home owners. According to a 2004 study by the independent consulting firm of Weston Edwards & Associates, 88% of the nation's top 350 real estate brokerage firms offered mortgage services in 2004, 66% offered title insurance and closing services, and 42% offered homeowners insurance. In addition, all of the nation's top ten home builders and 76% of the top 11-150 builders offered mortgages to their customers in 2004, and almost all of the top ten builders offered title insurance and closing services and 83% offered title insurance and closing services.[1] These numbers demonstrate the broad level of one-stop shopping that is currently offered across the United States.

II. RESPRO® 's Focus at this Hearing

As you know, Chairman Oxley requested the Government Accountability Office (GAO) to report to Congress on the price of title insurance, competition in the title industry, the relationship between title insurers, realtors, lenders, and home builders, and the purpose and use for captive reinsurance and affiliated business arrangements. My testimony will focus on relationships among title insurers, realtors, lenders, and home builders, but most specifically on affiliated business arrangements.

In RESPRO®'s opinion, affiliated title businesses that comply with RESPA and similar state laws – which I'll refer to in my testimony as 'legitimate' affiliated businesses -- increase competition in the title industry by facilitating entry into the title industry by non-traditional providers such as real estate brokers, home builders, and mortgage lenders. They also provide consumers the benefits of convenience, accountability, and potentially lower costs.

---

[1] "Significant Changes Found and Expected in the Way Houses are Bought and Sold", by Weston Edwards & Associates (March 2004).

Unfortunately, some providers in today's marketplace are violating RESPA and similar state laws by creating 'sham' joint ventures and affiliated business arrangements that are established primarily to evade RESPA's anti-kickback prohibitions. There also continue to be illegal kickbacks involving *both* affiliated and unaffiliated businesses.

RESPRO® has long been concerned about these violations of current law because they make it more difficult for legitimate affiliated businesses to compete, and we have consistently called for strong and fair enforcement of these laws.

We also are concerned that the negative publicity about 'shams' over the past year could make it easy to condemn *all* affiliated business arrangements and in essence throw "the baby out with the bath water". Given the important consumer benefits offered by legitimate affiliated businesses (which we will document in this testimony), it is important to carefully distinguish between legitimate and illegitimate affiliated business arrangements.

II. The Reasons for Creating Legitimate Affiliated Businesses

First, it is critical to understand why legitimate affiliated business arrangements are formed in the marketplace.

- **Convenience:** One reason for forming an affiliated business is, quite simply, is that our customers often prefer to be able get everything they need in one stop or one place rather than make four or five trips all over town.

  The most recent consumer survey of home buyer attitudes towards one-stop shopping of which RESPRO® is aware was a 2004 survey of over 3000 home buyers by the independent consulting firm of Weston Edwards & Associates. In response to the question, "How likely would you be to take advantage of a one-stop shopping service?", 35 percent of home buyers over the previous year said they would 'highly likely' use it, 35 percent said they would 'likely' use it, and 21 percent said they would 'somewhat' likely use it.

Another significant consumer survey in this area was performed in 2002 by Harris Interactive, the parent of Harris Poll. Harris Interactive surveyed 2052 recent and future home buyers and found that 82 percent of home buyers would "strongly" or "somewhat" strongly consider using a one stop shopping service for their home purchase, that 64 percent of home buyers who had recently used one stop shopping programs had a much better overall experience with their home purchase transaction, and that over 90% of home buyers who did not use one stop shopping programs believed that if they had used one, they would have had a better overall home purchase experience because they would have had just one person to contact, they would have saved money if the company offered discounted prices, it would have sped up the home buying process, it would have prevented things from falling through the cracks; and it would have assured one standard level of brand-named service from all providers of the home purchase services. Based on this survey, it appears that many consumers feel that having a single source that is accountable for each settlement service, including title insurance, is preferable to having to independently shop for these services.

- **Accountability and Control:** Affiliated business arrangements often are formed so that we can have some influence and control over the title and closing process for our customers.

Some have criticized the title insurance industry because it is subject to what is called "reverse competition", in which title agents market their services to real estate brokers/agents and/or mortgage lenders rather than consumers. There is nothing wrong with this as long as real estate brokers and lenders have the same interest as the consumers they represent -- to get the transaction done quickly, efficiently and cheaply by a reputable title company.

I have been in the real estate brokerage industry for many years, and do not believe that real estate brokers or agents who don't otherwise receive illegal kickbacks are going to risk their real estate commission or damage their relationship with their customer by recommending that they go to an overpriced, unknown, or disreputable title agency.

In fact, studies by the firm of Weston Edwards & Associates that I referred to earlier have found that realty-based affiliated businesses that are most financially successful over the long term are the ones that have great service and competitive pricing. This is because most real estate agents are independent contractors who are disinclined to recommend the real estate broker's affiliated mortgage or title business -- because if something goes wrong, the customer will blame the real estate agent who recommended the service.

II. The Documented Consumer Benefits and Competition Offered by Legitimate Affiliated Businesses

Over the last 15 years, there have been a number of economic studies documenting the increased competition and potentially lower costs that legitimate affiliated business arrangements have brought to the marketplace.

One of the first of these studies was conducted 1992 by Anton Financial Economics, Inc., which researched the price of a "basket" of title services in the Minneapolis-St. Paul marketplace by sampling 16 firms that together operated 77 offices in the Twin Cities area (70 percent of the offices in the marketplace). Anton also researched title and closing rates in Wichita County, Kansas, before and after the effective date of restrictive legislation that caused real estate broker-owned title companies in the State of Kansas to shut down in 1992.[2] The Anton study reached three significant conclusions:

- Affiliated title companies in the Minneapolis-St. Paul marketplace charged approximately $13 less for a basket of title services than unaffiliated title companies.

- The presence of affiliated businesses in the Minneapolis-St. Paul area has increased competition in the title marketplace -- in 1981, before the emergence of affiliated businesses, there were 8 title companies in the Twin Cities area. In 1992, there were approximately 130-150 title companies in the area, approximately half of which are affiliated businesses.

- After restrictive legislation in Kansas that had been advocated by unaffiliated competitors caused affiliated title companies to close their operations in 1992, the two largest title companies in Wichita County, which had been the most competitive title marketplace, raised their rates 50-60%, depending on the service offered.

In 1994, RESPRO® commissioned a study by Lexecon Inc., a national economic consulting firm specializing the application of economic data to legal and regulatory debates, which analyzed the title and closing costs of over 1000 home sales transactions for both affiliated and unaffiliated title agencies during a one-week period in September 1994. The transactions occurred in seven states -- Florida, Minnesota, Tennessee, Wisconsin, Mississippi, Pennsylvania and California. The study concluded that title services for transactions involving affiliated title companies not only are competitive with those provided by unaffiliated title companies, but actually result in a 2% cost savings.[3]

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[2] "Economic Issues Relating to the Title Industry in Minnesota: Would Further Regulation Be Helpful?", by Anton Economics, Inc.
[3] Economic Analysis of Restrictions on Diversified Real Estate Services Providers, January 3, 1995, Lexecon, Inc.

RESPA's primary regulator, HUD, also has consistently recognized the potential consumer benefits of affiliated business arrangements throughout the years. The following are some of its statements on the issue:

> "Controlled business arrangements and so-called "one-stop shopping" may offer consumers significant benefits including reducing time, complexity, and costs associated with settlements."[4]

> "[T]here is some reason to expect that referrals among affiliated firms may reduce costs to businesses and consumers. Business may benefit from lower marketing costs and the ability to share information on the home purchase or refinancing among settlement service providers. In the long run, any cost savings should be passed on to consumers in most cases. Consumers may benefit additionally from reduced shopping time and related hassles."[5]

> "HUD is aware of only one study that compares prices of settlement services provided by affiliated and non-affiliated firms. RESPRO®, an association of controlled businesses, commissioned a study by an independent contractor, Lexecon, Inc...[The study may be] biased in favor of the unaffiliated firms. Therefore, the [study] results might suggest that affiliated firms on average have lower prices than their competitors."[6]

III. The Regulatory Structure for Affiliated Businesses

While Congress and the Department of Housing and Urban Development (HUD) have recognized the consumer benefits that affiliated business arrangements can provide, they also

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[4] HUD's proposed Real Estate Settlement Procedures Act (RESPA) regulation, 59 *Fed. Reg.* 37360 (July 21, 1994).

[5] HUD Economic Analysis accompanying HUD's June 7, 1996 final Real Estate Settlement Procedures Act (RESPA) regulation governing affiliated business arrangements.

[6] Id.

have recognized that without any regulations or standards, potential consumer abuses might develop as well. Thus, they have enacted a regulatory regime to restrict the abuses but to permit the benefits to flow to the consumer.

In 1983, when Congress first amended RESPA to permit affiliated business arrangements and to allow companies to own more than one settlement service business, it placed three important conditions upon its exemption: (1) anyone referring business to an affiliated provider must provide the consumer at the outset of the relationship with a written disclosure of the nature of his or her financial interest in the affiliate and a range of charges that the affiliate typically charges ; (2) no one can require the consumer to purchase an affiliated service; and (3) the only payments that can be received by a person referring business to an affiliate must reflect a return on ownership interest or other payments permitted under the law -- in other words, there cannot be any payments for referrals of business passing among affiliated providers that are not allowed for anyone else under RESPA.

HUD issued a regulation in 1992 that further provided guidance to affiliated businesses under this statutory framework and expressly permitted discounts to be provided for the purchase of bundled services. In 1996, it also issued what are commonly referred to as 'sham' joint venture guidelines under RESPA that were designed to distinguish 'legitimate' affiliated businesses from shams that were being created to evade RESPA's prohibitions.

RESPRO® supported both HUD's 1992 RESPA regulations governing affiliated business and its 1996 'sham' joint venture guidelines before their publication. In addition, one of our top priorities as the national trade association for affiliated businesses is to educate our members on how to comply with RESPA as they establish and manage their affiliated businesses.

To accomplish this, we publish several regulatory compliance publications for affiliated businesses, their managers, their employees, and their real estate sales associates to help them comply with RESPA and state laws. Recently, we unveiled a comprehensive desktop reference kit on regulatory compliance issues for managers of affiliated businesses. We host numerous regulatory compliance workshops and conferences for affiliated businesses each year, we publish regulatory compliance advice and analyses in our newsletters, and our members have access to a library of regulatory compliance information regarding affiliated businesses through our web site at www.respro.org.

IV. RESPRO® Supports Strong, Fair and Clear Enforcement of RESPA and Similar State Laws

While legitimate affiliated businesses can bring numerous potential consumer benefits and enhanced competition to the title industry, RESPRO® members also see so-called 'sham' affiliated businesses entering our respective marketplaces that not only taint the reputation of legitimate affiliated businesses but also makes it more difficult for us to fairly compete.

In addition, we see illegal kickback in the marketplace such as certain title agents and/or mortgage originators blatantly paying some certain real estate agents for referrals of business. It is frankly frustrating to for companies like mine to devote substantial resources to assuring that our affiliated businesses are in compliance with RESPA and similar state laws and then to observe unknowing or unethical competitors bypassing those protections with clear-cut violations. For this reason, we strongly support HUD's ongoing efforts to bolster its RESPA enforcement resources.

However, we also believe that HUD should offer more clear guidance in some areas of RESPA. For example, HUD 1996 sham joint venture guidelines sometimes are unclear and cause confusion in the marketplace. HUD provided factors that should be considered in distinguishing between legitimate and sham affiliated businesses, then specifically stated that that not all factors need to be satisfied, but ultimately provided little guidance as to which factors are the most important. RESPRO would welcome the opportunity to work with HUD in developing clarifications or examples on certain issues for the industry.

We also support state efforts to enforce RESPA and state laws, and we support state efforts to put more 'teeth' in their state laws to enable them to more effectively curb sham affiliated businesses and illegal kickbacks by both affiliated and unaffiliated title companies.

It is important, however, that states assure that any new laws and regulations in this area are consistent with RESPA, HUD's RESPA regulations, and HUD's 1996 sham joint venture guidelines in order to prevent inconsistent and/or conflicting federal and state standards that could substantially increase legal costs for legitimate affiliated businesses and consequently put upward pressure on title prices to the consumer.

In this regard, RESPRO®'s Colorado Chapter recently worked closely with the Colorado Division of Regulatory Affairs (DORA) and the Colorado legislature to develop a new state law governing affiliated businesses in that state that is modeled after RESPA and which substantially avoided the creation of inconsistent and unnecessary federal and state standards. While the regulatory process to implement this new law is just beginning, we believe that the law itself provides a workable framework that can be a model for other states in the future.

V. Summary

As part of its ongoing study of prices and competition in the title insurance industry, the Committee has asked about relationships between title insurers and realtors, home builders, and mortgage lenders, and specifically about affiliated business arrangements.

RESPRO® believes that during this review process, that it is important that the Committee and Subcommittee recognize that legitimate affiliated businesses that seriously take steps to comply with RESPA and similar state laws have offered documented consumer benefits to the consumer such as convenience, accountability, and potentially lower costs.

These legitimate affiliated businesses are also concerned about 'sham' affiliated businesses in their marketplaces and also about illegal kickbacks by *both* affiliated and unaffiliated providers. Consequently, RESPRO® supports strong enforcement of RESPA and state laws and offers its assistance to Congress, HUD, and state regulatory agencies as they attempt to effectively deal with these practices in the future.

I thank the Committee for this opportunity to testify, and will be happy to answer any questions.

Profile

Arthur Sterbcow
President
LATTER & BLUM Inc., Realtors®

Arthur Sterbcow is a lifelong resident of the New Orleans area.

Arthur entered the real estate industry in 1977, specializing in Residential and Investment real estate.

His experience managing diverse offices and restoring high enthusiasm and morale has been of tremendous value in LATTER & BLUM'S strategy of acquisition and the merging of diverse corporate cultures.

Over the years, Mr. Sterbcow has managed offices in New Orleans East, Lakefront, Kenner, Mandeville, Folsom, Hammond, and Baton Rouge. In 1988, he was appointed Vice President of Residential Sales. His job description was General Manager for all residential offices and commercial sales in outlying branches. During this period, LATTER & BLUM grew to the largest real estate organization in the Gulf South. LATTER & BLUM acquired 16 real estate companies and has expanded to Baton Rouge, Lafayette, and the Mississippi Gulf Coast. On January 1, 1995, he was appointed President of LATTER & BLUM, INC. Since that time, the company has expanded to over $2 Billion in sales and leasing...and the company is still growing under his auspicious leadership.

Mr. Sterbcow's educational background includes attending both Louisiana State University, and the University of New Orleans. He also has the distinction of being one of only two Realtors in the Gulf South and one of a handful in the nation who have achieved the CCIM, CRB, CRS, GRI, ABRM, and ABR designations. He is a member of the Realtor's Land Institute and a licensed instructor for the Louisiana Real Estate Commission.

Over the years, Arthur has been a consultant to numerous developers, businesses, and universities on site selection, market conditions, and real estate research. He has served as President of the MLS of a local board and has served on many committees including Education, Professional Standards, Risk Reduction, with numerous Task Force assignments on behalf of local and state Associations of Realtors and the Louisiana Real Estate Commission.

He was appointed to the Louisiana Real Estate Commission by Governor Mike Foster and has served as Chairman of the Fair Housing Committee and the Education Committee of the Louisiana Real Estate Commission. Additionally, he has served as Education Chairman of the Association of Real Estate License Law Officials.

He has earned many honors for service to the industry and was the first Realtor to receive the Biff Breeding Award, which is the highest accolade that the St, Tammany Association of Realtors can bestow.

Arthur was appointed by former Louisiana Governor Mike Foster to a Property Insurance Task Force to recommend specific programs to the Governor, the Louisiana Legislature, and the State Insurance Commissioner that would expand the availability of insurance, reduce premiums, and increase coverage for consumers. He has also testified before the U.S. House of Representatives Banking Committee on property insurance reform.

Arthur is currently serving on the Louisiana Real Estate Commission, and enjoys strong affiliations with the Louisiana Realtors Association and National Association of Realtors, the latter from which he has earned the Life Membership Award. He is quite active with Realty Alliance, a brain trust of the top 60+ Real Estate Brokers across the nation, and the Chair of the Education Committee for the Association of Real Estate License Law Officials.

While managing the day-to-day operations of LATTER & BLUM, Mr. Sterbcow has found time to focus on various community improvement and outreach efforts as well. He has been instrumental in establishing the LATTER BLUM Endowment Fund to benefit the House of Ruth, a local United Way Agency, geared toward housing for the homeless. He has been a long time supporter of the Urban League of Greater New Orleans, the Preservation Center and Big Brothers/Big Sisters, to name only a few.

Arthur currently oversees all aspects of LATTER & BLUM Companies, including C.J. Brown Realtors® in Baton Rouge, and Essential Mortgage Company.

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Hearing Before The House Financial Services Subcommittee on Housing and Community Opportunity

Entitled

"Title Insurance: Cost and Competition"

Testimony of Thomas M. Stevens, CRB, CRS, GRI President

National Association of REALTORS®, April 26, 2006

Chairman Ney, Representative Waters, and Members of the Subcommittee, thank you for inviting me here today. My name is Tom Stevens, and I am the former President of Coldwell Banker Stevens (now known as Coldwell Banker Residential Brokerage Mid-Atlantic) – a full-service realty firm specializing in residential sales and brokerage. Since 2004, I have served as senior vice president for NRT Inc., the largest residential real estate brokerage company in the nation.

As the 2006 President of the National Association of REALTORS®, I am here to testify on behalf of our nearly 1.3 million REALTOR® members who represent all aspects of the residential and commercial real estate industry. NAR's membership includes more than 300,000 REALTOR® companies. By joining NAR, licensees pledge to conduct their business according to the association's strict Code of Ethics and Standards of Practice. I appreciate the opportunity to share our views on title insurance costs and competition in the marketplace.

Competition in the Title Insurance Industry

NAR believes that the title insurance industry is highly competitive and that this fact is not in serious dispute among real estate services providers. We do not turn a blind eye to anyone, whether it is a policymaker, analyst or media observer, who raises concerns about purported anti-competitiveness in any sector of the real estate services industry. In fact, just a few months ago, the Government Accountability Office (GAO) was asked to analyze competition in the real estate brokerage marketplace and found that the industry has a number of attributes that economists normally associate with active price competition including the large number of relatively small firms that are active throughout the country and the ease of entry into the profession.[1]

While the title companies and their trade associations are in a closer position to discuss the specific aspects of the industry's competitiveness, I would like to make a few observations. Looking at the title insurance industry from a real estate practitioner's perspective, it certainly

[1] U.S. Government Accountability Office, *Real Estate Brokerage: Factors that May Affect Price Competition* (2005).

meets a number of the criteria business analysts consider when examining competition in a particular marketplace. For example, there are many buyers and many suppliers of title insurance; there are limited number of products such as the lenders policy, owners policy informational binder and chain of title, but many different types of settlement services for a consumer to chose from; consumers have access to information on the selection of title companies and services – yellow pages, newspapers, through referrals, property listings, magazines and web sites; relatively low barriers to market entry; and the fact that consumers can shop and compare title insurance rates and settlement service prices. Thus, it seems to me, that with all these factors present to some degree in the title insurance marketplace, it implies that no one player or small group of title companies can significantly impact the overall market and control the price.

NAR does not take a position on the pricing aspects of title insurance because it is regulated at the state level. As you know, some states set minimum rates for title insurance and other title related services and others allow title companies to set their own rates which are filed with the state Departments of Insurance and must be adhered to. But again, speaking for real estate practitioners, we have not seen predatory pricing/rates (cutting prices or rates below costs in order to drive out companies from the market), limit pricing/rates (setting a price low enough to discourage entry), or price/rate discrimination (charging one group of consumers a rate higher than another based on cultural or social factors) in the title insurance marketplace, which if present, are not only unlawful but could be indicative of a concentrated, anti-competitive industry.

My final thought on competition and pricing in the title insurance industry is geared toward those who have questioned why the use of the Internet has not lowered the cost of title insurance as it has done in the selling of airline tickets and other products. Simply, each home has its unique title and history. Each sales transaction requires its own title "chain of title" search, its own title examination and commitment, title policy and settlement/closing. Furthermore, lenders require judgment searches on buyers, who are unique like each home and require individualized attention. The process is complex and time consuming. Because of the risk of liability involved in the transaction, there is no "do-it-yourself" route to issuing title insurance. While one can go on the Internet and literally 10 minutes later have an airline ticket to virtually anywhere in the world, the home purchase transaction and the accompanying real estate related services required for settlement usually necessitate weeks, if not one or two months, of work. It is, therefore, not surprising that an industry which operates on a property-by-property and buyer-by-buyer basis has not seen costs reduced as a result of the proliferation of Internet commerce.

Affiliated Business Arrangements

Real estate professionals interact with title companies in a number of ways. One way brokers and agents work with title companies is via affiliated settlement service providers. As we all know, housing is a high-cost commodity and its sales transaction is a complex matter. Real estate professionals perform significant services for consumers well beyond the traditional duties of matching buyers and sellers. For example, real estate brokers and agents provide guidance to consumers in finding a property, pricing a property, negotiating the best purchase or sales price, arranging inspections, closings and performing a myriad of other tasks that buyers and sellers trust their agent to carry out.

The very unique and often intense services that real estate professionals perform give brokers and agents access to consumers that other real estate-related companies would like to have. In some cases, providers of these services compete for the consumer's relationship; in other cases they cooperate with realty firms. One means of cooperation is through affiliate business arrangements where a person, such as a real estate broker or agent, is in a position to refer settlement business to a settlement service provider, such as a title company, that is owned, in whole or in part, by the referring party. Under this arrangement, the referring party receives no direct payment for the referral to the settlement service provider in which he has an ownership interest, but he can receive indirect compensation based on the financial growth of the affiliated provider.[2] The affiliated business arrangement exemption allows referrals of business to an affiliated settlement service provider if three conditions are met: (1) the relationship is disclosed in writing to the person referred, (2) the person referred is not required to use the affiliate, and

[2] Gardner v. First American Title Insur. Co., 296 F. Supp.2d 1011, 1016-17 (D. Minn. 2003).

(3) the referring party receives payment only in the form of a return on ownership interest (or permissible payment for services rendered).[3]

As a former broker/owner with 39 offices and 200 associates who did have affiliate relationships with real estate related service providers, I can tell you that having such cooperative partnerships was important to the growth of my firm. In my experience, real estate firms that establish joint ventures with title companies do so in order to offer clients the convenience of on-site services, bring efficiency to the transaction, and ensure a smooth and timely closing. I can also tell you that most real estate professionals consider affiliated business arrangements, particularly with title companies and mortgage lenders, an essential component of their future business model for expanding their professional services and profit basis beyond that of traditional brokerage activities. But I always stress to these professionals that entering into such business arrangements is not for the faint at heart for two major reasons: (1) there is no guarantee of financial success; and (2) violations of RESPA Section 8 carry both civil regulatory fines and criminal penalties. In fact, while NAR does not have comprehensive data on nationwide real estate-affiliated title companies, it is my experience in talking with brokers across the country that about 20 percent of real estate professionals have established title company affiliations with an average capture rate (number of transactions completed by the affiliate) generally acknowledged by industry experts at around 30 percent.

To a certain degree, it takes being successful in the business for a number of years before a broker/owner can be financially stable enough to create a new legal entity that performs a *bona fide* service that meets the U.S. Department of Housing and Urban Development's (HUD) "sham" test. For example, one of HUD's "sham" test criteria is that the affiliated business be sufficiently capitalized requires a serious financial investment that many broker/owners might not be in a position to make, especially when it can mean providing enough capital to cover all start-up costs and expenses to operate the business for 90 to 120 days without any income.

Another example that underscores my point about a certain level of business sophistication when it comes to affiliated business arrangements is that the broker/owner should have a good working

[3] 12 U.S.C. § 2607(c).

understanding of services to be performed by the type of entity at issue in order to meet the "substantial services" criteria under HUD's "sham" test, which comes with many years of experience in the industry. For an affiliated title agency, these substantial services are termed "core services" and include: examination and evaluation of title evidence to determine insurability; preparation and issuance of the title commitment; clearance of underwriting objections; preparation and issuance of the title policy; and handling of closing or settlement where the closing is part of an all-inclusive rate. Finally, it takes a very experienced business professional to recognize that creating affiliated business arrangements is in effect structuring an entity qualified to exempt itself from the law and that failure to structure the affiliate company properly or comply with regulatory requirements can mean serious legal and financial consequences. I'll bet that if you ask the average agent if they would be willing to risk going to jail over a referral fee, the answer will be a resounding "no."

On the issue of sham business arrangements or shell companies, I can tell you that real estate professionals are very frustrated with these problematic entities in the marketplace. Furthermore, NAR takes very seriously the implication from some regulators that real estate professionals may be involved in illegal kick-back schemes from these rogue companies. NAR does not condone violations of RESPA, Regulation X or HUD's 10 part "sham" test; rather, we applaud HUD and the state regulators for their increased enforcement effort in this area. NAR has proactively taken steps to remind its members about how HUD determines whether a mortgage or title company is a sham company by issuing compliance guidelines from our legal affairs department. Furthermore, our legal affairs department regularly features RESPA compliance as part of its risk management seminars and its REALTOR® publications. Last year, NAR elevated the importance of RESPA compliance by launching its "RESPA Realities Awareness Campaign," which includes compliance seminars at NAR's Midyear and Annual Governance Meetings; online (webcast) compliance seminars; a one-stop RESPA resource guide on REALTOR.org (www.REALTOR.org/RESPA), and RESPA educational products.

Real Estate Service Recommendations

Another way real estate professionals interact with title companies is via legal referrals of business or customer recommendations. There are approximately 2.5 million real estate professionals licensed by the states (as I mentioned, of which nearly 1.3 million are members of NAR). Nearly all real estate professionals are self-employed independent contractors. These non-salaried entrepreneurs make decisions about marketing plans, professional partnerships, and a host of other independent business decisions.

Like many business professions, reputation is key to the success or failure of a real estate broker or agent. In fact, the reputational factor was recognized by the GAO in their report on real estate brokerage which stated that the industry "has displayed more evidence of competition on the basis of nonprice factors, such as reputation or level of service, than on price."[4] Real estate professionals assist in nearly all aspects of the home purchase transaction by serving as a valuable source of information and offering their expertise to both first-time and experienced home buyers. According to NAR's *2005 Profile of Home Buyers and Sellers*, more than half of first-time homebuyers received a referral for a particular real estate agent compared with over one-third of repeat buyers. The importance of an agent's reputation is also reflected in the fact that 17 percent of repeat buyers chose an agent based on their previous experience with that agent in an earlier home sales transaction. Although buyers consider many factors when choosing an agent, reputation and a positive experience are by far the most important considerations.

The reputational factor is important to today's hearing because, to a certain extent, real estate professionals are involved in the marketing of title insurance and settlement services firms via the brokers' or agents' recommendation of service providers. As we all know, it is illegal for a real estate service provider to pay a broker or agent to be placed on a recommended service provider list. While HUD's visible enforcement of RESPA's Section 8 anti-kickback and referral fee provisions attempts to keep settlement service providers in check, it is the reputational risk, *our livelihood*, which drives compliance among real estate professionals.

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[4] GAO Report at 3, 8-12.

Because clients often seek real estate professionals' recommendations for service providers, it is in their best interest to give multiple recommendations based on the brokers'/agents' experience in working with those firms. Ideally, real estate professionals like to work with and recommend service providers, including title companies and settlement service firms, who are experienced, trustworthy, reliable and committed to providing quality service. If, for example, a home buyer uses one of his real estate agent's recommendations for a settlement agent and that client is dissatisfied with the service he received at or after closing, it reflects poorly on the agent's reputation. And if the agent's reputation is compromised, he not only loses the "customer for life" and likelihood of future business referrals, but may also damage his reputation in the community.

An important point I would like to make regarding client referrals is that, just because a broker has an affiliated title company, you cannot assume agents will automatically recommend the affiliates' service to their clients. This is because the broker/owner has little input as to how real estate agents manage their clientele. Agents are highly motivated individuals who are dedicated to their clients and hope that a high level of customer satisfaction will pay-off via future business referrals. Consequently, the agent's incentive for future business referrals outweighs a broker/owner encouraging an agent to recommend a particular service provider especially if they do not regularly work with that company.

Conclusion

NAR, like many of the trade associations which represent real estate service providers, is greatly concerned about allegations of problems in the title insurance market. We applaud HUD and state insurance commissioners for bringing sunshine to the issue of sham companies and illegal kickbacks. Real estate professionals want to see these rogue companies quickly removed from the marketplace. We are optimistic that HUD's increased enforcement efforts together with additional coordination with federal agencies and state regulators will send a clear signal to the bad actors that they are not welcome in our industry. We also issue a challenge to our industry partners to allocate resources to RESPA education efforts as NAR has done with its RESPA Awareness Campaign. In closing, the NAR is committed to ensuring that REALTORS®

understand RESPA and fully comply with its provisions and we welcome every opportunity to work with HUD on our compliance efforts. Thank you for your time and I will be happy to answer any questions you may have.

Testimony of the
National Association of Insurance Commissioners

Before the
Subcommittee on Housing and Community Opportunity

Committee on Financial Services
United States House of Representatives

Regarding:
State Insurance Regulators' Investigations of the
Title Insurance Industry

April 26, 2006

Erin Toll
Deputy Commissioner of Insurance, Colorado
Co-Chairperson, NAIC Title Insurance Issues Working Group

Testimony of Erin Toll
Co-Chairperson, Title Insurance Issues Working Group
National Association of Insurance Commissioners

Introduction

Chairman Ney and Congresswoman Waters, thank you for inviting me to testify before this Subcommittee on our investigations into the title insurance market. My name is Erin Toll and I am the Deputy Commissioner of Insurance for the State of Colorado. I currently serve as the Co-Chairperson of the Title Insurance Issues Working Group of the National Association of Insurance Commissioners (NAIC). Like you, state insurance supervisors are public officials who serve and protect your constituents' interests. We share your goal regarding the importance of regulation that balances the need for vigorous consumer protection with vibrant business competition to provide a healthy insurance marketplace for consumers.

Today, I would like to make a few basic points –

- First, although title insurance is different from other insurance products, it is a valid and important product. It protects buyers and lenders from problems that may arise with real estate title that establishes legal evidence of home ownership.

- Second, title insurance's uniqueness provides fertile ground for certain questionable activities.

- Third, both state and federal laws explicitly prohibit kickbacks – defined as the referral of title insurance business in exchange for something of value. We have found in Colorado, and other insurance officials have found in their states, that some title insurers, title agencies, real estate agents, lenders, homebuilders, and other settlement providers violated these anti-kickback laws by developing improper business arrangements and illegitimate reinsurance programs.

- Fourth, state insurance officials are working aggressively to uncover and prevent improper business practices by insurers and agents in the title insurance industry. State insurance supervisors have imposed penalties, ordered restitution to consumers, and have closed some businesses. We are also working together to strengthen title insurance laws and regulations.

- Fifth, our jurisdiction as state insurance officials extends only to title insurers and, in some states, to the title agencies and agents. Other players in residential real estate transactions, including real estate agents, lenders, and homebuilders, are subject to different oversight by different regulatory bodies.

Title Insurance Overview

What is title insurance? Is it necessary?

Title insurance protects the policyholder from potential disputes or problems with real estate title and allows all parties in the transaction to proceed with confidence. There are two general types of policies: an owner's policy and a lender's policy. An owner's title insurance policy protects the purchaser of residential real estate in the event an undisclosed lien, impairment or "cloud" is found on the property that negatively affects the value of the property. The typical owner's title insurance policy indemnifies the owner up to the purchase price of the home.

A lender's title insurance policy protects the lender, not the owner; though often the owner pays the premium. A lender's policy indemnifies the lender up to the value of the loan so the policy's value decreases as the loan is paid and provides no coverage once the loan is paid off. Though the purchase of title insurance is not typically required by law, a lender generally will not provide a loan to a homebuyer without a lender's title policy. So, with the exception of those who can pay cash for a home, virtually all homebuyers obtain title insurance.

Title insurance is an integral part of a residential real estate transaction that protects homeowners' value in their properties and protects lenders' collateral. The real estate agent contacts a title insurance agency to obtain title insurance for the purchaser. The purchaser of the policy may be the buyer, the seller, or both, and who pays can be negotiated in many states. The title insurance agency performs a title search of the property. The title insurance agency is under contract with a title insurer, the underwriter, who agrees to insure the property. The title agency and insurer are paid. The title insurer issues the title insurance policy to the new property owner in the mail usually a few weeks later.

Unique Characteristics of Title Insurance

Title insurance is a unique product when compared with other types of insurance.

- Title insurance insures against things that already have happened. Homeowners, auto and other insurance each insures against unknown future events.
- Consumers often do not have many meaningful options regarding the insurance product or who provides their title insurance. Real estate agents and lenders usually recommend the title insurance provider.
- The title agency normally retains 85 to 90 percent of the premium, and the remaining 10 to 15 percent goes to the insurer. Title insurance is a flat, one-time fee paid along with a host of other fees, as part of a large, complex transaction. Consumers pay for health and auto insurance monthly and these purchases are not part of other transactions.
- Compared to both the overall cost of the home buying process and other insurance lines, title insurance is inexpensive. In Colorado, the cost of title insurance for a $300,000 home is about $1,000. Given that the average person buys six homes in a lifetime, an average consumer may pay $6,000 for title insurance over the course of their lifetime (taking refinances out of the equation for simplicity) and have only six contacts with a title insurer. On the other hand, consumers have many contacts with auto and health insurers and pay more for these products over their lifetime. The average yearly cost of health insurance is about $2,400 a year

or $96,000 over one's lifetime. The average yearly cost of auto insurance is about $1,000 or roughly $40,000 over one's lifetime.

- Title insurance comprises just 1.9 percent of insurance premium that state regulators oversee, and title insurance represents an extremely small fraction of the consumer complaints and inquiries that state insurance departments handle each year.

Title Insurance Claims and Loss Ratios

One of the unusual characteristics of title insurance is that so few claims are paid. Over 10 years, all 86 title insurers across the country paid slightly more than 5 cents out in claims for every dollar of premium consumers paid.

- Compare this to other lines of insurance:
    - Homeowners: 75 cents for every dollar.
    - Auto: 60 cents for every dollar.
    - Health Maintenance Organizations: 86 cents for every dollar.

However, loss ratios for title insurance really should be at or near zero. The "risk" that there is a problem with a title has already occurred so, if the title search is done correctly, most forgeries, liens, or other problems with a title will be discovered and no claim will ever be made. The real cost of title insurance is the title search, not claims payment. This is why the agency that performs the title search retains up to 90 percent of the total title fee. The core value to title insurance is ensuring clear title.

Marketing of Title Insurance

Most lines of insurance are competitive on coverage, claims payment, service, and price. Currently this is not generally true in title insurance. Unlike other types of insurance, title insurance from any insurer provides virtually the same coverage; so there is little competition around coverage type. Likewise, claims payment is not a major point of competition because payments are so rare and should be nearly non-existent. Because title insurance is marketed to lenders and real estate agents, but paid for by the consumer purchasing the policy, there is a disconnect that allows for little price competition.

When all participants play by the rules, the primary form of competition that benefits consumers in the title insurance market is competition over quality (accuracy and depth of research) and service (speed, customer service, and surety of closing). For example, real estate agents have much greater knowledge about title agencies than the consumer because they have experience with many transactions, so the consumer benefits from the experience of the real estate agent. Since the efficiency of a residential real estate closing is greatly influenced by the competency of the title insurance agency, the real estate agent has a high incentive to choose a competent, reputable title agency. However, when kickbacks enter the equation, any incentive to compete over service is negated by the presence of the kickback, and competition of this type ceases to exist. When bad actors in the industry stop competing on consumers' behalf over quality and service and, instead, compete amongst themselves for the placement of business, consumers lose.

Laws Affecting Title Insurance

State and federal regulators recently have uncovered violations by title entities and settlement providers in the title insurance business that take various forms, but have collectively and accurately been defined under the Real Estate Settlement Procedures Act (RESPA) as "kickbacks." There are multiple parties involved in title insurance transactions and they are subject to different oversight. As a state insurance supervisor, the scope of my authority and testimony applies to the insurers, agencies and agents we supervise. From this perspective, kickbacks are violations of state anti-remuneration laws and RESPA.

- The state of Colorado and most other states have adopted rules prohibiting referral of title insurance business in exchange for something of value. In keeping with the NAIC's commitment to continually improve the state insurance supervisory system, the NAIC's Title Insurance Issues Working Group is charged with monitoring and working with the U.S. Department of Housing and Urban Development (HUD) on any changes to the Real Estate Settlement Procedures

Act (RESPA). The Working Group is also updating the NAIC's Title Insurers Model Act and the Title Insurance Agents Model Act.

- *Sec. 2607. Prohibition against kickbacks and unearned fees* of RESPA stipulates that: "No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." RESPA also stipulates that "the Secretary, the Attorney General of any State, or the insurance commissioner of any State may bring an action to enjoin violations..."

Using the authority granted by these rules and state laws, state insurance regulators aggressively pursue and impose penalties, order restitution, and revoke or suspend the licenses of unscrupulous title entities.

Eliminating kickbacks from the title insurance transaction is the only way to ensure a level playing field where the interests of those selecting the title insurance and those paying for it align. This ultimately requires aggressive enforcement and collaboration among state and federal regulators who have oversight over the various settlement providers engaged in this practice.

Title Insurance Business Practices

State laws and RESPA define acceptable and unacceptable business practices regarding referrals in the title insurance business. These laws empower state insurance commissioners to stop violations.

Acceptable Business Practices

State anti-kickback laws and RESPA do not prohibit a settlement provider from marketing to another settlement provider or providing an incentive to do business with each other so long as it is not based on the referral of business. Conversely, neither state anti-kickback laws nor RESPA prohibit a settlement provider from referring business to another settlement provider so long as nothing of value is exchanged for that referral. Finally, RESPA and some state laws permit affiliated business arrangements under defined circumstances.

Unacceptable Business Practices: Kickbacks

The practices listed above are legitimate and reflect a market where companies may do business in good faith with one another in ways that provide quality service to consumers. However, bad actors exist, and they have used a variety of direct and indirect ways to deliver kickbacks for the referral of business. One example we uncovered in Colorado was a title agency flying top producing real estate agents on its corporate jet to spa vacations.

Indirect kickbacks: Captive title reinsurance

In February 2005, Colorado uncovered an arrangement where real estate agents, lenders and homebuilders promised to refer all of their business in a defined geographical location to a particular insurer, if that insurer agreed to reinsure the risk with a reinsurance entity owned by those real estate agents, lenders, and homebuilders. Reinsurance itself is legal and encouraged in some circumstances where risk is high, particularly where an insurer sheds off or "cedes" some of its risk above a particular dollar amount. This particular type of reinsurance is known as excess reinsurance, and it helps prevent smaller companies from becoming insolvent from one or two big claims.

To understand why this captive reinsurance arrangement is illegal for title insurance, it is important to understand how title insurers split commissions and to remember that they only pay five cents in claims for every dollar in premium. I have attached a flowchart to facilitate this understanding (Attachment A).

Typically, a title insurer retains only 10 to 15 percent of the premium. A title insurer's main function is to pay claims. Title agencies get the business and perform the title search, but they do not pay the claims. This split is not set by law. Historically, title insurers have determined that they can pay all claims, overhead, and premium tax and make a profit by retaining only 10 to 15 percent of the premium.

Yet in these illegal reinsurance deals, the insurer sheds off or cedes 50 percent of the "risk" for 50 percent of the premium, less a "processing fee." The processing fee covers the cost of the title search performed by the insurer. The title agent is not a party to these transactions. In other words, even though in a "normal" non-reinsured transaction, they only retain 10 to 15 percent of the premium to cover the risk that they will have to pay claims, they pay the reinsurance entity 50 percent of the total premium (less a processing fee) for 50 percent of the risk. If they were appropriately pricing this "reinsurance," the price for half of the risk would be no more than half of what they retain to pay claims – five to seven-and-a-half-cents on the dollar, instead of about thirty-five cents (after deducting the processing fee then paying 50 percent of the remainder).

This difference between what this reinsurance should cost and what the insurer pays and what the person referring of the business receives, is a thing of value or kickback as defined by law, and therefore illegal. Although it seems like a small amount, when these entities act together to take a small amount of money from consumers in every transaction, they add up to millions and millions of dollars in kickbacks.

Another way to look at these transactions is to consider the loss ratio discussed earlier. Title insurers over ten years have paid out five cents for every dollar of premium the consumer pays. Since the risk is that they have to pay a claim, the cost of shedding 50 percent of the risk should be two-and-a-half cents per dollar. Therefore, the only reason to pay the referrer's reinsurance entity thirty-five cents per dollar is to deliver a kickback. Nationally, not one of the reinsurers involved in these arrangements has paid a covered claim over the nine years since their inception.

For all of these reasons, it is our firm belief as state regulators that these reinsurance arrangements, where the value of risk transferred is not commensurate with the money paid, are nothing more than vehicles established to provide kickbacks to real estate agents, homebuilders and lenders who referred business to the title insurer.

Indirect kickbacks: Sham affiliated business arrangements.

The other indirect form of kickback that state regulators and HUD are seeing across nearly all states is illegitimate or "sham" affiliated business arrangements. Affiliated business arrangements (AfBAs) are ownership arrangements between and among title insurance entities and settlement service providers (lenders, homebuilders, real estate agents, among others). State and federal regulators and the industry itself have been grappling with their legality for years. HUD issued guidelines and a test to determine whether an AfBA is a sham. Nationally, for several years certain title insurance competitors have proposed legislation imposing percentage limitations on the amount of business that can be referred from an affiliated source.

In 2005 the Colorado Division of Insurance commenced an investigation of every title insurance agency in the state. Although that investigation continues, there have been some interesting discoveries that will be discussed in the next section of this testimony.

In Colorado, the pervasiveness of kickback schemes in the residential real estate transaction process has created a black market that makes it impossible for those who play by the rules to compete. The cost of providing kickbacks is passed on to consumers and rolled into the rate.

State Actions in Response to Improper Business Practices

The title insurance marketplace has evolved and expanded greatly over the last 30 years as lenders typically require confidence in the title for a real estate transaction to progress smoothly. We just have witnessed the largest housing boom in our nation's history, where home ownership is at an all-time high and interest rates were at all-time lows. The sheer volume of transactions has contributed to the explosion in the size of the title insurance market. In fact, title insurance premium volume has increased 400 percent over the last ten years. As the title insurance market has grown, so have the number of bad actors looking to exploit it.

What Are We Doing About It?

Many of the title insurers the Colorado Division of Insurance investigated operate in multiple states, and it is evident from our investigations that illegal practices are likely occurring in nearly all states. The Division shared its findings with the NAIC's Market Analysis Working Group and together, the states have taken significant regulatory steps to end these practices.

As mentioned in the previous section, the Colorado Division of Insurance commenced an investigation last year of every title insurance agency in the state, looking in particular for sham AfBAs. Our goal was to identify and distinguish between good AfBAs and bad AfBAs. State laws and RESPA provide guidance as to what is a legitimate AfBA and what is a sham AfBA. In Colorado, we believe that AfBAs are not inherently bad and that consumers like the convenience offered from the "one-stop-shopping" that legitimate AfBAs afford. We are in the initial stages of our investigation and, at this point, have examined about 15 agencies. We targeted these 15 agencies because we believed 14 were shams operated by the same title agent and one was legitimate. Indeed, our assumptions were correct. The legitimate AfBA had its own management, a discrete office location from its referral source, it performed its own searches, it was adequately capitalized and it had its own staff. The sham AfBAs are described in more detail below. Although the investigation into all agencies is ongoing, we have made some interesting discoveries.

The number of title agencies in our state exploded from 200 to over 500 in three years, growth that other states shared as well. More than 40 percent of all agencies polled responded that they were AfBAs. More than 20 percent failed to respond because the addresses listed were wrong, they had already ceased operations, or they never commenced operations. In many cases, the Division determined that multiple agencies were conducting business from the exact same addresses and under the same management.

The Division then conducted "no-knock" investigations of targeted agencies. We discerned that the first grouping of AfBAs that we investigated were shams for various reasons, including they had no staff, the same address was listed for more than five agencies, there was little or no capital infusion and title services were contracted out to another title agency. Please refer to the flow chart to better understand these operations (Attachment B).

The Division concluded that the only purpose for establishment of these entities was to create vehicles to provide kickbacks to the real estate agents and mortgage brokers who owned the businesses, and we shut them down. The Division also has refused to provide licenses for new agencies to those involved in these scams. In addition, we contacted the sham agencies' underwriters and held them responsible for running off any existing business to prevent consumer harm.

This market conduct examination report and the actions we have taken can all be reviewed on our website at http://www.dora.state.co.us/insurance.

Ultimately, in Colorado there are a number of AfBAs that exist only as mechanisms to provide kickbacks, and they are harming consumers in several ways. As mentioned earlier, title insurers compete mainly on service, and where sham AfBAs are operating, that service is compromised. Where the real estate agent, lender and homebuilder pick a title insurance entity based upon the kickbacks it receives and not upon quality and service, the consumer suffers. Examples of cases we have seen proving that quality and service are compromised:

- The agency fails to remit premium to the insurer and therefore policies are not issued even years after the closing. It is unclear whether exceptions to title were deleted because the consumer does not have a policy.

- Fly by night AfBAs close their doors after six months to a year and the records of the transaction are lost forever. Title insurance is a long claim tail business, meaning claims are made many years after the insurance is purchased. Problems leading to a claim usually are discovered when the homeowner goes to sell his or her home. By then, the AfBA is long gone, and the claim goes unpaid.
- Legal instruments are not recorded in a timely manner creating title problems down the road.
- Loan proceeds are not disbursed timely or appropriately and the consumer suffers financial harm.

Colorado shared its investigative processes and findings with other states at the last several NAIC meetings. Other states are reporting findings similar to ours. We spent a great deal of effort researching and analyzing HUD's guidelines, RESPA and laws in Colorado and in other states to define a sham business operation. However, it often is just a question of peering into a title agency's window to discern if it is a sham.

Results of Investigations into Title Insurers

After commencing an investigation of all title insurers operating in the state of Colorado, the Colorado Division of Insurance determined that three of the nation's largest insurers were engaged in illegal captive title reinsurance arrangements. Indeed, these three insurers, which do business in virtually all states (except Iowa) under a variety of names, control about 75 percent of the national title insurance market.

In February of last year, Colorado negotiated a settlement with the country's second largest title insurer, where they agreed to refund $24 million to consumers in all eight states where they engaged in captive title reinsurance arrangements. The Colorado Division of Insurance asserted that the captive title reinsurance arrangements into which the insurer entered were kickback schemes.

In September of last year, Colorado negotiated another multi-state settlement with the nation's largest title insurer concerning captive title reinsurance arrangements. Colorado worked with the NAIC's collaborative action committee to coordinate state efforts. Fully 26 states signed onto the settlement. The agreement provided consumer refunds of about $1.3 million in all 26 states.

Although the one remaining insurer has refused to enter into a multi-state agreement, Colorado, with assistance from the NAIC, so far has returned over $25 million to consumers. In addition, several other states have concluded their own settlements regarding these arrangements, including California, Arizona and Virginia. All together, the states have assessed $49.7 million in fines and penalties.

In Colorado and in other states insurance officials are looking at ways to reduce the premium and put more emphasis on price competition. We have posted an interactive premium comparison guide to our website where consumers can shop for rates. We already have witnessed increased rate competition as this new transparency encourages insurers to lower their rates. We also are looking more closely at rate justification requirements, among other things.

In addition, Colorado and several other states currently are investigating and taking actions to shutter the doors on sham affiliated business arrangements. Working through the NAIC, state officials have been able to share information and forge a unified approach to addressing the proliferation of sham title entities. To facilitate this level of inter-state collaboration, every state insurance department has a Collaborative Action Designee (CAD) who works within the NAIC's Market Analysis Working Group to ensure their state is up to speed on the challenges and approaches to solutions being taken by different states. The NAIC's Title Insurance Issues Working Group, which I co-chair, is re-examining the Title Insurance Agents and Title Insurers Model Acts to ensure that they reflect the evolving title insurance market, and the level of sophistication of improper business practices.

In addition to these activities, officials in Colorado have taken the following actions:

- Legislation has passed the Colorado legislature granting additional fining authority to the Commissioner of Insurance and the Director of the Division of Real Estate. The legislation grants both bodies the same oversight authority and penalty as HUD, and allows for restitution to all aggrieved parties, in addition to existing fining authority. This legislation tracks RESPA by requiring disclosures of AfBAs. This legislation also requires the two Divisions to share information regarding illegal practices, and to consult with each other to promulgate appropriate rules. (HB 1141).
- Colorado heads up an NAIC subgroup to rework the title insurance section of the Market Conduct Handbook.
- Colorado is in the process of increasing the testing requirements for title insurance agents to include more information anti-remuneration statute compliance, RESPA compliance and kickbacks in general.
- Colorado is examining ways to reduce rates, including examining and requiring greater justification for the agency retention rate.
- Colorado reviews background checks of the principals, not just the responsible producer, when processing a new request for an agency license. The Division has denied licenses where principals were associated with sham companies.
- Three proposed bills concerning the mortgage lending industry are proceeding through the Colorado legislature. The Department of Regulatory Agencies, the umbrella agency for the Division of Insurance, supports one. It is a mortgage broker registration and bonding program run by the Division of Real Estate. The other two bills concern mortgage fraud.
- Colorado will be amending its title insurance rule (3-5-1) to define sham AfBAs and to impose measures designed to stop their proliferation. (Capitalization requirements, staffing requirements, provision of core services, etc.)

California co-chairs the NAIC Title Insurance Working Group and has been a leader in the fight against title insurance fraud. They have taken the following actions:

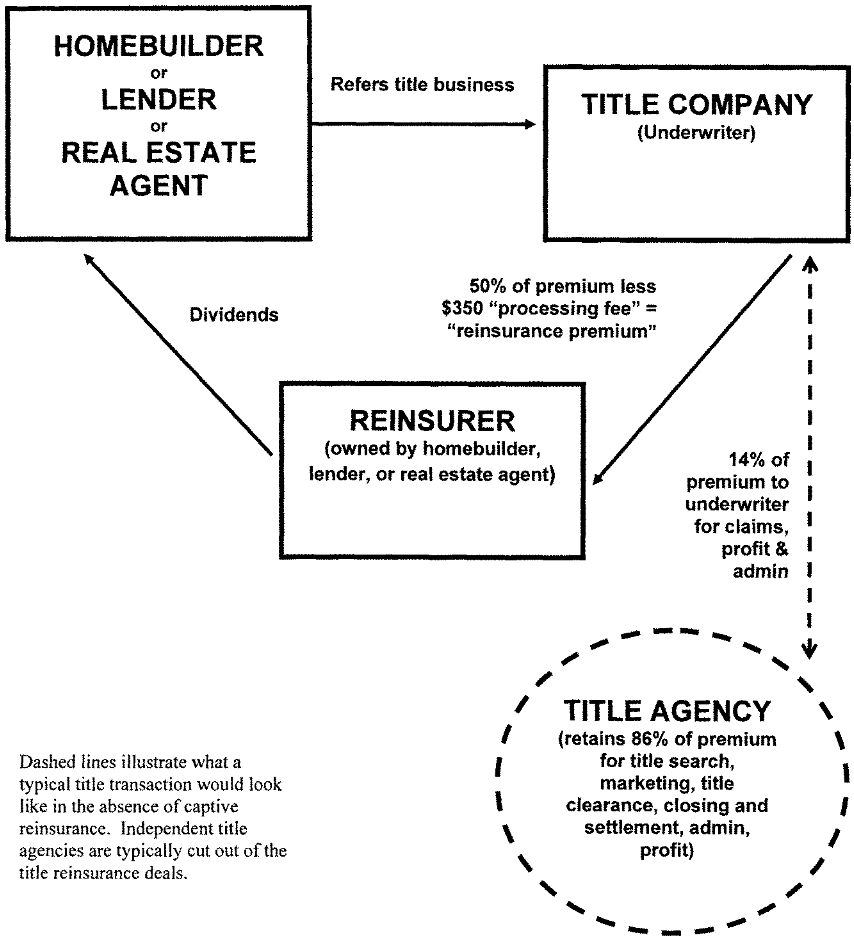
- In December 2005 the California Department of Insurance fined one company $1 million for illegal rebating. In addition, the Department restricted the company's license for 18 months in all counties and for two years in San Diego County. The illegal kickbacks provided to real estate agents and brokers totaled more than $455,000, including cash payments, fraudulent billings, fraudulent invoices, printing services, and other miscellaneous items. In return the agents were expected to steer business to the company.
- In June 2004 the Department seized $500,000 in escrowed funds that were part of a 2002 settlement with one company, due to evidence of continued illegal rebating. The Department's investigation uncovered suspected illegal activity including: the compensation of employees for fraudulent and fabricated invoices and expense reports in excess of $47,000; providing food, beverages, and entertainment in excess of $174,000; providing gifts and gift certificates in excess of $62,000; and providing business support services in excess of $218,000, all to benefit real estate agents and brokers.
- In April 2005, the Department fined yet another company $590,000 and ordered it to pay $160,000 in restitution in connection with illegal kickbacks. The Department's investigation found that the inducements Stewart gave to agents amounted to $594,102. They came in the form of payments for business support services, providing gift certificates and door prizes for realtor events, making rent payments, funding special events, and sponsoring broker activities.
- Also in April, Commissioner John Garimendi held a public hearing into illegal kickbacks in the title industry, including phony reinsurance arrangements.
- In July 2005, the Department settled with three large title insurers in connection with the fraudulent reinsurance scam described above. The three companies agreed to pay a total of $12.5 million in penalties.

Conclusion

The unique structure of the title insurance industry involves a variety of groups subject to different laws and levels of oversight. As insurance supervisors, we have an obligation to protect consumers from bad actors in this marketplace, but our authority is limited.

Colorado has regulatory authority over the title insurers, title agencies and title agents, but some states only regulate the title insurer, not the agencies. For our efforts to enforce aggressively the laws governing these groups to have the greatest impact, the entities enforcing laws over the other settlement providers need to be aggressive and effective as well. Ultimately, a collaboration of federal and state law and supervision is necessary to protect consumers from improper business practices in the title insurance industry.

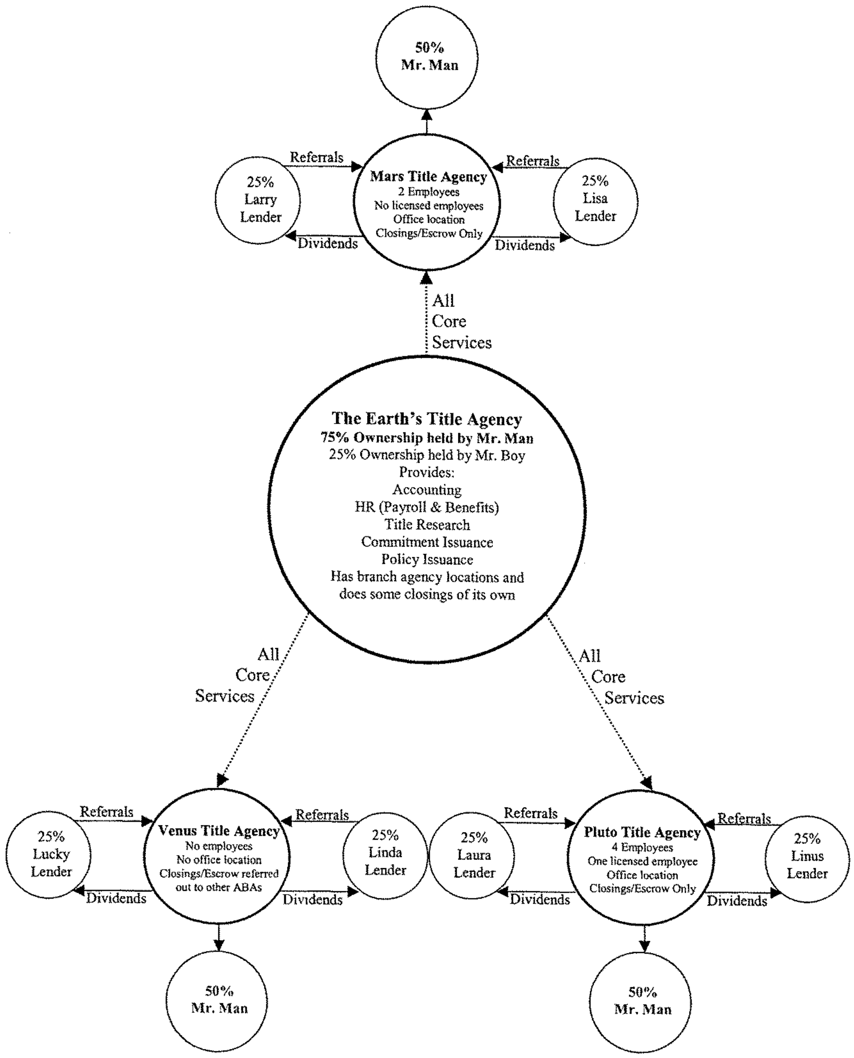
As state officials, we will continue aggressively to enforce our laws prohibiting these practices. However, even when RESPA and state laws are aggressively enforced, they are not potent enough to deter these practices. RESPA only provides state regulators authority to enjoin violations, not impose penalties. The penalties for violating RESPA and state laws should be much greater. In Colorado, our General Assembly saw the problems with our current statutes and legislation increasing our fining authority recently passed the Colorado House and Senate. Again, since our jurisdiction extends only to those providing the kickbacks (the insurance industry), other regulatory bodies with jurisdiction over the recipients of the kickbacks need greater fining and regulatory authority as well.



Dashed lines illustrate what a typical title transaction would look like in the absence of captive reinsurance. Independent title agencies are typically cut out of the title reinsurance deals.

§10-11-108, C.R.S.: "A title insurance company or title insurance agent shall not...give or receive or attempt to give or receive remuneration in any form pursuant to any agreement or understanding, oral or otherwise, for the referral of title insurance business..."

AFFILIATED BUSINESS ARRANGEMENTS



United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives

For Release on Delivery
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Wednesday, April 26, 2006

TITLE INSURANCE

Preliminary Views and Issues for Further Study

Statement of Orice M. Williams, Director
Financial Markets and Community Investment

GAO
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GAO-06-569T

April 26, 2006

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Highlights

Highlights of GAO-06-569T, a testimony before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives

TITLE INSURANCE

Preliminary Views and Issues for Further Study

Why GAO Did This Study

Title insurance is a required element of almost all real estate purchases and is not an insignificant cost for consumers. However, consumers generally do not have the knowledge needed to "shop around" for title insurance and usually rely on professionals involved in real estate—such as lenders, real estate agents, and attorneys—for advice in selecting a title insurer.

At the request of the House Financial Services Committee, GAO currently has work under way studying the title insurance industry, including pricing, competition, the size of the market, the roles of the various participants in the market, and how the industry is regulated. On April 24, 2006, GAO issued a report on the preliminary results of its work to date that identifies issues for further study. This testimony discusses that work, and focuses on: (1) the reasonableness of cost structures and agent practices common to the title insurance market that are not typical of other insurance markets; (2) the implications of activities identified in recent state and federal investigations that may have benefited real estate professionals rather than consumers; and (3) the potential need for regulatory changes that would affect the way that title insurance is sold.

www.gao.gov/cgi-bin/getrpt?GAO-06-569T.

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 williamso@gao.gov.

What GAO Found

Some cost structures and agent practices that are common to the title insurance market are not typical of other lines of insurance and merit further study. First, the extent to which premium rates reflect underlying costs is not always clear. For example, most states do not consider title search and examination costs—insurers' largest expense—to be part of the premium, and do not review these costs. Second, while title agents play a key role in the underwriting process, the extent to which state insurance regulators review agents is not clear. Few states collect information on agents, and three states do not license them. Third, the extent to which a competitive environment that benefits consumers exists within the title insurance market 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. Finally, multiple regulators oversee the different entities involved in the title insurance industry, but the extent of involvement and coordination among these entities is not clear.

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 the past several years, regulators, industry groups, and others have suggested changes to the way title insurance is sold, and further study of these suggestions could be beneficial. For example, the Department of Housing and Urban Development announced in June 2005 that it was considering revisions to the regulations implementing the Real Estate Settlement Procedures Act. In addition, the National Association of Insurance Commissioners is considering changes to model laws for title insurers and title agents. Finally, at least one consumer advocate has suggested that requiring lenders to pay for the title policies from which they benefit might increase competition and ultimately lower consumers' costs.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our preliminary views and issues concerning the title insurance industry. As you are aware, title insurance is designed to ensure clear ownership of a property when it is sold or refinanced, and is a required part of most real estate purchases. According to a recent national survey of lenders, title insurance can account for as much as one-third of loan origination and closing fees.[1] Recent investigations and studies have raised questions about practices and competition within the industry, in part because title insurance differs markedly from other types of insurance. My remarks today focus on our preliminary report, which identifies issues for further study that was completed as part of ongoing work in this area for the Chairman of the House Financial Services Committee.[2] These issues relate to (1) the reasonableness of cost structures and agent practices in the title insurance market that are not typical of other insurance markets; (2) activities identified in recent investigations that may have benefited real estate or other professionals rather than consumers; and (3) proposed regulatory changes that would affect the way that title insurance is sold.

My remarks are based on a review of studies of the title insurance industry, title insurance regulations in selected states, and financial information on title insurers and agents. We also had discussions with officials from national organizations whose members are involved in the marketing or sale of title insurance; the National Association of Insurance Commissioners (NAIC); the Department of Housing and Urban Development (HUD); several state regulatory officials; title insurers and agents; and industry consultants.

In summary:

In part because title insurance differs from other lines of insurance, some aspects of the industry raise questions that merit further study. First, while the amount of premium paid to or retained by title agents—generally to pay for title search and examination costs and agents' commissions—is

[1]Bankrate.com conducted a 2005 mortgage closing cost survey using online information when it was available, and contacted title agents as necessary. We did not assess the validity of the survey data.

[2] GAO, *Title Insurance: Preliminary Views and Issues for Further Study*, GAO-06-568 (Washington, D.C.: Apr. 24, 2006).

commonly title insurers' largest expense, most states do not take these costs into account during premium rate reviews. Second, although title agents play a key role in the underwriting process, the extent to which state insurance regulators review their operations is unclear. Few states regularly collect information on title agents' operations, and three states do not license title agents. Third, while the competition among agents for their share of the business can be intense, the extent to which a competitive environment that benefits consumers exists within the title insurance market is also not clear. Consumers generally lack the knowledge necessary to "shop around" for a title insurer and often rely on real estate professionals for referrals that may not always be the most cost-effective choices. Fourth, real estate brokers, lenders, and builders are increasingly becoming full or partial owners of title agencies in what are called "affiliated business arrangements." These arrangements may benefit consumers to some extent, but also create potential conflicts of interest. Finally, multiple regulators oversee the different entities involved in the title insurance industry, but the degree of regulatory involvement and coordination among agencies is also not clear.

In addition, recent state and federal investigations have identified potentially illegal activities—primarily involving alleged kickbacks—that also merit further study. The investigations alleged instances of real estate agents, mortgage brokers, lenders, and attorneys receiving referral fees (or other inducements) in return for steering business to particular title insurers or agents. These activities may have violated federal or state anti-kickback laws. Participants used several methods to convey the fees or inducements, including captive reinsurance agreements, allegedly fraudulent business arrangements, and free or discounted business services. Other investigations alleged that title agents mishandled or misappropriated customers' premium payments, so that customers did not get the insurance they paid for.[3]

Finally, in the past several years, regulators and others have suggested changes to regulations that would affect the way title insurance is sold. For example, HUD is considering revisions to regulations that implement the Real Estate Settlement Procedures Act (RESPA), and NAIC is considering changes to the model laws for title insurers and title agents.[4]

[3] Colorado Division of Insurance Order No. 0-06-089 (Nov. 15, 2005).

[4] Pub. L. No. 93-533, 88 Stat. 1724 (Dec. 22, 1974), as amended, *codified at* 12 U.S.C. §§ 2601-2617.

Further review of the effects and feasibility of such changes will help Congress, HUD, and state regulatory agencies in their oversight and decision-making processes.

Background

Title insurance is designed to guarantee clear ownership of a property that is being sold. The policy is designed to compensate either 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. Title insurance is sold primarily through title agents who check the history of a title by examining public records. The title policy insures the policyholder against any claims that existed at the time of purchase but were not in the public record.

Title insurance premiums are paid only once during a purchase, refinancing, or, in some cases, home equity loan transaction. The title agent receives a portion of the premium as a fee for the title search and examination work and its commission. The party responsible for paying for the title policies varies by state. In many areas, 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. According to a recent nationwide survey, the average cost for simultaneously issuing lender's and owner's policies on a $180,000 loan (plus other associated title costs) was approximately $925, or about 34 percent of the average total loan origination and closing fees.[5]

Certain Aspects of the Title Insurance Market Merit Further Study

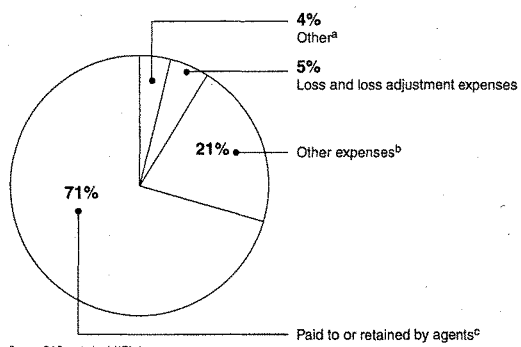
We identified several important items for further study, including the way policy premiums are determined, the role played by title agents, the way that title insurance is marketed, the growth of affiliated business arrangements, and the involvement of and coordination among the regulators of the multiple types of entities involved in the marketing and sale of title insurance.

[5]2005 Bankrate.com survey.

The Extent to Which Premium Rates Reflect Underlying Costs Is Not Always Clear

For several reasons, the extent to which title insurance premium rates reflect insurers' underlying costs is not always clear. First, the largest cost for title insurers is not losses from claims—as it is for most types of insurers—but expenses related to title searches and agent commissions (see fig. 1). However, most state regulators do not consider title search expenses to be part of the premium, and do not include them in regulatory reviews that seek to determine whether premium rates accurately reflect insurers' costs. Second, many insurers provide discounted premiums on refinance transactions because the title search covers a relatively short period, but the extent of such discounts and their use is unclear. Third, the extent to which premium rates increase as loan amounts or purchase prices increase is also unclear. Costs for title search and examination work do not appear to rise as loan or purchase amounts increase, and such costs are insurers' largest expense. If premium rates reflected the underlying costs, total premiums could reasonably be expected to increase at a relatively slow rate as loan or purchase amounts increased, however, it is not clear that they do so.

Figure 1. Where the Money Goes: 2004 Title Industry Costs as a Percentage of Premiums Written



Source: GAO analysis of ALTA data.

[a]"Other" represents the difference between total premiums written and total expenses, and is not meant to be a measure of profitability. [b]"Other expenses" includes all other expenses such as salaries, rent, and equipment costs incurred by the insurer. [c]The "Paid to or retained by agents" category includes both affiliated and nonaffiliated agents.

The Extent of Regulatory Focus on Title Agents Merits Further Review

Title agents play a more significant role in the title insurance industry than agents do in most other types of insurance, performing most underwriting tasks as well as the title search and examination work. However, the amount of attention they receive from state regulators is not clear. For example, according to data compiled by the American Land Title Association (ALTA), while most states require title agents to be licensed, 3 states plus the District of Columbia do not; 18 states and the District of Columbia do not require agents to pass a licensing exam.[6] Although NAIC has produced model legislation that states can use in their regulatory efforts, according to NAIC, as of October 2005 only three states had passed the model law or similar legislation.

The Extent of Competition in the Industry That Could Benefit Consumers Is Not Clear

For several reasons, the competitiveness of the title insurance market has been questioned. First, while consumers pay for title insurance, they generally do not know how to "shop around" for the best deal and may not even know that they can. Instead, they often rely on the advice of a real estate or mortgage professional in choosing a title insurer. As a result, title insurers and agents normally market their products exclusively to these types of professionals, who in some cases may recommend not the least expensive or most reputable title insurer or agent but the one that represents the professional's best interests. Second, the title industry is highly concentrated. ATLA data show that in 2004 the five largest title insurers and their subsidiary companies accounted for over 90 percent of the total premiums written. Finally, the low level of losses title insurers generally suffer—and large increases in operating revenue in recent years—could create the impression of excessive profits, one potential sign of a lack of competition.

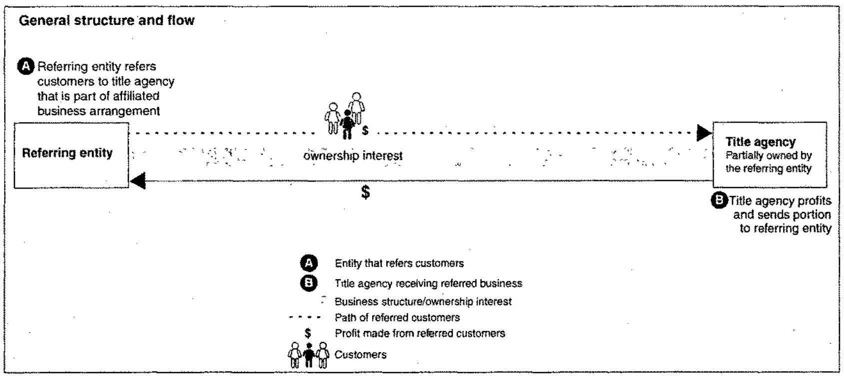
Further Study of the Effect of Affiliated Business Arrangements Could Be Beneficial

The use of affiliated business arrangements involving title agents and others, such as lenders, real estate brokers, or builders has grown over the past several years. Within the title insurance industry, the term "affiliated business arrangements" generally refers to some level of joint ownership among a title insurer, title agent, real estate broker, mortgage broker, lender, and builder (see fig. 2). For example, a mortgage lender and a title agent might form a new jointly owned title agency, or a lender might buy a

[6]The District of Columbia does not require title agents based there to be licensed, but agents based in Maryland or Virginia that conduct business in the District must be licensed by their respective states.

portion of an existing title agency. Such arrangements, which may provide consumers with "one-stop shopping" and lower costs, can also can also be abused, presenting conflicts of interest when they are used as conduits for giving referral fees back to the referring entity or when the profits from the title agency are significant to the referring entity.

Figure 2: Example of an Affiliated Business Arrangement



Source: GAO.

The Extent of Involvement of and Coordination among Regulators of the Multiple Entities Involved in the Sale of Title Insurance Is Worthy of Further Study

Several types of entities besides insurers and their agents are involved in the sale of title insurance, and the degree of involvement of and the extent of coordination among the regulators of these entities appears to vary. These entities include real estate brokers and agents, mortgage brokers, lenders, and builders, all of which may refer clients to particular agencies and insurers. These entities are generally overseen by a variety of state regulators, including insurance departments, real estate commissions, and state banking regulators, that interact to varying degrees. For example, one state insurance regulator with whom we spoke told us that the agency coordinated to some extent with the state real estate commission and at the federal level with HUD, but only informally. Another regulator said that it had tried to coordinate its efforts with other regulators in the state, but that the other regulators had generally not been interested. HUD, which is responsible for implementing RESPA, has conducted some investigations in conjunction with insurance regulators in some states. Some of these investigations of the marketing of title insurance by title insurers and agents, real estate brokers, and builders have turned up allegedly illegal activities.

Recent State and Federal Investigations Have Identified Areas of Potential Interest

Federal and state investigations have identified two primary types of potentially illegal activities in the sale of title insurance, but the extent to which such activities occur in the title insurance industry is unknown. The first involves allegations of kickbacks–that is, fees that title agents or insurers may give to home builders, real estate agents and brokers, or lenders in return for referrals. Kickbacks are generally illegal. In several states, state insurance regulators identified captive reinsurance arrangements that title insurers and agents were allegedly using to inappropriately compensate others, such as builders or lenders, for referrals.[7] State and federal investigators have also alleged the existence of inappropriate or fraudulent affiliated business arrangements. These involve a "shell" title agency that generally has no physical location, employees, or assets, and does not actually perform title and settlement business. Investigators alleged that the primary purpose of these shell companies was to provide kickbacks for business referrals. Investigators have also looked at the various types of alleged kickbacks that title agents have provided, including gifts, entertainment, business support services, training, and printing costs.

Second, investigators have uncovered instances of alleged misappropriation or mishandling of customers' premiums by title agents. For example, one licensed title insurance agent who was the owner (or partial owner) of more than 10 title agencies allegedly failed to remit approximately $500,000 in premiums to the title insurer. As a result, the insurer allegedly did not issue 6,400 title policies to consumers who had paid for them.

In response to the investigations, insurers and industry associations say they have begun to address some concerns raised by affiliated businesses, but that clearer regulations and stronger enforcement are needed. One title insurance industry association told us that recent federal and state enforcement actions had motivated title insurers to address potential

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

kickbacks and rebates through, for example, increased oversight of title agents. In addition, the insurers and associations said that competition from companies that break the rules hurt companies that were operating legally and that these businesses welcome greater enforcement efforts. Several associations also told us that clearer regulations regarding referral fees and affiliated business arrangements would aid the industry's compliance efforts. Specifically, we were told that regulations need to be more transparent about the types of discounts and fees that are prohibited and the types that are allowed.

Proposed Regulatory Changes Raise a Number of Issues

Over the past several years, regulators and others have suggested changes to regulations that would affect the way title insurance is sold, and further study of the issues raised by these potential changes could be beneficial. In 2002, in order to simplify and improve the process of obtaining a home mortgage and to reduce settlement costs for consumers, HUD proposed revisions to the regulations that implement RESPA. But HUD later withdrew the proposal in response to considerable comments from the title industry, consumers, and other federal agencies. In June 2005, HUD announced that it was again considering revisions to the regulations. In addition, NAIC officials told us that the organization was considering changes to the model title insurance and agent laws to address current issues such as the growth of affiliated business arrangements and to more closely mirror RESPA's provisions on referral fees and sanctions for violators. Finally, some consumer advocates have suggested that requiring lenders to pay for the title policies from which they benefit might increase competition and ultimately lower costs for consumers, because lenders could then use their market power to force title insurers to compete for business based on price.

The issues identified today raise a number of questions that we plan to address as part of our ongoing work. We look forward to the continued cooperation of the title industry, state regulators, and HUD as we continue this work.

Mr. Chairman, this completes my prepared statement. I would be pleased to answer any questions that you or Members of the Subcommittee may have.

Contact and Acknowledgments

For further information about this testimony, please contact Orice Williams on (202) 512-8678 or williamso@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributors to this testimony include Larry Cluff (Assistant Director), Tania Calhoun, Emily Chalmers, Nina Horowitz, Marc Molino, Donald Porteous, Melvin Thomas, and Patrick Ward.

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AMERICAN
LAND TITLE
ASSOCIATION

TESTIMONY OF RANDE YEAGER
ON BEHALF OF
THE AMERICAN LAND TITLE ASSOCIATION

"Title Insurance: Cost and Competition"

BEFORE THE
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY
U.S. HOUSE OF REPRESENTATIVES

APRIL 26, 2006
2:00 p.m.

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PREPARED STATEMENT OF
RANDE K. YEAGER, PRESIDENT AND CEO OF
OLD REPUBLIC NATIONAL TITLE INSURANCE CO.,

ON BEHALF OF THE AMERICAN LAND TITLE ASSOCIATION

BEFORE THE
SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY
OF THE HOUSE COMMITTEE ON FINANCIAL SERVICES

APRIL 26, 2006

Mr. Ney and Members of the Subcommittee. My name is Rande Yeager and I am the President and Chief Executive Officer of Old Republic National Title Insurance Company, based in Minneapolis, Minnesota. I am appearing today on behalf of the American Land Title Association (ALTA), and I am currently serving as President of the Association. ALTA is the national association for the land title industry, representing over 3,000 members, with more than 100,000 employees, including title insurers, title insurance agents, abstracters, and attorneys. Our members operate in every state and county throughout the country.

With me today is Dr. Nelson R. Lipshutz, the President of Regulatory Research Corporation, who is one of the most knowledgeable and experienced economists in the United States on issues relating to title insurance and the workings of the title insurance industry. State insurance departments recognize Dr. Nelson as an expert on the industry's economics and on a wide variety of regulatory issues affecting the industry.

Mr. Chairman, on behalf of ALTA I appreciate the opportunity to appear before your Subcommittee today to discuss questions – and misconceptions – that exist about the title insurance industry. All of us who work in the title business are justifiably proud of the essential role that our industry has played, and continues to play, in making the

United States real estate market the envy of the world. Nowhere else in the world is the creation and transfer of interests in real property accomplished more efficiently and securely than in the United States.

Title insurance products and services have facilitated a level of security, stability, and efficiency in real estate transactions that is unparalleled in history. This safety and security has been achieved despite the facts that:

- real estate interests can be divided and subdivided in so many complex ways: with rights being granted to the surface of the earth, below the surface (e.g., oil, gas, and other mineral interests), and above the surface (e.g., rights in condominium units in high-rise buildings, air rights easements) – and over time (e.g., fee simple interests, life estates, future interests that do not arise until some future event, time share interests);
- the mortgage lending history has created a dizzying array of loans to meet the diverse needs of consumers and other borrowers; and
- our society allows an enormous range of liens and encumbrances against real estate that may affect the title a buyer obtains.

It is because we are so proud of the many good – and unappreciated – things that our industry does to facilitate real estate transactions in America that we are also so concerned about the adverse publicity that has attended certain competitive practices involving members of our industry. We understand why that publicity may have led Chairman Oxley to request the Government Accountability Office to examine various questions about title insurance and competition in the industry. ALTA has been working with the GAO staff to provide them with information and data about title insurance and our industry so that their study will reflect the realities of our industry, and the important role it plays in maintaining the safe and secure real estate market that we enjoy, as well as to dispel misconceptions that so often prevail in the press and elsewhere. In any event, because the GAO is still gathering information for its study, and a final report is many months away, we cannot, of course, comment at this time on that study or what conclusions it will reach.

My statement today will address four topics that ALTA believes are important to the Subcommittee's and the public's understanding of our industry, and to its appreciation that the problems that have received publicity in recent months are being addressed, and, indeed, that ALTA supports further changes to minimize their reoccurrence in the future.

First, I will explain what title insurance is, the role it plays in ensuring that buyers and lenders in residential and commercial real estate transactions walk away from the closing table with the assurance that the interests they contracted to obtain have been properly conveyed, and how title insurance differs in important respects from other lines of insurance. This discussion will also address the roles of title insurance companies and title insurance agents (collectively, "title companies") in the process by which title insurance policies are issued. Second, I will address certain major misconceptions that exist about title insurance. Third, I will discuss the two major competitive problems that have been the focus of state and federal attention in recent months and that appear to be of concern to the Subcommittee: captive reinsurance arrangements and sham affiliated business agencies. Finally, I will discuss why regulatory mechanisms in place today have been effective in responding to such problems, and, of even greater importance, what further steps can be taken to minimize those problems in the future.

I. AN OVERVIEW OF TITLE INSURANCE AND THE TITLE INSURANCE INDUSTRY.[1]

Title insurance plays an essential role in facilitating ownership and investment in real estate in the United States. Purchasing a home, or obtaining or financing or refinancing for a home, are generally the most significant financial decisions most consumers ever make. Beyond residential transactions, every week there are thousands of transactions, some of which involve hundreds of millions or even billions of dollars, relating to the acquisition, development, and sale of commercial real estate, almost all of which are financed with borrowed funds. The willingness of individuals and businesses to invest in real estate anywhere in the United States, or to loan money to those who own or are acquiring real estate, and the ready marketability of those interests and loans, is truly remarkable in light of the inherent complexities that exist with regard to the rights that may be claimed in or against real estate. The title insurance industry, through the policies it issues and the significant work it must perform to be in a position to issue those policies, has rendered such investments safer, more secure, and more marketable than in any time in world history.

The "ownership" of real estate really involves the ownership of a bundle of rights relating to the use and disposition of the property that we have come to associate with the general term "ownership" or, the more technically correct phrase, fee simple title. As discussed in the introduction to this Statement, ownership rights in real estate may

[1] Additional background information on the nature of title insurance and the title insurance industry is set forth in the "Title Insurance Primer," prepared by the American Land Title Association (Attachment A), "The Nature of Title Insurance," by Prof. Harry Mack Johnson, Journal of Risk and Insurance (Sept. 1966) (Attachment B); and "Clouds on Horizon After Title Industry's Bright Year," A.M. Best Special Report (Oct. 2005) (Attachment C) (hereafter "the A.M. Best Report"). See also Nelson R. Lipshutz, The Regulatory Economics of Title Insurance, Praeger Publishers (1994).

be divided in a number ways and over time. Prior owners may have created interests in the property by contract, or suffered liens against the property, that will have affect the rights acquired by a new purchaser. Because of the value, permanence, and immovability of real estate, federal, state, county, and municipal governments have created or recognized a vast array of liens and encumbrances that may be asserted against real estate: rights that may affect the use of the property or otherwise encumber the "ownership" rights of the holder of the fee simple interest. These include:

- liens against the property that serve as security for the payment of an obligation (e.g., mortgage liens, judgment liens for unpaid court judgments, tax liens, state and local liens for failure to pay real estate taxes or assessments, mechanic's liens to secure payment for improvements, liens for recovery of child support payments or, as in New York City, for unpaid parking tickets);
- easements that have been created by contract or arisen through use or adverse prescription (e.g., rights of way for utilities, rights acquired by neighbors because of a fence encroachment);
- building or use restrictions contained in a recorded plat; and
- rights or claims arising out of bankruptcy.

In any real estate transaction, the buyer wants to be certain that he will ultimately be acquiring ownership of the property subject only to those liens and encumbrances he knows about and is willing to accept. The seller, who may be conveying the property by a general or special warranty deed (in which he will be providing certain warranties of title to the buyer and will be contractually liable to the buyer if those title warranties are not correct), likewise has an interest in ensuring that the title obtained by the buyer will not be subject to any claims that will trigger liability under those warranties. The mortgage lender is willing to provide financing for the transaction but only on the condition that the buyer, in fact, will own the property and that the mortgage lender will obtain a valid and enforceable mortgage lien of the appropriate priority that is not subject to any other lien or claim that could adversely affect that mortgage interest.

While various approaches have been used in the history of the United States and in different parts of the country to provide these assurances, the predominant mechanism by which buyers and lenders obtain these assurances today is title insurance – the only form of insurance invented in the United States. To understand the reasons why this has come to be the case, one must first understand title insurance and how it satisfies important market demands.

A. The Nature of Title Insurance and Why It Has Become the Predominant Mechanism for Facilitating Real Estate Transactions.

In general, there are two major types of title insurance policies, both of which are typically issued after the closing of a real estate transaction: an owner's policy and a loan policy (sometimes referred to as a mortgagee policy or lender's policy).

An owner's policy insures the purchaser against financial loss or damage that may arise from defects in the title as insured, including the assertion of liens and claims against the property that are not otherwise excepted from policy coverage. The policy includes protection against title defects that may be found in public records but were not discovered during the search of those records or their significance was not appreciated, and those "non-record defects" that even the most comprehensive search of the records would not reveal. These non-record risks include, among others:

- fraud or forgery in the execution of documents in the chain of title;
- mistakes in interpretation of wills and other legal documents;
- the execution of documents by minors or incompetent persons who could not legally convey property interests;

- the existence of undisclosed heirs who did not consent to a prior transfer;
- deeds executed under an expired power of attorney or on behalf of someone who has died; and
- mistakes in the recording or indexing of documents in the public records.

The policies are issued for a one-time fee, paid at the closing, and there are no renewal premiums. Because the protection of an owner's title insurance policy continues as long as the insured owns, or has any liability with regard to, the insured property, an owner's policy will protect the insured even after he sells the property if his buyer later asserts claims under a warranty deed with regard to matters covered by that original owner's policy.

A loan policy basically insures the lender that it will have a valid, enforceable lien on the property in accordance with the mortgage interest created by the loan, that the person to whom it is making the mortgage loan has title to the property being mortgaged, and that no other claimant, other than those specifically noted in the policy, has a prior, superior claim. The policy continues in force as long as there is a balance due on the loan. The policy covers a purchaser of the loan in the secondary mortgage market.

Under both policies, the title insurer is obligated to pay for the costs of defending the title as insured against any covered claim. In most areas of the country, if an owner's policy is issued in the transaction, the cost of a loan policy that is "simultaneously issued" with the owner's policy involves a relatively small additional charge to the cost of the owner's policy.

Because the history and current status of each parcel of property is unique, title insurance policies cannot be issued on a "casualty" basis – e.g., by assuming that, statistically, so many properties are going to have "good title" or certain kinds of claims against them. Rather, title insurance policies can only be issued on the basis of a thorough search and examination of the relevant public records pertaining to the particular property to be insured. This search and examination will determine whether the seller, in fact, owns the fee simple title rights he has contracted to convey to the buyer, and what liens or encumbrances exist that will limit the use or value of the property when acquired by the buyer.

The title search and examination (discussed further below) is critical not just from the title insurer's standpoint in underwriting the issuance of the policy. It is also important from the standpoint of the buyer because the preliminary title commitment (or the preliminary title report) given by the title insurer or its agent to the prospective buyer/insured (or his representative) will identify the matters of record found in the title search and examination process that, if not taken care of prior to the closing, will be excepted from coverage in the policy as issued.[2] This information enables the buyer (and his attorney or real estate agent) to determine whether any action needs to be taken by the seller or others to eliminate any lien or claim identified in the commitment before the transaction is closed.

Prior to the widespread adoption of title insurance, this function of searching the title records, examining the relevant documents, and informing the purchaser about the rights he may be acquiring was performed by people known as conveyancers, many of

[2] Such commitments or preliminary title reports are not given to the borrower in a refinance transaction because no owner's policy is issued in that transaction.

whom were attorneys. Because real estate records are generally found in the locale (typically the county) where the property is located, this was an archetypical local function. What title insurance brought to the table – and what accounts for its almost universal use today – is that:

- whereas prior to title insurance, purchasers and lenders who obtained an erroneous opinion on the state of the title had to sue the conveyancer or lawyer; they could only recover if the conveyancer or lawyer had acted negligently and had enough assets to meet the judgment; and they could not recover for damages caused by non-record defects,
- with title insurance, owners and lenders have a right of recovery as a matter of contract and without having to establish negligence; they have these rights against a financially sound and regulated entity with continuous corporate existence; and the policy also protects them against claims caused by non-record defects.

Indeed, these advantages of title insurance were critical factors contributing to the growth of the secondary mortgage market – which, in turn, contributed significantly to the continued growth of title insurance.

B. A Brief Historical Perspective on the Growth of Title Insurance.

The need for title insurance arose from the fact that traditional methods of conveying real property did not provide adequate safety to the parties involved. Indeed, the origin of title insurance is directly traceable to the limited protection that was provided through the use of conveyancers.

The 1868 decision in Watson v. Muirhead, 57 Pa. 161, was a watershed event in the history of title insurance. Muirhead, a conveyancer, had searched the title for a parcel of property to be purchased by Watson. In good faith, and after consulting an attorney, Muirhead concluded that certain recorded judgments against the seller would not be liens against the property Watson was buying. Watson went ahead with the purchase of the property, but was subsequently required to pay off those judgments against his seller, which were found to constitute liens on the property Watson had purchased. Watson sued Muirhead to recover his losses, but the Pennsylvania Supreme Court ruled that, given the state of the law at that time, there was no negligence on Muirhead's part, so no recovery could be had. Watson, an innocent purchaser who had relied on Muirhead's erroneous, but not negligent, conclusion about the state of the title he was purchasing, had no recourse. Shortly after that decision, the first title insurance company – The Real Estate Title Insurance Company – was founded in Philadelphia. The purpose of the infant industry – still relevant today – was expressed in the initial advertisement of the company:

> This Company insures the purchasers of real estate and mortgages against loss from defective titles, liens, and encumbrances. Through these facilities transfer of real estate and real estate securities can be made more speedily and with greater security than heretofore.

While the use of title insurance expanded in the decades that followed, as other companies were established in Pennsylvania, New York, Virginia and in other states, the single greatest impetus to the growth of title insurance was the development of the secondary mortgage market following World War II. Transactions in the secondary mortgage market include:

- the sale of mortgages by the originator of the loan to a third party investor who will hold that loan in its portfolio (e.g., the sale of a mortgage by an originating bank to a life insurance company); and
- the sale of mortgages to an entity, such as Fannie Mae or Freddie Mac, that will thereafter either resell the mortgages or sell mortgage-backed securities based on a portfolio of mortgage loans.

The essential purpose of the secondary mortgage market is to facilitate mortgage financing by broadening the base of investors and increasing the availability of investment funds for mortgage financing. It has served that purpose well.[3] However, the need for safety and protection from title problems on mortgages that will be sold in the secondary market is more acute than in the historical situation where a local lender might retain the mortgage loan in its own portfolio. The local lender might have been willing to make and retain the loan based on its familiarity with local law and customs, and its reliance on the title opinion of a local attorney whose work the lender was familiar with. In contrast, a national lender or a purchaser of loans or mortgage-backed securities is not willing to rely on the opinions of title of local lawyers or conveyancers, and is certainly not going to want to have to bring a negligence suit in the lawyer's or conveyancer's home town if the opinion turns out to be wrong or the transaction mishandled. Secondary market purchasers want – and require – the protection of a standardized title insurance policy, whose terms and coverage they are comfortable with, issued by a financially sound company that they know will be there if a title problem needs to be corrected or paid off.

C. How Title Insurance Differs from Other Types of Insurance.

Title insurance differs in fundamental ways from most other forms of insurance, such as auto, homeowner's or life insurance. Understanding these differences is important to avoiding misconceptions that may result from inappropriate or erroneous comparisons with those other lines.

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[3] For example, from the end of 1990 to the end of 2003 Fannie Mae's and Freddie Mac's combined portfolios of mortgages has grown from $132 billion (or 5.6 percent of the single-family home-mortgage market), to $1.38 trillion (or 23 percent of the home-mortgage market). Virtually all of the loans in those portfolios are protected by title insurance.

First, most other forms of insurance provide protection for a limited period of time and, hence, the policy must be periodically renewed. If the premiums do not continue to be paid, the policy lapses. Title insurance is issued for a one-time premium. There are no renewals, and policy protection extends for as long as the insured owner (under an owner's policy) owns the property or has liability in connection with the property, or the insured lender (under a loan policy) has a balance due on the loan secured by the mortgage.

Second, other forms of insurance insure against future events after the policy has been issued – such as a fire, an accident or, in the case of life insurance, death. Title insurance insures against title defects that arose before the policy is issued.[4] While the claim may not be asserted until after the policy is issued, it has to be based on matters that existed prior to the policy issuance date. Thus, a buyer of real property who suffers a lien to be incurred on his house after a title insurance policy has been issued to him (e.g., because he failed to pay a financial obligation that the law permits to be enforced through a lien on her property) cannot seek indemnification for that claim from the title insurer.

Third, as a result of these fundamental differences in policy coverage, there are fundamental differences in the way in which insurers of these lines underwrite the policies they issue. Property/casualty insurance companies try to minimize claims by taking steps to inspect and assess the risks they are being asked to insure before they issue the policy. However, there is only so much information they can obtain and

[4] Some new policy forms are providing limited protection for certain post-policy events, such as the forgery of a document filed after the policy is issued and that clouds the insured's title, and a neighbor building an extension on his home that encroaches on the insured's property.

assess before the policy is issued that will predict the likelihood of a future claim. Rather, they rely primarily on an actuarial determination of the likelihood of various kinds of claims and losses taking place in the future and then determine the appropriate charge to make in order to generate adequate revenue to pay the level of claims that they know are statistically likely to occur.

Since title insurance generally insures matters that exist at the time the policy is issued, the underwriting of title insurance, on the other hand, operates almost entirely on the basis of identifying, evaluating, and addressing title problems before the policy is issued. It is theoretically possible, through a thorough search and examination of the title, to identify all the record defects (but, of course, not the non-record defects) that may exist and then to eliminate them, insure over them, or exclude them from coverage.[5] (As discussed in the next section, this process frequently results in title companies taking curative actions to remove invalid or satisfied liens or claims from the public records, or otherwise to repair errors in the title records.) While claims and losses are inevitably bound to occur, title insurers seek to do all they can to minimize the possibility of future claims.[6]

This trade off between (i) using revenue from the one-time premiums primarily to identify and, if possible, eliminate title risks prior to the issuance of the policy – thereby reducing the likelihood of having to pay claims -- rather than (ii) using such revenue to

[5] Just as no homeowner's insurance company would insure a house if it knew at the time that a fire was raging in the basement, a title insurer will not insure against a significant lien or claim it knows to exist and to be enforceable against the property.

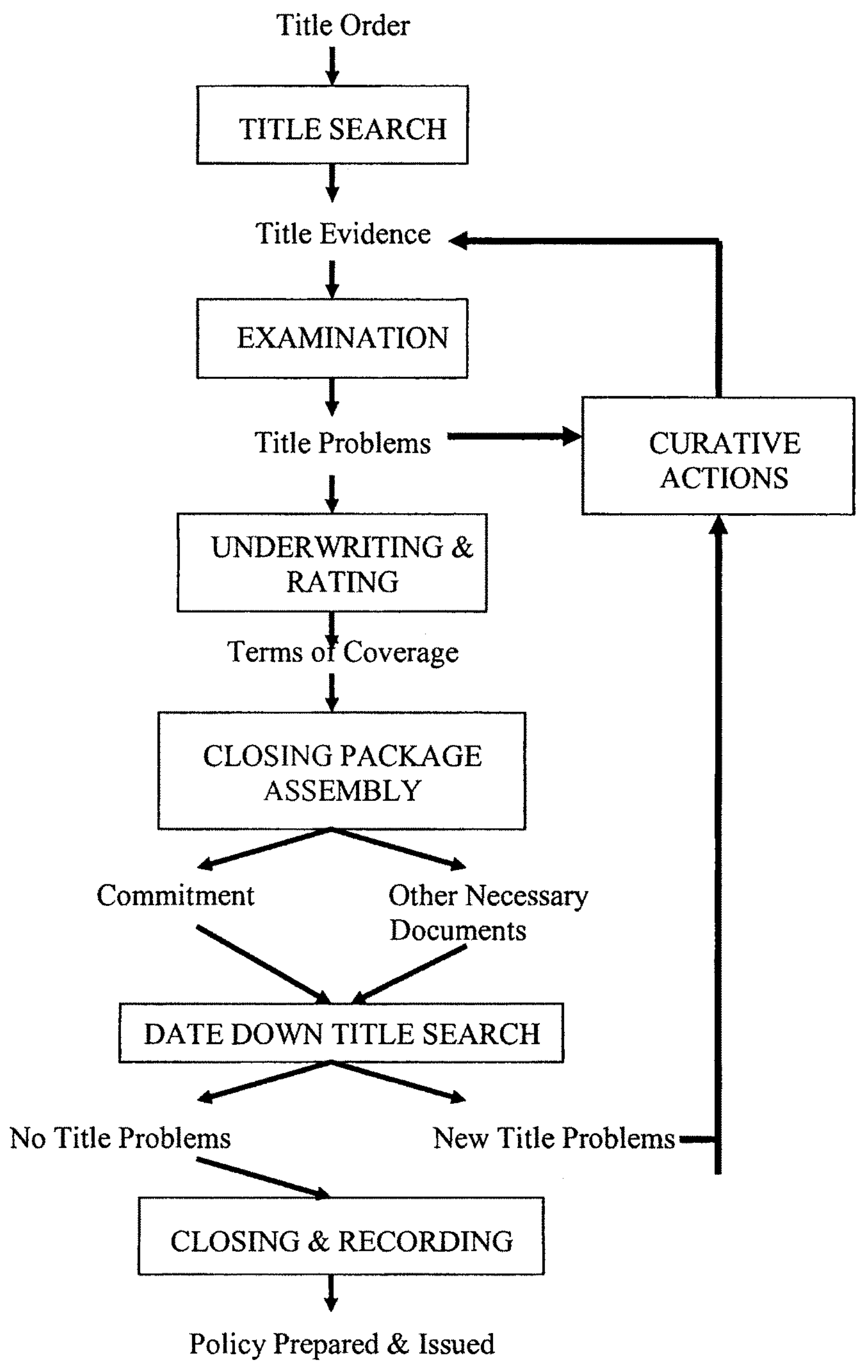
[6] In this regard, title insurance is somewhat akin to boiler insurance, where a significant portion of premiums are devoted to inspecting and correcting any problems with the boiler before the policy is issued.

pay claims that will inevitably arise if less intensive work is done in the up-front search/examination functions, is of unquestioned benefit to consumers and to all insureds. The importance of this point cannot be over-emphasized. All owners and investors in real estate, whether residential or commercial, want the safe, secure, and peaceful use of the property they are acquiring. If there is a problem with the title that could affect that use or the property's value, they want to know about it before they buy or invest in the property. Compensation for the loss of the property, or having to be involved in litigation by a party challenging their rights in the property, is not what the buyer or lender wants if such claims could otherwise be avoided.

Thus, it serves everyone's interest, including most particularly the industry's insureds, that title companies spend the preponderant share of their revenue on the title search, examination, and curative functions, which, if performed properly, will inevitably result in fewer losses and claims payments.

D. The Process of Issuing Title Insurance Policies and the Unique Role of Agents in the Title Insurance Business.

The process by which title insurance policies are issued is outlined in the figure on the following page.


Title Order
TITLE SEARCH
Title Evidence
EXAMINATION
Title Problems
CURATIVE ACTIONS
UNDERWRITING & RATING
Terms of Coverage
CLOSING PACKAGE ASSEMBLY
Commitment
Other Necessary Documents
DATE DOWN TITLE SEARCH
No Title Problems
New Title Problems
CLOSING & RECORDING
Policy Prepared & Issued

The first step a title company takes after an order is received is to collect the relevant records and information pertaining to the property to be insured, and information regarding possible claims against the seller or owner that could affect the title to the insured property. This is referred to as the "title search," and the information collected is the "title evidence." Such evidence can be obtained in any of several ways:

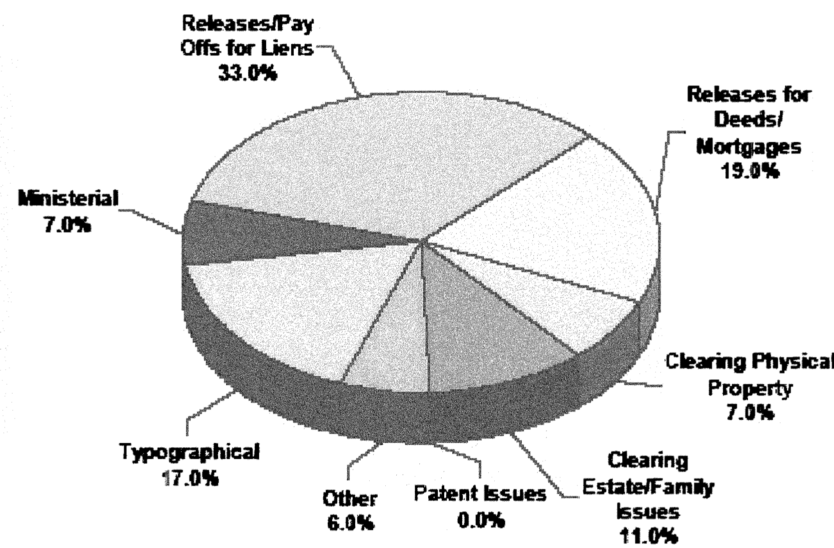
- by conducting a search at the various records centers where relevant information may be located;[7]
- by purchasing the evidence from a third party provider; or
- by owning or having access to a "title plant" – a privately-owned facility, now frequently maintained on a computerized basis, in which information and documents from the various public records centers are obtained, and then reorganized and maintained so that a search of any property in the locale can be conducted at any time without having to go to all of the public records sources.

Having collected the title evidence, professionals experienced in real estate law and title insurance principles must then examine the title evidence to reach a determination as to whether the seller can convey fee simple title to the buyer, and what title defects have to be noted as exceptions to the policy's coverage. It is at this "title examination" stage that the title company performs one of the most valuable services that is an inherent part of the title insurance underwriting function: curing defects and problems that may exist in the title records. As the chart on the following page shows, this curative action includes obtaining releases or pay-offs for discovered liens (e.g.,

[7] These could include the Office of the Recorder of Deeds (sometimes referred to as the Registrar of Deeds or the County Clerk's Office) (e.g., for deeds, plats, mortgages, and other documents relating to the property may be located), local or state courts (e.g., for judgments and liens), probate courts (e.g., for records on estates, marriages and divorces, adoptions, changes of name), federal bankruptcy courts, and various other cites.

2005 Abstractor and Title Agent Operations Survey
(Association Research, Inc.)

AVERAGE ALLOCATION OF CURATIVE ACTIONS BY TYPE



Source: 2005 ALTA Operations Survey

prior mortgage liens, child and spousal support liens, judgment liens, and tax liens where the release or pay-off of the lien was never recorded); obtaining releases for prior mortgages; and correcting typographical problems that could create problems (misspelled names, incorrect legal descriptions). A recent study by Association Research Institute indicates that such curative actions are taken, on a nationwide basis, in approximately 36% of residential real estate transactions.[8]

On the basis of the title examination, a commitment to insure the property is then sent to the prospective insured or his representative that will set out the conditions that must be met for a title insurance policy to be issued (e.g., the execution of a deed of trust, the pay-off of the seller's mortgage lien, the execution of a new mortgage in favor of the buyer's lender), and any exceptions (in addition to standard exceptions, such as for current taxes due) to be taken from policy coverage as a result of the title defects discovered in the title search and examination process. If those exceptions pose problems for the prospective insured, steps may be taken by the parties, with the assistance of the title company, to eliminate those defects that can be eliminated. If the defect cannot be removed, the title company may be willing to insure over the defect, either because it concludes that the risk of assertion or financial damage is small, or because an indemnity is obtained from the seller or another party.

Those defects that cannot be removed will be listed as exceptions to the policy's coverage. If the excepted defect is serious enough, the buyer may seek to modify the terms of his purchase contract with the seller or, in an extreme case, decline to proceed with the transaction. The latter situation is generally very rare because the title industry

[8] See "2005 Abstracter and Title Agent Operations Survey," Association Research, Inc. (April 2006) at 12-13 (Attachment D).

has done such a good job over time in cleaning up titles, and preserving the integrity of the public records,[9] that it is rare that a seller's title is so defective as to be uninsurable or unmarketable.

The closing package is then prepared and then a "bring-down" search is run to ensure that nothing has been filed of record since the date of the original search that adversely affects the underwriting determinations regarding the policy that can be issued.

The last steps in the process involve the closing of the transaction (i.e., the execution of relevant deeds, mortgage instruments, and other documents, and the exchange of funds), the recording of the new deed and mortgage lien, and the issuance of the title insurance policies to the lender and the purchaser.

Two important observations on the foregoing general discussion deserve noting.

First, all of the steps described in the process of issuing a title insurance policy may be performed by a title insurance company through a branch office it maintains in the locale where the property is located, or by a title insurance agent acting on the insurer's behalf. Unlike agents in other lines of insurance, who primarily perform, and are compensated for, sales-related functions, title insurance agents will generally perform all of the steps in the title insurance issuance process described above – the search, examination, curative work, issuance of the commitment, handling of the closing, recording of the documents, and issuance of the policies.[10] Thus, since the

[9] Indeed, in times of calamity, title records maintained by title companies have taken the place of public records that have been destroyed.

[10] Accordingly, title insurance agents are primarily compensated for the work they do in connection with the issuance of the policy. In transactions involving agents, the insurer will provide the agent with blank title insurance policies pre-signed on behalf of

preponderant portion of the revenue generated by the one-time title insurance premium is used for these functions and not for the payment of claims, it should not be surprising that the preponderant portion of the premium is paid to the agent for performing these functions.

Second, because of the historical differences in laws, customs, and practices in various parts of the country – and even within different areas of a single state – the title insurance issuance process described above is subject to numerous variations throughout the country. For example, in many parts of the eastern United States (and elsewhere) attorneys still play a significant role in residential real estate transactions and frequently act as title insurance agents on behalf of a commercial title insurance company or a "bar-related" title insurance entity. In these areas, the closing takes place when parties gather together around a "closing table" to sign and exchange documents and funds. In the Midwest, abstracters generally perform the role of preparing the title evidence (compiled in a document called an "abstract") from which a lawyer or a title company will perform the examination. Depending on the region, closings are conducted either around a closing table as described above or through an escrow, where the transaction is closed pursuant to written instructions received by the escrow holder from the parties. In California and other parts of the western United States, title

(continued)
the insurer that, upon being counter-signed (where required) and issued by the agent, become binding policies of the insurer. The insurer will generally not know that a policy has been issued by its agent until the end of the month (or some other period) when the agent remits the "net premium" due to the insurer (i.e., the total premium less the agent's commission or "retention" as it is referred to in the title industry) for all policies issued in the most recent period, together with a list of the policy numbers on the issued policies.

companies or independent escrow companies are available to handle this escrow function.

As title insurance expanded throughout the country, it tended to either become an overlay – an umbrella of added protection – on top of traditional methods of title searching and conveyance in the locale, or to supplant those methods by having the title insurer, either directly or through its agents, perform the search, examination, and closing functions. This explains why there are so many regional and local variations in how the conveyance of real estate is handled and the functions that title insurers and agents perform. It also explains why there are so many variations in what is covered by the title insurance premium. In some areas, the title insurance premium may encompass the issuance of both the owner's and lender's policies, the search and examination, and the closing of the transaction. In most others areas, the escrow or closing charge is not included and there are separate premiums for the owner's and the loan policies (although a significantly reduced simultaneous issue rate is available for a loan policy issued at the same time as the owner's policy). In some parts of the country the premium may include the search and examination function, and in other areas it may represent only a "risk rate" with the agent or insurer charging separately for the search and examination functions.

Accordingly, simply comparing title insurance premiums between or among different parts of the country will generally not result in an apples-to-apples comparison. Any meaningful and appropriate comparison between comparably priced transactions would have to include a comparison of the full range of charges that appear in the 1100 series of items in the HUD-1 uniform settlement sheet (which includes all title insurance and related charges).

E. Basic Approaches to Title Insurance Regulation.

Because of the important and unique role that title insurance plays in home ownership and in our economy, a more extensive regulatory framework applies to title insurance than is generally applied to other lines of insurance. While the specifics of such regulation vary from state to state, certain core elements of regulation remain consistent across all states.

Title insurance is one of the few lines of insurance that is required to be monoline: that is, a licensed title insurer is not permitted to offer any other line of insurance. Similarly, an insurer licensed to engage in another line of insurance cannot provide title insurance coverage. This restriction is expressly set forth by statute in a majority of states and, as to the balance, imposed generally through licensing statutes. This monoline restriction was adopted by states following the collapse of the title insurance industry in New York during the Great Depression. At that time, title insurers had been allowed to issue mortgage insurance and those other insurance activities had caused their insolvency as many borrowers were unable to repay their loans. Monoline restrictions were imposed in order to prevent this kind of disaster in the future and as a means of ensuring the safety and solvency of title insurers.[11]

[11] The importance of the monoline restriction has recently been questioned on the mistaken view that it somehow limits competition. That is not the case. Such restriction does not prevent any other insurance company from establishing a title insurance company as a separate corporate affiliate. It simply prevents them from mixing their title insurance risks with other kinds of insurance risks in the same company.

Additional regulatory requirements are imposed to ensure the safety and solvency of title insurers. States generally impose heightened capitalization and reserve requirements on title insurers, including statutory premium reserves requirements, recognizing, in part, the longer loss tail for these policies and the fact that there is no revenue from the renewal of policies. Title insurers are also subject to restrictive limitations on dividend distributions and specialized financial reporting requirements.

As discussed above, title insurance is a loss prevention type of insurance. In order to minimize losses, an extensive search of public records is performed as a predicate to the issuance of a policy. This search requirement is codified in many states to ensure that the search is always performed and that title insurance is not issued on a "casualty" basis. Such a requirement is intended to preserve the solvency and integrity of the title industry by minimizing claims. In addition to federal requirements under the Real Estate Settlement Procedures Act (RESPA), many states impose additional restrictive market conduct practices on title insurers and agents.

With regard to their approach to the regulation of rates, virtually all states require that title insurance rates must not be excessive, inadequate, or unfairly discriminatory. However, there are differences in the specific approaches taken to achieve that objective:

(continued)

Moreover, Dr. Lipshutz discussed the continued importance of the monoline limitation at length in a recent study. See Attachment E. Indeed, recent legislative efforts sponsored by non-title insurers to remove or modify the monoline statutes in California and South Dakota were defeated, with neither bill leaving committee. Likewise, the State of Arkansas has recently enacted a mono-line statute and a title insurance bill that contains a monoline provision has recently passed both houses in Illinois.

- a few states (three) promulgate the rates that may be charged and the split of the premium between insurer and agent;[12]
- a number of states (nine) require title insurers to obtain the prior approval of the state insurance regulator before the rates become effective;
- the great majority of states (27) require the filing of rates and then a specified waiting period before they may be used (so as to afford the regulator an opportunity to review the rates before their use);
- two states have a "use and file" approach; and
- eight states have no express regulation of title insurance rates.[13]

Two important aspects of all title insurance rates are that (1) they avoid the problems that would be posed if title charges in a particular transaction were based on the actual costs incurred in handling the particular transaction, and (2) they intentionally incorporate cross-subsidization principles between higher value and lower value transactions that ensures the ready availability of title insurance for moderate and low-income consumers.

Regarding the first benefit, if charges were based on the time and effort involved in searching, examining, curing defects, and closing particular transactions, the seller and the buyer would not know what the cost of the title-related process would be at the outset of the transaction,[14] since the total charge would only be known after the work in connection with the issuance of the policy was done. Not only would this make the cost

[12] Two other states, South Carolina and Connecticut, do not regulate rates but do control the level of agent commissions.

[13] For a listing of the regulatory approaches of the various states, see the A.M. Best Report at 16 (Attachment C).

[14] In many areas of the country, it is customary for the seller to pay for the owner's title insurance policy to be issued to the buyer, the buyer to pay for the simultaneously issued loan policy, and the parties to split the cost of the closing.

of many transactions uncertain, but it would make it difficult to comparison shop among title companies.

Regarding the second benefit, the fact that premiums are based on a rate per-thousand of liability results in a situation where higher price properties subsidize the cost of producing policies on lower-priced properties. Since title insurance rates are intended to cover all of the costs involved in producing policies and claims, there is an average cost per policy that the title insurer incurs. The premiums for lower-priced homes will fall below this average cost and the premiums for the higher-priced homes will generate revenues in excess of this average cost. The result of the rate structure is that transactions involving lower-priced homes will be subsidized by the transactions involving higher-priced homes. The incorporation of cross-subsidization into title insurance rate schedules thereby serves the important social function of making lower-priced properties more marketable.

II. CORRECTING MISCONCEPTIONS ABOUT TITLE INSURANCE.

The unique nature of title insurance, combined with the relative infrequency with which consumers purchase title insurance, has led to several general misconceptions about the purpose and value of title insurance. Many consumers who do not understand the product and its purpose, or who have not experienced a title problem, sometimes question the need for, or pricing of, title insurance. These misconceptions are then often reflected in the press, spreading their impact. While the industry, through ALTA and other state land title associations, has undertaken substantial consumer educational efforts, these misconceptions continue to persist in the marketplace and among some regulators.

We here address two of the more common misconceptions. Misperceptions relating to the significance of recent federal and state regulatory actions taken with regard to certain kinds of referral arrangements entered into by title insurance companies – captive reinsurance and agency arrangements with sham affiliated business companies – will be addressed in Part III, below.

A. Misconception: Because the industry pays out a relatively small portion of its total revenues in claims, this must mean that title insurance is of little value.

Based on inappropriate comparisons with property and casualty insurance and other lines of insurance, it is a frequent misconception that title insurance must be of little value because title insurance companies pay out a relatively small portion of their total revenues in claims. This misconception fails to recognize the significant differences between title insurance and those other lines of insurance that are discussed above in section I.C, of this Statement.

The purchase of a home generally represents the single most significant financial investment made by a consumer. Before the purchase, the prudent consumer wants assurance that he will be acquiring the safe and secure use of the property, free of unknown title defects. This assurance is provided by title insurance which, through the exclusions and exceptions noted in the commitment and ultimately in the policy, advises the consumer about title defects the company is unwilling to insure and provides indemnity against any unknown title defects that may cause financial damage to the insured.

As discussed in Part I.D., above, to accomplish its function of minimizing title claims and thereby serve the primary need of their insureds, title companies expend substantial time collecting and evaluating the title evidence, curing defects, making underwriting decisions, issuing a commitment that will enable the consumer to review and consider the exceptions to coverage for identified defects in the title insurance policy that will be issued, and issuing the policy. Each of these functions requires highly trained employees and professional personnel. In order to evaluate the condition of title, title company personnel must be familiar with all applicable legal aspects of title, including real property law (which often varies by state and even in different counties within a state) as well as bankruptcy, probate and family law. While many title companies maintain or have access to title plants (as mentioned earlier) in order to obtain their title evidence, in many parts of the country the title evidence is still obtained through direct searches in the recorder's office, at the county court house, and in other public records centers. These searches tend to be labor intensive requiring direct review of the applicable documents since only approximately 15% of public records are computerized. Even in those geographic areas where title plants are used, the cost of developing these plants is expensive as is the on-going cost required to constantly update the plant with all new public record filings. Even then, a search of the public records may still be required from the date of the last posting of the plant until the date of the transaction.

Over the last 20 years, loss and loss adjustment expenses[15] have accounted for approximately 6.4% of revenues. This compares with loss ratios in the

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[15] Loss" refers to amounts paid out to the insured for a loss under the policy. It includes payments to remedy a problem (e.g., paying off a prior mortgage or a missed lien), paying damages due to inability to use the property because of some covered title defect (e.g, an easement or covenant), or paying the value of the property in the case of a complete failure of title). "Loss adjustment expense" includes all costs incurred in

property/casualty insurance industry of approximately 70-80%.[16] On the other hand, operating expenses in the title insurance industry – which include the expenses incurred in the search, examination, curative, and policy-issuing functions – average around 92% of revenue, whereas operating expenses are in the range of 23-28 for property/casualty insurance companies.[17] On a combined basis, the total of operating expenses and loss and loss adjustment expenses for title insurers amounts to 98.4% of revenue, with the balance (1.6%) constituting the historical profit margin in the industry.[18] (See the table on the following page.)

Thus, the relatively low loss ratio simply reflects that title insurance is properly serving its function of assuring safety in real estate investments. If title insurers had a much higher claims rate, consumers and other insureds would be highly dissatisfied because they would be confronted much more frequently with unexpected and unwanted title problems. Moreover, the cost of title insurance would ultimately have to increase substantially to cover such claims.

B. Misconception: There Is a Lack of Competition in the Title Insurance Industry.

As various state regulators have considered whether title insurance rates within their state are "excessive, inadequate or unfairly discriminatory," a misconception has

(continued)
connection with the claim other than loss payments (e.g., legal fees in defending an insured title, a portion of the general expenses of the legal and claims administration departments).

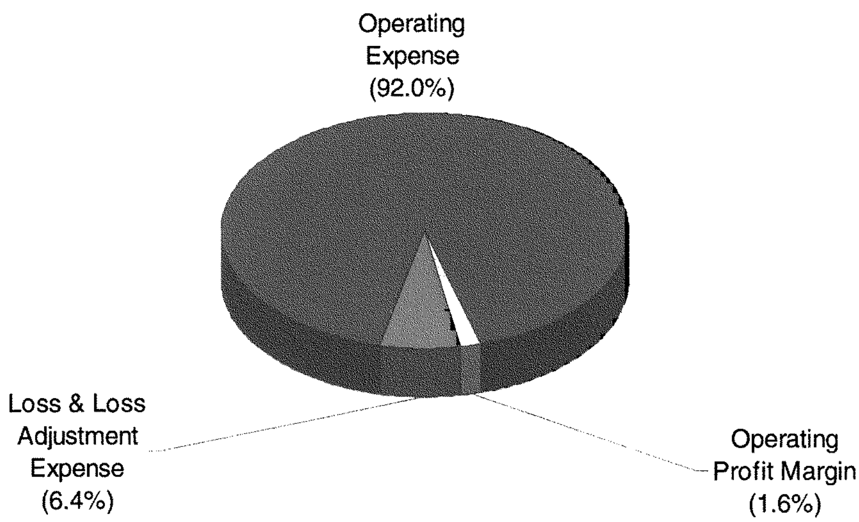
[16] See Exhibit 8 of the A.M. Best Report (Attachment C).

[17] Attachment C, Exhibit 9.

[18] Attachment C, Exhibit 10.

Title Insurance Industry Expenses & Operating Profit

(1984-2004)



Source: A.M. Best Report (Oct. 2005)

developed that there is a lack of competition within the industry. This misconception has been fueled by a recent report prepared by Birny Birnbaum for the California Commissioner of Insurance entitled "An Analysis of Competition in the California Title Insurance and Escrow Industry." While the regulatory objective of the Commissioner in asking for this report appears contrary to California law,[19] in any event the report misapplied outdated economic theory, selectively evaluated data, and drew conclusions unsupported by appropriate empirical data.

Following the issuance of the Birnbaum report, and given the importance of the question of competition, ALTA engaged Dr. Nelson R. Lipshutz of Regulatory Research Corporation to review the report and determine if it was based on sound and appropriate economic theory, and supported by appropriate empirical data. Dr. Lipshutz made that evaluation and determined that the report was incorrect and unreliable.[20]

In addition to the evaluation of Dr. Lipshutz, other noted economists reviewed and evaluated the Birnbaum report. Dr. Gregory S. Vistnes of CRA International, who has held positions as an economist at both the Federal Trade Commission and the Department of Justice's Antitrust Division and who was personally involved in

[19] The California Insurance Commissioner has publicly stated that he wants to reduce title insurance rates in California through regulation or otherwise. The Legislature in California, however, has expressly rejected such regulation. "It is the express intent of this article to permit and encourage competition between persons or entities engaged in the business of title insurance on a sound financial basis, and nothing in this article is intended to give the commissioner power to fix and determine a rate level by classification or otherwise." Cal. Ins. Code § 12401.

[20] "Incorrect Conclusions About Competition in the California Title and Escrow Markets Asserted in the December 2005 Contractor Report to the California Insurance Commissioner, Dr. Nelson R. Lipshutz, Regulatory Research Corporation, January 5, 2006) (Attachment F). The Executive Summary of Dr. Lipshutz's study describes the five most serious deficiencies of the Birnbaum report.

formulating federal policy regarding competition, determined that Mr. Birnbaum's conclusion that a reasonable degree of competition does not exist in California "has no basis in fact, and flows from an inappropriate and error-ridden analytic methodology."[21] Dr. Jared E. Hazleton, Professor of Finance, Insurance, Real Estate, and Law of the University of North Texas, similarly severely criticized the Birnbaum report.[22] Finally, Michael J. Miller, FCAS, MAAA, evaluated the Birnbaum report from the perspective of an actuary and found the report seriously flawed.[23] All experts who have reviewed the report concur that it is so flawed and inaccurate that it should be disregarded by public policymakers.

Dr. Bruce E. Stangle and Dr. Bruce A. Strombom of Analysis Group, Inc. have undertaken a study of competition in the California market.[24] They conclude from a careful review of available data and a proper application of economic principles: "The data show that the title insurance industry in California is competitive and rates are not excessive. For the median priced home in California, the base price of a standard owner's title insurance policy per thousand dollars of coverage has declined significantly from $6.89 in 1962 to $3.06 in 2005. Prices for refinance loan policies have fallen even further. . . . Competition among title insurance companies forces firms to provide more

[21] "An Economic Analysis of the December 2005 Birny Birnbaum Report to the California Insurance Commissioner," Gregory S. Vistnes Ph. D., CRA International (January 5, 2006) at 1. (Attachment G).

[22] See Attachment H.

[23] See Attachment I.

[24] "Competition and Title Insurance Rates in California," Drs. Bruce E. Stangle and Bruce A. Strombom, Analysis Group, Inc. (January 23.2006) (Attachment J).

innovative products and services and to offer lower prices through modified pricing programs."[25]

ALTA believes that there is intense competition within the title insurance industry. Indeed, it is because of this intense competition that some companies have engaged in kickback and referral fee arrangements in order to increase (or maintain) their market shares.

When one discusses competition it is important to recognize that competition exists on several different levels. It is not just limited to price. There is significant competition in the industry both at the insurer level and the agent level, and even between insurers and agents, with regard to (i) the quality and nature of services provided, (ii) the speed with which they can handle a transaction, (iii) the variety of title products that they offer, and (iv) the ability to attract and retain knowledgeable, trained and efficient title employees and attorneys. But, even with regard to price competition, the analysis of Drs. Stangle and Strombom confirms that there is active price competition in California, as ALTA believes to be the case in those states where rates are not promulgated by the state.[26]

Consumers benefit from this competition generally through lower rates, better and more efficient service, and the development of more market sensitive title products.

While the misconception that there is no competition within the title industry is generally driven by those believing it to be a way to force lower title insurance rates, it is

[25] *Id.*, at 1.

[26] Florida, New Mexico and Texas promulgate rates.

simply that – a misconception. There is intense competition within the title industry in a wide variety of ways, including rates.

III. ALTA'S PERSPECTIVE ON THE PROBLEMS OF UNLAWFUL PAYMENTS AND SHAM AFFILIATED BUSINESS ARRANGEMENTS.

The title industry is a very competitive industry. Competition for business and market share not only exists between title insurers, but between title insurers and title agents, and among title agents. Because title insurance is generally purchased only in connection with a real estate transaction – either a sale transaction or a mortgage refinance transaction – and there are no renewal premiums, most consumers do not have the familiarity with title insurance or title insurance providers that they have with auto or homeowners insurance that they purchase on a recurring basis.

Consumers today are generally more knowledgeable about real estate and mortgage transactions – and title insurance – than they have been in the past. This is in part because of educational efforts of ALTA and other real estate professionals, as well as because consumers have bought, sold or refinanced their homes far more often than in past decades.[27] The fact remains, however, that most consumers still look to their real estate agent or mortgage lender for advice on the selection of a title company, and that is not likely to change in the foreseeable future. Reliance by consumers on the recommendations of real estate professionals makes sense because those professionals are involved in real estate transactions on a day-in, day-out basis, and are in an a far better position than the consumer to assess which title companies provide

[27] Indeed, ALTA posts on its website extensive consumer advice regarding the home purchase process and the need for title insurance as part of its effort to help educate consumers about title insurance.

the best combination of service, quality, underwriting, and price. For that reason, it is inevitable that title companies will seek to compete actively for the referrals of those real estate professionals.

The title industry has very high fixed costs because of the huge investment required to maintain title plants and the need to retain, regardless of the volume of business, highly skilled and relatively scarce people to perform the search, examination, and underwriting functions on a county-by-county basis. Critics of the title industry often think that computerization of some title plants greatly reduces the cost of the title search without recognizing the enormous expense involved in the construction and maintenance of these plants.

Industries and firms with high fixed costs, however, often find that the marginal cost of producing an additional unit, beyond where the fixed cost is covered, is minimal. Any units sold beyond this point have only a small variable cost associated with them. Therefore, the revenue derived from the sale of these additional units can be lower than the average cost of production and still add to the company's profit. In the title industry, companies seeking to attract additional marginal business may be willing to give part of the revenue generated by that marginal additional business to the parties who can refer that business to them. If such reductions in revenue were experienced in all transactions, however, the firm would lose money and eventually be forced out of business. But such reductions in order to obtain the marginal additional transactions may make economic sense. In great measure, these factors help explain why title companies, in order to obtain marginal additional business, have been willing to enter into arrangements with real estate professionals who may be able to generate the marginal additional business. When the arrangement reflects reasonable payment for real services provided by the entities owned by those real estate professionals, there is no violation of RESPA or comparable state law provisions. When the arrangement does not reflect reasonable payment for real services, but payment for the referral of business, there is a potential RESPA problem.

Recently, there has been significant publicity regarding certain practices engaged in by title insurance companies and agents with those real estate professionals in a position to refer title insurance business. These practices have been alleged to be in violation of RESPA or state law. Two arrangements have received particular attention. The first, referred to as captive reinsurance, involves title insurers purchasing reinsurance from licensed companies that are owned by a builder, lender, or real estate broker who was involved in the original transactions that generated the title insurance policies for which the reinsurance was obtained. The second involves title insurers that have entered into agency arrangements with title insurance agencies owned by builders, lenders, or real estate brokers, where the affiliated agency obtains most or all of its business from referrals by its owners but does not perform many, or perhaps even any, of the customary functions performed by independent title agencies, yet receives a substantial commission similar to the commission received by a full service agent. The entities in this second example have been referred to as "sham affiliated title insurance agencies."

Both kinds of arrangements represent situations where the title insurer, competing for business to expand its market share, may be providing an indirect kickback or referral fee to the builder, lender, or broker involved in the arrangement in order to influence the referral of business. In both kinds of arrangements, the entity affiliated with the referrer of business – the reinsurance company or the affiliated title insurance agency – may be providing some services to the insurer. But the key question from a RESPA or comparable state law perspective is whether the payments made by the insurer to the affiliated entity – the reinsurance premiums paid to the captive reinsurer, or the commissions paid to the "sham" title insurance agency – exceed the reasonable value of the services that are provided by those entities to the title insurer. If they do, then the excess payment may be viewed by federal or state agencies, or the courts, as a referral fee paid to the builder, lender or broker.

While ALTA cannot comment on the specifics of any particular arrangement, some general comments on these practices may be helpful to the Subcommittee in obtaining a perspective on these matters.

A. Captive reinsurance arrangements

Reinsurance arrangements are well established and widely used throughout the insurance industry, including by the title insurance industry, to enable an insurer to spread its risk of loss on either a single policy (generally a large commercial risk) or over a range of policies or an entire portfolio of risks. Under reinsurance arrangements, the insurer that issued the policies pays a reinsurance premium to the reinsurer for its acceptance of a portion of the risk on those policies. When the reinsurer is owned by a party who generated the insurance business in the first place (e.g., the builder, lender, or real estate broker), the arrangement is commonly referred to as captive reinsurance. RESPA principles permit captive reinsurance so long as the amount paid for the reinsurance is reasonably related to the risk assumed.

In a 1997 letter, then Assistant Secretary of HUD-FHA Commissioner Nicholas Retsinas set forth the RESPA parameters for captive reinsurance arrangements entered into by mortgage insurers.[28] The two key principles articulated in that letter were that (a) payments to the captive reinsurer must be for reinsurance services actually furnished, and (b) compensation paid to the captive reinsurer must not exceed the value of such services.

Several title insurers then began to consider entering into captive reinsurance arrangements and the application of those principles to title insurance. Because of certain differences that exist between mortgage insurance and title insurance, and between historical reinsurance practices in the two industries, ALTA sought guidance from HUD as to how the principles articulated by HUD in connection with captive mortgage reinsurance would be applied in the title insurance context.[29] Unfortunately, HUD failed to respond to that letter for more than five years and, when it did respond, simply reiterated the two principles from the mortgage insurance letter without any analysis of their application to title insurance.[30] In the absence of any response from HUD in the years following the ALTA letter and company inquiries, title insurers were left without any guidance from the agency (a matter that will be discussed further in Part IV of this statement). Accordingly, several companies entered into captive reinsurance arrangements that they believed were in compliance with the HUD mortgage insurance

[28] See Attachment K.

[29] See Attachment L. Likewise certain title insurers approached HUD to determine if their proposed reinsurance programs were RESPA compliant and received no definitive guidance.

[30] See Attachment M.

guidelines. Because of the lack of HUD guidance on title insurance, other title insurers did not pursue such arrangements.

In late 2004 and early 2005, certain state insurance departments, including Colorado and California, began to examine these captive reinsurance arrangements, in part because of information brought to their attention by other members of the industry who were not engaged in those practices and who were concerned about their loss of market share. The Colorado and California departments, and subsequently others, came to the view that such arrangements were not consistent with RESPA and various state law provisions. Consequently, the companies that had been engaged in such arrangements terminated the practice and elected to settle the dispute, rather than engaging in lengthy litigation over whether such arrangements in fact violate RESPA or state law. It is ALTA's understanding that all such reinsurance arrangements have now been terminated and that the insurers involved have reached, or are in the process of reaching, settlements with the insurance departments that involve payments to consumers whose policies were reinsured under such arrangements.

ALTA believes that if HUD had responded to its 1999 letter more promptly and with more definitive guidance, these arrangements might never have been created in the first place. Moreover, the Subcommittee should consider several other pertinent factors about these arrangements. First, consumers whose policies were reinsured under those arrangement did not pay a higher price than the price paid by consumers in comparable transactions that were not subject to such arrangements. This does not, of course, determine whether the arrangements were or were not violations of RESPA or state law. But no one should believe that the consumers involved were "overcharged" in those transactions.

Second, such transactions represented a very small portion of the total number of transactions of the title insurance companies involved and of the aggregate premium revenue of the industry as a whole. In other words, even if some portion of the reinsurance premiums paid by the companies were in excess of the value of the reinsurance obtained from the captive reinsurers, the total amount of such excess payments is a miniscule portion of the total revenues of the industry. Any contention, therefore, that such excess payments demonstrate that, as a general matter, title insurance is overpriced simply cannot be sustained. These marginal additional payments were made to obtain marginal additional business.

This is not, of course, to condone these or any other arrangements that may violate RESPA. Rather, it is to make clear that general conclusions about title insurance charges or profitability cannot be derived from this kind of evidence.

B. "Sham" affiliated business title agencies.

Prior to 1983, there was a substantial question as to whether Section 8 of RESPA, which prohibits the giving or receipt of any kickback or referral fee in connection with a real estate settlement service, applied where a person in a position to refer settlement business had an ownership interest in a company (e.g., a title company) to which it referred business and from which it received dividends. During several years of Congressional debate on that issue, ALTA took the position that limitations should be placed on the amount of business such entities could accept from referrals by owners. Congress did not agree with that position. In 1983, Congress amended Section 8 of RESPA to make clear that persons in a position to refer settlement service business (e.g., builders, lenders, and real estate brokers) can establish or own title companies and other settlement service providers to which they refer business provided that three conditions are met:

- the person making the referral provides an Affiliated Business Disclosure Statement to the consumer explaining the nature of the affiliation between the person making the referral and the affiliated business entity, and an estimate of the charges to be made by that entity;
- the person making the referral has not required the use of that provider; and
- the only thing of value to the person making the referral is a return on the ownership interest in the affiliated business entity.

In 1996, HUD promulgated regulations implementing these statutory provisions that provided further guidance on what parties needed to do to avoid their affiliated business arrangements being considered "sham arrangements" that would not fall within the statutory safe harbor. These requirements, which apply to the establishment of affiliated title insurance agencies, basically require that the affiliated provider be a *bona fide* business entity, with sufficient capital and employees to manage its own affairs, and must provide substantial services.

Thus, a clear and lawful regulatory path exists for builders, lenders, or real estate brokers to establish affiliated business title insurance agencies. In fact, the overwhelming number of affiliated business title agencies that exist today were created and are operated in compliance with these RESPA rules. All of the major trade associations whose members are involved in such arrangements, including ALTA, provide seminars and other material for their members on the do's and don'ts of establishing such lawful arrangements.

Thus, while there is no need for the establishment of "sham" agencies when a lawful and appropriate vehicle exists for builders, lenders, and brokers to offer title insurance through a legitimate affiliated business title agency, these kinds of agencies do exist, primarily in order to avoid the costs of providing real title agent services while still realizing for the owners much of the revenue that a legitimate agent would realize. Whether the impetus for the establishment of such "sham" arrangements comes from the party controlling the business or from the title insurance company who is seeking the additional business is irrelevant. In either event, ALTA opposes such arrangements and believes that the recent level of enforcement activity that by HUD and state insurance departments directed against such arrangements has had a significant impact in cautioning all of the affected industry participants about the risks of such arrangements.

Indeed, the fact that, in recent years, these and other practices have been the subject of increased federal and state regulatory attention and civil actions demonstrates that, in great measure, regulatory regimes are in place today that are able to address and correct these problems. In fact, HUD has taken more enforcement actions in the past 15 months than in any other period since RESPA was enacted. Moreover, the recent actions by various state insurance departments further demonstrates that state regulators are also focusing on these competitive issues and are capable of taking meaningful action.

As discussed next, however, there is more that can be done to minimize these problems in the future.

IV. ACTIONS THAT CAN BE TAKEN TO MINIMIZE THESE PROBLEMS IN THE FUTURE.

It is important for the Subcommittee to appreciate that ALTA and its members have historically been strong supporters of the principles of RESPA and its objective to ensure that competition is not skewed by illegal referral fees and other kickback practices. The reason for that support is clear: such payments and practices cause ALTA members that are complying with RESPA to lose business. Thus, the more we can encourage all companies to comply with the letter and the spirit of RESPA, the better off our members – and their consumer customers – will be.

Our industry therefore has a strong interest in working with the National Association of Insurance Commissioners, state insurance departments, and HUD to maximize the clarity of the rules that guide competition in our industry, and to ensure that these rules are enforced fully and fairly. Indeed, many of the enforcement actions that have been taken by those authorities have been the result of information provided by members of the industry who are concerned about the competitive advantage their competitors may be gaining through a bending, or breaking, of the rules. Accordingly, a number of the changes that we would like to see, and that we believe will be of significant help in minimizing unfair competitive practices in the future, involve building on the private-public partnership the foundation of which is already in place.

First, we believe that Section 8 of RESPA should be amended to provide competitors the right to bring a Section 8 case for injunctive relief and attorneys' fees/court costs against other companies that are violating the provision. Companies in the industry invariably know when their competitors are engaged in questionable or unlawful practices to get business. They have a strong incentive to discover and stop such practices. Indeed, this may provide the best approach to the enforcement of RESPA. This approach would not require additional HUD enforcement staff, nor would it increase taxpayer expense.

Second, we would like to obtain a commitment from HUD that it will respond within a reasonable time to requests for guidance on RESPA issues that are submitted by ALTA or by other national trade associations representing firms involved in the real estate settlement process. As discussed above with regard to the problems that arose in connection with captive reinsurance arrangements, HUD's failure to provide timely and meaningful advice on important RESPA issues has resulted in companies engaging in practices that might well have been avoided if such advice had been provided on a timely basis.

While it is understandable that HUD cannot issue comprehensive responses to every RESPA question it gets, if the questions are submitted by the settlement service trade associations it will ensure that only important questions that truly involve "open" issues that have broad significance to an industry will be brought to HUD's attention for advice and clarification. Another potential approach that might further minimize HUD's workload in this regard is for HUD to provide its views on (e.g., to endorse or reject) opinions regarding RESPA issues that are developed by private RESPA counsel and submitted to HUD by the national trade associations. Such opinions could be made available on the HUD RESPA website so as to provide guidance to others beyond the industry seeking HUD's views. It is certainly more beneficial and less costly to HUD to clarify RESPA issues up front than to have to litigate over practices that may or may not be violations.

Third, we believe the states should be encouraged to adopt and enforce referral fee prohibitions against the recipients of such payments. Frequently, it is the title insurance companies that are under pressure from persons in a position to refer business to make questionable payments in order to get referrals. These parties may play one title company against the other. Better enforcement against the recipients of unlawful things of value will help to reduce the demand for unlawful payments or arrangements.

Fourth, like all responsible national trade associations, ALTA allocates substantial resources to educating its members. But, in addition, we believe that greater emphasis should be placed on consumer education both directly and through the Internet. ALTA has been actively engaged in consumer education for many years. ALTA has constantly updated its website so that it now contains clear and helpful information for consumers and important information for regulators. ALTA has developed pamphlets and materials to explain the nature and purpose of title insurance to consumers, and encourages the distribution of these materials, or similar materials, by state regulators and state land title associations. Greater consumer education about title insurance and the real estate settlement process should be the objective of all settlement service providers and their regulators. While it is likely that consumers will continue to rely on their real estate professionals in selecting title insurance and other settlement service providers, ALTA believes that as the sophistication of consumers increases, the frequency of improper market conduct will diminish.

CONCLUSION

ALTA appreciates this opportunity to provide its views to the Subcommittee and is prepared to respond to any questions the members may have about title insurance or our industry.

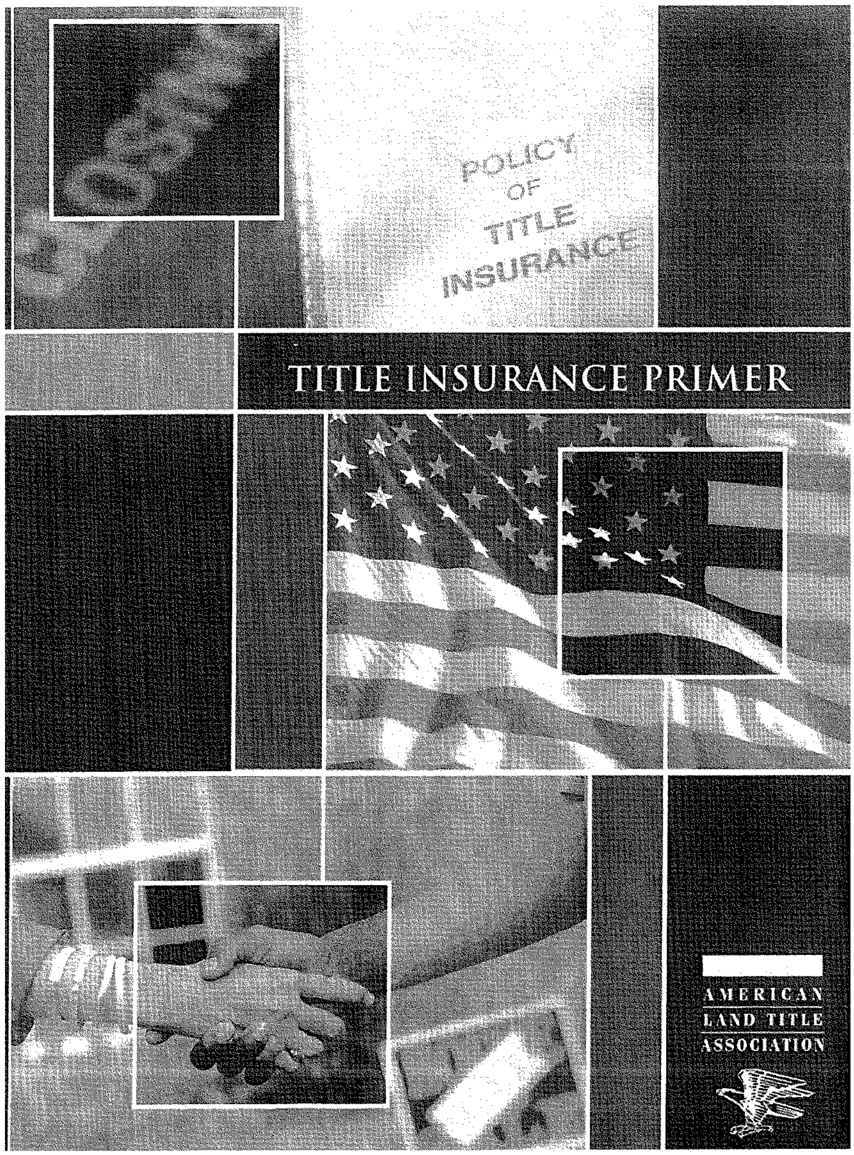
**ATTACHMENTS TO THE PREPARED STATEMENT OF
RANDE K. YEAGER, PRESIDENT AND CEO OF
OLD REPUBLIC NATIONAL TITLE INSURANCE CO.,
ON BEHALF OF
THE AMERICAN LAND TITLE ASSOCIATION**

TAB	DOCUMENT
A	"Title Insurance Primer" prepared by the American Land Title Association
B	"The Nature of Title Insurance," Prof. Harry Mack Brown, Journal of Risk and Insurance (Sept. 1966)
C	"Clouds on Horizon After Title Indusry's Bright Year," A.M. Best Special Report (Oct. 2005)
D	"2005 Abstracter and Title Agent Operations Survey," Association Research, Inc. (April 2006)
E	"The Role of the Monoline Requirement in Assuring Title Insurance Effectiveness," Dr. Nelson R. Lipshutz, Regulatory Research Corporation (December 1, 2004)
F	"Incorrect Conclusions About Competition in the California Title and Escrow Markets Asserted in the December 2005 Contractor Report to the California Insurance Commissioner," Dr. Nelson R. Lipshutz, Regulatory Research Corporation (January 5, 2006)
G	"An Economic Analysis of the December 2005 Birney Birnbaum Report to the California Insurance Commissioner," Gregory C. Vistnes, Ph. D., CRA International (January 5, 2006)
H	"Review and Comment on 'An Analysis of Competition in the California Title Insurance and Escrow Industry' by Birney Birnbaum," Dr. James E. Hazelton, Professor of Finance, Insurance, Real Estate and Law, University of North Texas
I	"Workshop Regarding Title Insurance Competition Report and Implications for Rate Regulation," Michael J. Miller, FCAS, MAAA (January 5, 2006)
J	"Competition and Title Insurance Rates in California," Dr. Bruce E. Strangle and Dr. Bruce A. Strombom, Analysis Group, Inc. (January 23, 2006) (Attachment J)
K	Letter from Nicholas P. Retsinas, Assistant Secretary of HUD for Housing-Federal Housing Commissioner, regarding the application of

RESPA Section 8 to captive mortgage reinsurance arrangements (August 6, 1997)

L Letter from James R. Maher, Executive Vice President of the American Land Title Association, to HUD General Counsel Gail W. Laster seeking guidance on application of RESPA Section 8 to captive title reinsurance arrangements (February 23, 1999)

M Response of HUD Associate General Counsel John P. Kennedy to ALTA's letter of February 23, 1999 (August 12, 2004)


POLICY
OF
TITLE
INSURANCE
TITLE INSURANCE PRIMER
AMERICAN
LAND TITLE
ASSOCIATION

While this primer strives to explain the overall concepts and background that formed the title insurance industry, in order to truly understand the industry you must know how title is regulated at the state level. Even though national title insurance companies offer their product across the country, each state determines the rules and regulations that must be followed to do business within its borders.

The American Land Title Association, in conjunction with the national law firm of Kirkpatrick & Lockhart LLP, has assembled all the pertinent information on how the title business is conducted in each state and the District of Columbia. ALTA's Title Insurance Regulatory Survey is the most comprehensive collection of regulatory information and practices of the title industry available. Those looking to expand their knowledge of the industry, should contact ALTA at 1-800-787-ALTA about obtaining a copy of this resource.

WHAT IS TITLE INSURANCE, AND WHY DO YOU NEED IT?

Title Insurance – Then and Now

The objective of title insurance remains the same as it has always been—to help the parties in real estate transactions determine their rights and interests and assure that land transfer is expeditious and secure. Protecting the parties involved in real estate transactions is the reason the product of title insurance was developed.

In this country matters affecting ownership and other real estate interests are entered in public records. Before a transaction is completed, a title search of the records can be made in an effort to locate potential problems so that they can be rectified and the sale can proceed.

While most problems can be located in a title search by skilled professionals, there can be hidden hazards that even the most thorough search will not reveal. Examples include forgeries in the chain of title, a claim by a previously undisclosed relative of a former owner, or a mistake in the records. Liens, easements, rights-of-way, life estates, air and subsurface rights, and future interests are also found in a title search.

Until the nation was nearly a century old, the conveyancing of real property did not include any form of guarantee or insurance. Many of the transactions were handled by conveyancers, who either personally searched titles or obtained some form of abstract (summary of public records) to determine ownership of the land and encumbrances on the title. Before taking title to property, the buyer required that the title be free of any rights, interests, liens, or encumbrances of others for which he or she would be responsible. Based on the title search or abstract, the title could be examined and an opinion rendered by the conveyancer that the title was clear, and thus marketable.

There clearly were limits on the protection that the conveyancer could provide to the parties involved. This inadequacy of safeguards was emphasized in a historic court decision in 1868 that led to the creation of title insurance—which brought a new dimension of security and stability to the real estate market.

In 1876 a group of Philadelphia conveyancers founded the first title insurance company. In an initial advertisement, the company said it was beginning operation to insure "the purchasers of real estate and mortgages against losses from defective titles, liens and encumbrances," and added, "Through these facilities, transfer of real estate and real estate securities can be made more speedily and with greater security than heretofore."

Subsequently, title insurance companies were organized in other cities—among them New York City, Chicago, Minneapolis, San Francisco and Los Angeles.

As the industry grew, title companies and their agents began providing essential services to real estate buyers, sellers, lenders, brokers, attorneys, developers, builders, and others. Following World War II, as returning servicemen began to buy homes in large numbers, the title industry began to change from an essentially local enterprise to one doing business on a national level. Yet despite this, national lending/investment title work continues to be based on local law and custom.

Title Insurance Today

With the advent of new types of mortgages and the rapid growth of an aggressive secondary mortgage market, title insurance companies have responded impressively to investor needs by creating new policies offering innovative coverages. (More on policies and the Secondary Mortgage Market later.)

Title companies in some locations have seen their functions evolve into much more than just title searching. Today many are involved in completing all aspects of the closing process from preparation of documents to recording instruments, to preparation of closing forms, to collecting and disbursing funds.

The title insurance industry continues to provide security to real estate investors, especially as rapid and dramatic developments drive the real estate market. From a single-family home purchase to a multimillion dollar commercial transaction closing simultaneously in several cities, real estate investors in this country will continue to receive title protection at a level of excellence unequaled anywhere in the world.

Title Insurance Minimizes Risk/Claims

Since its inception title insurance has offered protection that is significantly different from other lines of insurance. Typically, other types assume a particular risk and provide financial indemnity in the event the risk occurs. Title insurance, on the other hand, emphasizes loss prevention by eliminating risks caused by title problems arising from past events.

Besides minimizing the possibility that title hazards will threaten ownership or use of property, the concentration on risk elimination greatly reduces the number of claims to be defended against or satisfied by the insurer.

With other types of insurance, an annual premium is usually paid. For title insurance it is a onetime fee paid at closing.

There are two basic kinds of title insurance—owner's and lender's. In a typical residential transaction the title policy often required by the mortgage lender will not safeguard the rights and interests of the homebuyer. Separate owner's title insurance is necessary to protect the buyer.

Owner's title insurance is typically issued in the amount of the real estate purchase price and remains in effect for as long as the owner, or his or her heirs, retains an interest in the property. In addition to identifying risk before a transaction is completed, owner's title insurance will pay valid claims and will pay the defense costs against attacks on the title.

Who pays for the owner's title policy is a matter of local custom. In some parts of the country the seller purchases the owner's title insurance for the buyer, in effect telling them the title is clear. In other parts of the country both lender's and owner's title insurance are issued simultaneously, and in still others the buyer must ask for owner's title insurance and pay separately for it.

Lender's title insurance assures the lender of the validity, priority, and enforceability of its lien (mortgage)—serving as protection for the lender's security interest in real estate. Lender's title insurance is issued in the amount of the loan, and liability decreases as the mortgage debt is reduced.

TITLE INSURANCE – COMMON MISCONCEPTIONS

Myth: Transferring title to real estate is as simple and as inexpensive as transferring title to an automobile.

Facts: There are few interests involved when an automobile title is transferred—usually they are limited to the owner and the lender. Consequently there normally is little to consider when an automobile is sold.

But there may be literally dozens of persons and entities with different interests and rights in, or claims against, a single parcel of real estate. The value of rights in a parcel of real estate often far exceeds the value of the most expensive automobile.

Some may have the right to use the property for certain purposes (such as electric companies accessing power lines), while others may claim the right to prohibit specified use. Some may have a right to occupancy and some the right to rental fees for occupancy by others.

Some may have the right to use part of the land for specific purposes (such as a driveway for power line construction) and others the right to use the surface of the property, air rights above the surface, and the right to minerals beneath the surface. Still others, some yet unborn, may have rights that will not commence until many years have passed.

Literally scores of claimants and governmental entities have the right to enforce liens, claims, and encumbrances against the property. Their rights may emerge for such diverse reasons as court judgments, unpaid taxes, welfare payments, unpaid claims of those who make improvements on the property, water and sewer assessments, and so forth.

Because the surrounding laws and records are complex, making an evaluation of the scope and validity of any claim or interest in real property requires an experienced professional. The continually evolving body of real estate law ensures that the numerous kinds of rights in property can be described, preserved, transferred, inherited, devised, levied upon, leased, restricted, zoned, taxed, mortgaged, and acquired by eminent domain.

Simplification of land transfer is a commendable goal—one that is endorsed and pursued by members of the American Land Title Association. But as long as society continues to recognize so many diverse interests and claims in real estate, transferring title to land will remain far more complicated than transferring title to an automobile.

Myth: Title insurance and other title-related charges make up a substantial portion of closing costs and are a major obstacle for buyers of moderately priced homes.

Facts: Title insurance and other title-related charges, in fact, make up a modest percentage of total closing costs normally incurred in the purchase of a home.

Loan discount points, realty agent sales commissions, prepaid items, recording fees and taxes, and lender charges make up a much greater percentage of costs paid by the buyer. None of these is in any way related to title protection. In some states governmental transfer taxes alone may exceed the total of title-related charges.

High interest rates, high down payments, increased construction costs, higher taxes, and rising maintenance and utility costs may be cited as barriers to homeownership; however title-related charges are not a serious obstacle. They represent a small portion of total settlement expense.

Myth: Lender's title insurance protects the homebuyer.

Fact: The interests of the lender and the owner in a real estate transaction are substantially different. Therefore, it is a hazardous assumption for the owner to expect protection from the lender's title policy.

The lender's policy is written in the amount of the loan. If there were a total failure of title, the lender would be covered for the full amount of its investment—while the buyer would have no coverage at all.

Owner's title insurance will protect the purchaser if a claim is made against the title. Owner's title insurance will also pay any legal fees incurred in defending the claim. If only lender's title insurance has been issued, the homeowner would not be covered for legal fees and might lose the property should a problem arise.

Myth: Title services aren't necessary when property is resold shortly or refinanced.

Fact: Regardless of the length of the intervening time period, a new title search and examination and a new title policy are needed to fully protect the parties when property is resold or refinanced. The owner-seller may have created or experienced claims, liens, or encumbrances since the original policy. Here are some examples:

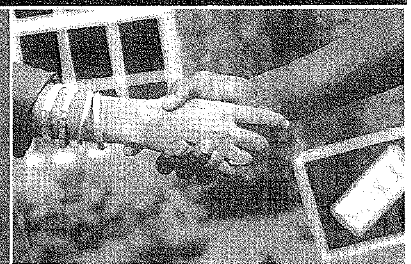
- The owner may have placed a second mortgage on the property.
- There may be outstanding mechanic's or materialmen's liens as a result of improvements made to the property.
- The owner may have created rights of way, utility easements, or other encumbrances.
- Eminent domain rights may have been exercised with respect to part of the property, such as the widening of a road.
- Various involuntary liens may have been placed against the property as a result of unpaid taxes or judgments, welfare claims, etc.
- The owner may have been subjected to bankruptcy or divorce proceedings since purchasing the real estate.
- Other persons may have been granted a lease, life tenancy, or other estate in the property by the owner—beyond the owner's initially acquired fee simple interest.

Virtually all public records searched during the initial real estate purchase have to be reexamined to bring title up-to-date for the subsequent sale. The work involved for issuing new title insurance to provide full protection would be comparable to that for the initial purchase of the property.

TITLE INSURANCE BENEFITS

Title insurance services offer a wide range of protection to the many different parties who have various interests in real estate transactions. The benefits of title insurance protect:

- Real Estate Purchasers
- Sellers
- Lenders
- Real Estate Brokers
- Attorneys
- Homebuilders



The Purchaser

Whether the transaction involves a multimillion dollar office building or a single family home, the purchaser faces possible serious financial loss or could lose the right to own the property altogether if a serious cloud on the title goes undetected. An expert title search before the purchase will identify the nature of title and fix any problems that are clouding the title.

As mentioned earlier, owner's title insurance offers protection against various hazards, including those even the most thorough search of the public records will not disclose, such as forgeries, missing heirs, or recording errors. And, owner's title insurance will pay valid claims and the defense costs against attacks on or challenges to the title.

For a onetime premium that is modest in relation to the value of property involved, the purchaser receives the protection of a title policy backed by the reserves and solvency of an insurance company. In the unlikely event the insurance company ceases to operate, reserves offer the assurance that another insurer will accept risk for the existing policyholders.

The Seller

Similarly, sellers want to be sure the title is marketable, so they can sell their property. A title insurer facilitates the flow of mortgage money by identifying title problems so they can be resolved whenever possible, and then by insuring against title risks. Title insurance encourages the expeditious completion of a transaction, thus the sellers receive their money in a timely fashion.

The Lender

Financial organizations are acutely concerned when it comes to the security of the funds they lend for real estate investments.

Lender's title coverage provides a high degree of safety against loss of capital from title hazards. By identifying risks and eliminating them when possible, the title industry is a major element in encouraging lenders to invest in mortgages—rather than in other assets with lower risk.

Lender's title insurance guarantees the lender a valid and enforceable lien and assures that no claimant other than those noted in the policy has a prior claim against the real estate. The policy assures that the purchaser-borrower has title to the property being pledged as security for the loan. And the policy obligates the title insurer to pay for defending against any claim filed against the title that might supersede the lender's lien. And, if unsuccessful, it must satisfy that claim should it be upheld in court.

Another benefit is the in-depth expertise of title company personnel, who facilitate the mortgage loan process and help in resolving differences among the various parties in a transaction. This can range from relatively routine assistance in a basic residential loan to helping with the multifaceted legal and financial aspects of complex, multimillion dollar commercial transactions. In the more complicated examples the title company's effort on behalf of the lender can extend even further.

The Real Estate Broker

There is much to be gained by the real estate broker who calls the title insurance company in the early stages of transaction. The security of title insurance greatly enhances the possibility for loan approval. And, abstract or title insurance personnel—by fast, accurate verification of title or by swift resolution of a title problem—often make it possible to promptly complete a transaction that would have been seriously delayed or would have been altogether lost.

By calling the title company or its agent, the broker promptly becomes informed of the alternatives for clearing up title problems found in a search of public records and learns in a timely manner what information the title company needs to issue the insurance. This close contact also enables the broker to become better informed on available title coverages so the parties can be readily assisted with their needs.

Having up-to-date knowledge of title hazards and safeguards will enhance the broker's stature as an important market resource.

The Attorney

In some states it is a real estate attorney who handles the closing. The attorney will create an attorney's opinion, setting forth what he/she believes to be the condition of the real estate title. Title insurance enables the real estate attorney to offer his or her client substantially greater protection than what is attainable with a legal opinion alone. Title insurance resolves this dilemma by backing up the attorney's title search with guaranteed financial indemnity from a licensed, regulated corporate insurer and by providing adequate capital and reserves to respond to claims.

The protection of title insurance extends far beyond the risk that may be incurred by the purchaser as a result of an error or negligence by the person performing the search and examination. Among the many risks covered by title insurance (that would not be covered by the attorney's malpractice insurance) are:

- Mistakes in the interpretation of wills or other legal documents
- Impersonation of the owner
- Forged deeds, mortgage releases, etc.
- Instruments executed under fabricated or expired powers of attorney
- Deeds delivered after death of seller or buyer
- Undisclosed or missing heirs
- Wills not probated
- Deeds or mortgages by those mentally incompetent or of minor age (or supposedly single but actually married)
- Birth or adoption of children after date of will
- Mistakes in the public records
- Falsified records
- Confusion from similarity of names
- Transfer of title through foreclosure sale where requirements of foreclosure statute have not been strictly met

While ALTA recommends that all parties to real estate transactions be represented by their own counsel, it is the view of the association that no real estate attorney adequately protects the interest of a client without advising that client of the availability and protection of title insurance.

The Homebuilder

Delays for the homebuilder can also be minimized by contacting the title company early in the building process. Actions initiated by the title company that have a positive effect on the builder's completion time can include the following:

- Calling a meeting of everyone involved to establish coordination and minimize problems (builder, developer, attorney, engineer, architect, escrow holder, etc.)
- Expediting title search and examination so any difficulties can be dealt with more quickly
- Advising on mechanic's lien coverage and other title insurance needs of parties to the transaction
- Setting up sale escrow accounts and handling disbursements upon closing
- Coordinating with subcontractors so their problems can be dealt with in the early stages of the project
- Arranging for prompt handling of any title claims that arise

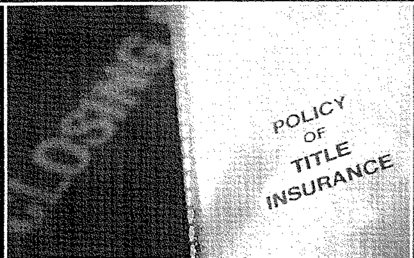
By assuring priority of the first lien mortgage for the lender, title insurance makes construction loan financing considerably more attractive.

Title company personnel help the builder or developer establish ownership rights to assure local government that a project may proceed as planned. This normally expedites plat approval.

And title companies will insure titles to individual lots in a development on a mass production basis, often at a reduced rate, so new owners title policies can be promptly furnished to home buyers after updating of title work, rather than following extensive and time-consuming back searches upon the issuance of each policy.

Besides the basic owner and lender policies, title insurers offer various special coverages that are important to different parties. Additional coverages relating to new construction are available in some areas. These coverages could include mechanics lien protection or special coverages regarding surveys or zoning.

Title Insurance and the Secondary Mortgage Market



Beginning in the mid-1940s the nationwide growth of a secondary mortgage market has proved to be an especially dramatic benefit for millions of American home-buyers. The positive effects of this phenomenon have reached out to numerous other related sectors of the economy.

Essentially, the purpose of the secondary market is to broaden the base of investment for mortgage financing and to attract funds from areas of the country with abundant capital to areas where mortgage money is needed.

Unlike the New York Stock Exchange and other organized trading markets where representatives of buyers and sellers meet in a single location, the secondary market consists of a complex network of organizations, intermediaries, and various channels of communication. Through this facility, lenders in one area of the country with funds to invest can readily make or purchase mortgage loans on real property located elsewhere.

Secondary market operations may be as simple as a lender in California selling mortgage loans to another lender in New York or as complex as the development and sale of Government National Mortgage Association pass-through securities, which are guaranteed by GNMA and are backed by a pool of mortgages worth millions of dollars.

The need for protection from title problems is even more acute in dealing with mortgages in the secondary market than in what is normally encountered by a local lender.

Knowing the local customer and the attorney rendering an opinion may be sufficient for a local lender to lend and portfolio a mortgage. However, a title opinion from a local attorney will not provide the assurance for a national lender that is unfamiliar with local risks and/or unwilling to take a chance.

In view of these considerations, it is easy to see why virtually every mortgage traded in the secondary market is covered by a lender's title insurance policy. With financially sound corporate insurers standing behind the validity and enforceability of mortgage liens, marketability of insured loans is greatly improved. National or out-of-town lenders know that, should a title problem develop on property located in a distant part of the country, they can deal with title company experts whose capabilities are well-known and who can quickly come to grips with the difficulty and initiate appropriate action.

Mortgage loans on all types of real property constitute the nation's largest single category of institutional investment. Lender's title insurance has enhanced the remarkable growth in the availability of mortgage funds, which has brought an impressive stimulus to real estate investment from coast to coast.

This expansive viability has been characterized by two major developments, both directly linked to title insurance:

- Mortgage investment has become more secure.
- Mortgage money has become widely available throughout the country through the post-World War II development of a nationwide secondary mortgage market.

Safety of investment ranks at least equally with return realized where institutional investors are concerned. This fiduciary emphasis on security by the lending community means that the protection brought to real estate transactions by title insurance is vital if mortgage money is to remain widely available. Without the title company's assurance that the lender has a valid and enforceable lien and that the borrower has marketable title, real estate investment would be considered highly speculative and would not enjoy its current high acceptance among lending institutions.

Most lenders also know that the familiar ALTA Loan Policy (lender's title insurance), developed with their input and voluntarily used by ALTA member title insurers, is a nationally prominent means of protection that adds even greater facility to trading within the secondary market.

Gambling that the title insurance of the lender will meet the needs of the buyer can be costly. For example, a utility company may decide to exercise a previously undisclosed easement and construct a power line through the buyer's yard. This can have serious consequences for the buyer's ownership without adversely affecting the lender's security interest. Owner's title insurance would protect the owner's interest in the property in this situation.

Uniform Title Policies Aid Lenders/Consumers

In the beginning there was no uniformity of policy certificate coverage. Each title company issued its own form of policy, guarantee, or certificate. This created many problems for insureds, particularly lenders who desired the same coverage in all parts of the country and did not want to review each policy from each company to make sure the desired coverage was present.

Since the ALTA membership included most title insurers in business at the time, lenders were able to persuade the association to develop the 1929 lender policy that was responsive to their needs. Over the years an extensive array of additional forms have been developed through the association.

Presently there are six basic ALTA title insurance policies. They are Lender's, Lender's Leasehold, Owner's, Owner's Leasehold, Residential (plain language), and Construction Loan policies. Additionally, a special policy has been designed for use by the United States government in its purchases and condemnations.

Major revisions of the ALTA policy forms are made every few years, usually as a result of either a lender's request, a perceived ambiguity in existing language, or an answer to a court whose decision interpreted a policy in a different manner from that deemed proper within the title industry.

ALTA policy forms provide coverage for the usual or standard type of real estate transaction, and can be used in such transactions without a need for change or addition.

However, with the development of the real estate industry, and the increasing complexity of both the conveyancing and the financing in transactions, there are situations not applicable to the ALTA forms. In an effort to help the title industry tailor the ALTA forms so they are even more useful in larger transactions, ALTA has created various endorsements or groups of endorsements for the market.

These ALTA endorsements include, but are not limited to, coverage for zoning, condominiums and planned unit developments, variable rate mortgages, residential environment liens, and special restriction, easement, and mineral problems.

In addition to its regular title policies, ALTA also created short form and master mortgage policies, which have been approved by Federal National Mortgage Association (Fannie Mae) for use in all its residential loan packages.

Although policies and endorsements have received primary attention from ALTA, other forms have been created by the association in response to title industry needs. Principally, these forms have dealt with reinsurance and protection for the insured

ALTA has developed three types of reinsurance agreements. These agreements have become the accepted agreement used in transactions requiring a spread of risk by a title insurer through the purchase of reinsurance from other insurers.

A closing protection letter has been designed to provide lenders, and in some instances owners, with safeguards against possible mistakes or defalcations by agents of the title insurer. The closing protection letter is subject to its terms and conditions, which include requiring the recipient of the letter to order title insurance from the agent of the sender, and gives proper instructions concerning how the agent is to handle the transaction and disbursement of funds. Through the closing protection letter, the addressee is protected against damages suffered if the agent fails to follow the specific instructions of the insured for closing the transaction and against incorrect disbursements.

Title Searching 101

Searching the public records provides a basis for title insurance and usually includes visits to the offices of recorders or registers of deeds, clerks of courts, and other officials. Title searchers look in the records for mortgages, judgments, street and sewer system assessments, special taxes and levies, and numerous other matters.

Searches may be performed directly from the public records or from a "title plant." In many jurisdictions, information about a piece of property and any liens against it may be filed in different ways. They can be filed under the seller's name, the owner's name, by lot number, or by street address. This can make searching cumbersome. In order to make searching easier, many title companies create title plants, which contain virtually the same information as the county records; however, they are indexed the same way (i.e., by name or lot number) so that title searches may be performed more quickly and accurately than through direct searching in public offices. In major metropolitan areas the title can be searched and title insurance issued in 24 to 48 hours.

The Impact of Title Searches

The following shows why it is a good idea to involve the title company in the early stages of land transfer.

A title search revealed that two acres of land being purchased were once part of a five-acre tract. A prior deed to the five acres restricted use of the property to "a single family dwelling and the usual outbuildings." The other three acres from the original tract already contained a single family dwelling, and there was a serious question as to whether the purchaser could build a home on his two acres. With assistance from the title company, releases were obtained from the appropriate parties to remove the problem and allow the house to be built.

Occasionally, title problems may be so serious that the most prudent course is not to proceed with a transaction. For example, a buyer was about to close his purchase when the title search revealed pipeline, utility, flood, and road easements across the property that would have severely limited his use of the real estate. When these findings became known, the buyer decided not to continue with the transaction. Only a title search would uncover these problems.

Title Insurance – Common Misconceptions, cont.

Myth: Title insurance losses are low.

Fact: In 2001 and 2002 title insurers paid 465 million dollars and 582 million dollars in claims respectively.

However, focusing on losses paid by title insurance companies as a measure of performance is misleading without simultaneously paying attention to their effectiveness in identifying and helping remove title problems before the closing process. And it must be remembered that title insurers incur substantial overhead in dealing with claims and losses.

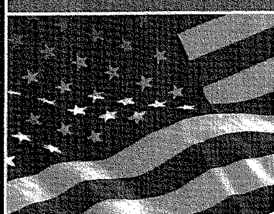
Despite their emphasis on risk elimination, title insurance companies will continue to experience loss—making it necessary to continue offering coverage that pays valid claims and pays for defending against attacks on title. And even the most expert title searching and examination will never be able to identify all hazards before real estate transactions are completed.

Myth: Title companies favor complicated land records.

Facts: ALTA has sought improvement and simplification of land records for many years. Many land records are complex and often in a chaotic state. Problems presented by the many different locations where records are kept, difficulties encountered in searching the records, and the sheer volume and complicated nature of liens, claims, and encumbrances recognized in real property only bring higher costs to the title industry through the expense of services and claims that must be defended against or satisfied.

The title industry has been involved in the following activities to simplify land records:

- Support for substituting a tract index in place of the cumbersome and inefficient grantor-grantee indices presently used in may locales.
- The centralization of all land records in a single location; in many areas these records are now in a number of separately located buildings.
- Support for work initiated by the American Bar Association to develop a universal land identifier system for land records.
- Cooperation with the Commission on Uniform State Laws to develop a Uniform Land Transactions Code "to simplify, clarify and modernize the law governing transactions."
- Cooperation with the American Bar Association in the development of the Uniform Probate Code, which greatly simplifies the transfer of real property in a decedent's estate.
- Support of work within the Real Estate Settlement Practices Act (RESPA) to establish demonstration land parcel recording systems "to facilitate and simplify land transfers and mortgage transactions."
- Cooperation with the Mortgage Industry Standards Maintenance Organization (MISMO) to develop recommended new standards and automation definitions to greatly reduce processing time for home mortgage transactions.



Continuing State Regulation Advocated

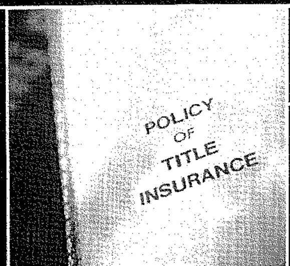
Leaders in the title insurance business generally hold the view that state regulation is the most effective form of governmental supervision for their industry. Following approval of the National Association of Insurance Commissioners Model Title Insurance Code by that organization in 1983, an increasing number of states have become more active in the regulation of title insurance activity within their borders.

Although recent years have seen a political trend toward governmental deregulation in numerous types of private enterprise, title insurance leaders have supported continuing state regulation as the most responsible approach for their industry—especially where consumer interests are concerned.

While commercial and industrial title insurance customers are often directly involved in securing desired coverage and negotiating rates in an environment where insurers compete for their business, this seldom occurs among homebuyers.

In residential real estate transactions, homebuyers frequently have no contact with title insurance companies issuing the coverage to protect their individual interests. Instead, because of market structure and custom, a homebuyer is normally directed to a title insurance agent through a real estate professional involved in his/her transaction—such as an attorney, a broker, a builder, or lender.

As a result, residential title insurance customers are in greater need of governmental regulatory supervision to encourage reasonable rates and appropriate practices in the marketplace.

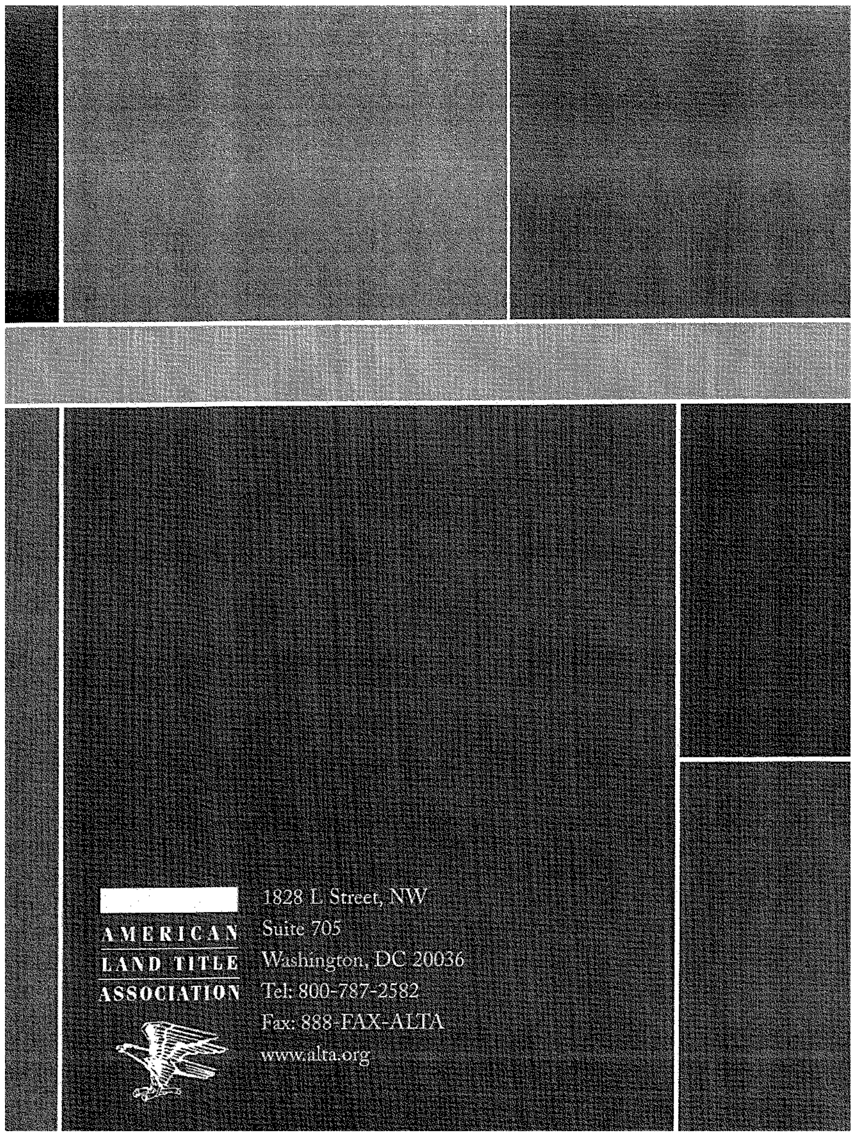


Title companies have been protecting the American dream of homeownership for more than 125 years. Real estate/property is the nation's largest asset. In fact, the 1990s was one of the best decades in American history for housing. The behind-the-scenes work of title companies ensures the remarkably quick and secure transfer of land, giving lenders and consumers confidence in their investment.

Title insurance is substantially different from other types of insurance coverage, which can often lead to a misunderstanding of the product. Title insurance emphasizes risk prevention rather than risk assumption, so the coverage offers the best possible opportunity to avoid claims and losses in real estate transactions.

During their title search, title companies find and fix problems with the title in 36% of their transactions—usually unbeknownst to the consumer or lender. In addition, title companies pay millions of dollars each year in claims. Title insurance provides significant value to lenders and consumers.

The American Land Title Association, the national trade association for the title industry, was founded in 1907 and currently represents 2,000 abstracters, title insurance agents, and title insurance underwriting companies. Members search, review, and insure land titles to protect homebuyers and mortgage lenders and are dedicated to the secure and efficient transfer of property.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THE NATURE OF TITLE INSURANCE

HARRY MACK JOHNSON

Title Insurance has the distinction of being one of the few forms of insurance invented in the United States. The first title insurance company, formed in 1876, was the Real Estate Title Insurance Company of Philadelphia.[1] Although the industry has not developed the large number of carriers frequently found in other areas of insurance, a study conducted in 1957 found 147 companies writing title insurance, with a premium volume of about $100 million in 1954. At an average premium rate of $3.50 a thousand, this represents some $28.5 billion of title insurance coverage.[2]

A conservative estimate of the earned premiums in 1962 is $203 million. The American Land Title Association statistics for its members showed a gross income of $262.5 million in 1962, some of which, however, represents title searches without the issuance of title insurance. In terms of 1962 premium writing, this means that the title insurance business is comparable in size to ocean marine insurance and surety bonding, with premiums of $237 million and $230 million respectively. Based on annual premium volume for separate coverages, title insurance is larger than fidelity bond insurance (1962 premiums of $108 million), burglary and theft insurance ($116 million), crop-hail insurance ($107 million), boiler and machinery insurance ($70 million), and glass insurance ($42 million).

One of the major reasons for this volume of title insurance business in the United States is the demand by lending institutions for title insurance covering ownership rights under real estate mortgage loans. At one time title insurance companies were departments in banking institutions, and their operations were an integral part of the money lending apparatus. The recent growth of title insurance can be traced to the more rapid turnover of real estate in the last three decades and to the expansion of mortgage lending, particularly on an interregional scale, stimulated by the mortgage insurance and guarantee programs of the Federal government.

In the modern economy, the demand for capital investment is so large that the supply of funds must emerge on a national, rather than on a local, basis. This has created a demand by nationwide lenders for title insurance in areas where local lenders had long been content with uninsured evidence of title. National lending institutions have insisted on title insurance as security before they would accept a mortgage instrument.

Despite increasing use of title insurance, the subject has been virtually neglected in insurance literature. The resulting lack of information has made it difficult for insurance scholars to form rational judgments about its relative merits as a means of title

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This article was submitted in July, 1965.

[1] Roberts, Ernest F., Jr., *Title Insurance and Abstracters.* (Villanova University Press, 1961), p. 2.

[2] Johnstone, Quintin, "Title Insurance," *Yale Law Journal*, Vol. 66, No. 4 (February 1957), p. 492.

protection. This paper attempts, therefore, to describe the content and scope of coverage of title insurance.

Risks in Real Estate Transfer

The term real property refers to rights or interests in land or realty. These rights are legally enforceable claims to specified control over the use of the land for given time periods. These rights are distinct from the physical object to which they pertain. When real estate is sold, the rights are transferred, rather than the land itself; the rights are the objects of commerce. Two or more persons may hold similar and/or different rights to a piece of land or realty at the same time, and the interrelationship of their rights can be very complex.

Although title is frequently considered synonymous with ownership, this is not strictly accurate since any number of rights to real property may exist. The word *title* applies to the legal ownership of any rights that a person owns. On the other hand, the usual usage of *ownership* involves the concept of an unencumbered fee interest and includes that group of rights to real property that cause most people to assume that the real property belongs to the individual.

A seller of real estate, however, can transfer only those rights to which he actually has a valid claim, and an attempted sale of a right he does not own cannot defeat the rights of the true owner. For example, one person cannot, by selling his own rights, defeat outstanding dower, homestead, or curtesy rights that other parties may possess in the same property. Although a person may be of the opinion that he is the owner of all rights to a parcel of property, the evidence may show that his title is not clear but is cloudy or incomplete. When the proof of ownership is clear and unambiguous, and there appears to be no basis for other claims, his title is said to be clear, or merchantable.

Even though a title is clear at time of sale, it may be subject to a contest at any future time; that is to say, every title and ownership is subject to challenge, valid or invalid, from persons, known or unknown, who may claim ownership for themselves. A holder of rights thus owns those rights, subject to being able to establish his claims to ownership by means of accepted processes of law, whenever challenged. When a challenge occurs, a court contest may be necessary to confirm the title.

Since the purchase of real estate normally involves large sums of money, a purchaser wants to know that the seller has a good and clear title to the property being transferred and that the property is free of all liens, encumbrances, and other significant claims; or else to know what these claims or encumbrances are. For this reason, a search of title is generally made. This involves an examination of all public records where items might appear which represent claims against the title relating to the given premises.

While making a search of title, the examiner writes a summary of the important features of each item he finds. This statement of the history is known as an abstract of title. It shows how the title has purportedly passed from owner to owner, and it may also reveal serious breaks in the chain whenever the record fails to reveal how certain rights were transferred. When completed, the abstract is examined by a lawyer who gives an opinion of title, which is an expression of his judgment as to the status of the title at that time, based upon the abstract.

The buyer relies upon this opinion of title when he purchases property. If the lawyer indicates that the title is clear and marketable, the buyer is reassured and accepts title. If the opinion of title points out defects or indicates that the title is clouded, the buyer is warned and must act accordingly. Depending on the terms of the sales contract, he may insist that the cloud be removed before purchase is made, or accept the risk involved, or refuse to continue the purchase.

Even though the opinion of title indicates a clear title, the buyer is still not absolutely certain that the title is good. The abstracters may have failed to perform a careful search. The lawyer writing the opinion of title may have failed to point out substantial defects. The following is a partial listing of the types of defects which may exist and not be discovered by a title search:

1. Fraud or forgery in the execution of papers affecting the property.
2. Execution of papers by a minor, an insane person, an incompetent person, or other improper parties.
3. Heirs, not disclosed in the public records, who did not execute the required instruments, including children born after the death of a former owner or after the will was drawn up.
4. Undisclosed will found which leaves the property to others than those believed to have inherited it.
5. Heirs of a former owner who died before judgment on a foreclosure action and who now claim an interest in the property.
6. Deeds executed under a power of attorney which was discovered later to have expired because of death, insanity, or revocation.
7. Undisclosed marriages and divorces with resulting widow's dower, or widower's curtesy rights.
8. Claims of creditors of a bankrupt former owner.
9. Technical errors and mistakes in the records, such as clerk's errors in recording and indexing.
10. Fraud, misrepresentation, or coercion involved in a transfer of title.
11. Tax liens, or unpaid real estate taxes.
12. Undisclosed judgments outstanding against the seller.
13. Outstanding mortgages.
14. Confusion due to similar or indentical names.
15. False affidavits of service.

It follows that the most careful scrutiny of the records will not always reveal all or even most of the conditions which may cause a title to be defective. There is an additional risk of easements and physical conditions which even a thorough investigation of the property may not disclose. If the defect is based on a valid and hence enforceable claim, the buyer or owner may lose his total investment in the property. At the least, later removal of the defect may require considerable expense and inconvenience to the purchaser.

Characteristics of Title Insurance

It is apparent that the buyer of a piece of real estate is faced with a serious risk, i.e., that the title he acquires to the property may be defective and a valuable purchase may be lost, and/or expenses may be incurred in defending his claim of ownership. Title insurance has been developed as a method for shifting or transferring to the title insurance company the risks of defective title assumed when real property interests are acquired.[3] The business of title insurance is not standardized, and various forms of contracts exist. The following presentation, therefore, is necessarily general in nature, rather than specific; nevertheless, the pattern of title insurance risk coverage outlined below is usually followed by most firms.

Perils Covered by the Policy

1. *Defective Title.* The basic benefit provided by title insurance is protection against loss or damage resulting from defects in or failure of ownership title to a particular parcel of realty, or from undiscovered liens existing against it at the time of the insurance. Not only does the

[3] Title insurance policies are also called title guarantee and guarantee title policies.

policy insure the completeness of results of the title search to the insured, but it also protects him from loss arising out of undiscoverable defects in existence at the time the policy was issued, for which the abstracter or attorney could not be held liable.

In a few jurisdictions a more limited form of title insurance is also available. In Ohio and the District of Columbia, a simple *record title* policy is sold which covers only the title as it is described in the public records. This policy protects only against oversights by title examination and oversights outlawed by statute. In contrast with full coverage, it does not insure against the other risks mentioned previously.

2. *Marketability*. A second benefit, which is not provided by all policies, but which the broader policy forms provide, is insurance on the marketability of the title. That is, a title insurance policy may insure against loss by reason of unmarketability of a real estate title. Most real estate buy-and-sell agreements provide that the buyer is not obligated to purchase the seller's title if it is found to be unmarketable. If a buyer's search of the title discloses material defects or raises such grave doubts about its validity that a court of equity would not compel a purchaser to accept it, the title is said to be unmarketable. Under these circumstances, the buyer need not complete the transaction and can recover his deposit. With such a defect the seller might not ever be able to sell his title, even though his use of the property might in no way be restricted.

The title insurance policy protects the holder of the real estate from the risk of unmarketable title. If a buyer refuses to purchase a property because of an unmarketable title, the title insurance company will either buy the property from the insured-seller at the agreed price, but not exceeding the contract face amount, or will undertake court proceedings in order to determine the validity of the objection of the buyer and to enforce the buy-and-sell agreement.

Although not all title policies insure marketability of title, life insurance companies and other national mortgage lending institutions have for many years requested that title insurance policies include such protection. They desire this coverage for two reasons. The first is to have uniform title insurance policies as a business expedient. Companies doing a large volume of business on a national scale prefer the American Land Title Association policy form which includes this protection. Second, many lenders feel that the broader protection afforded by a marketability guarantee is essential for a salable title in many parts of the country.

This paper does not propose to define the technicalities of a marketable title; however, certain court rulings provide some illuminating information. Legal marketability requires an almost flawless title; thus restrictive covenants, liens, easements, outstanding interests, encumbrances, all have caused titles to be considered not marketable. Destruction of county records has resulted in titles being technically nonmarketable. A title is not rendered marketable by the mere fact that a title insurance company is willing to insure it. On the other hand, court rulings have held that a title company's refusal to insure makes a title unmarketable.

In certain parts of the country whole counties may contain titles that are technically not marketable. For example, in Chicago, because of the Chicago fire and the destruction of all Cook County records, the chain of title is incomplete for all properties. Title insurers operating in the Chicago area and areas with similar problems therefore oppose guaranteeing marketability because of the technical nonmarketable title. Limited policies not insuring marketability are common in Illinois, Georgia, and Texas.

Regardless of the technical legal problems, insurability has succeeded legal marketability as the appropriate criterion for acceptability of title in most areas. Title insurance policies are accepted and insisted upon by insurance companies and other institutional mortgage lenders as evidence of title in many cases where it is clear that, judged by strict legal standards and in the absence of title insurance, the titles would be technically and, in some cases, practically unmarketable.

3. *Mortgage Guarantees.* During the 1920's and 1930's lending institutions were issued title insurance policies which not only protected against defects in title and title marketability, but which guaranteed payment of mortgage principal and interest. After 1929, many title insurance companies which were doing a mortgage guarantee business, suffered severe financial setbacks. For example, in New York, 44 title insurance companies were organized in the 1920's to enter the real estate financing field. During the subsequent depression of the 1930s, 31 of these companies were taken over by the New York State Insurance Department for rehabilitation and subsequent liquidation.[4] Because of such disastrous financial experience, most states now prohibit the sale of guaranteed mortgages or participation certificates by title insurance companies.

Retrospective Nature

Title insurance is not like other insurance contracts which protect the insured from events that happen after the contract is written. Rather, title insurance protects the insured against possible losses occurring by reason of undiscovered claims, (or hidden perils) that have as their basis circumstances that existed prior to the policy date. This is not the great disadvantage to the insured it would seem to be when it is remembered that the policy insures against the acts of others, not against the acts of the insured that might cause defects in the title.

Defects in title occurring after the issue date of the policy result from willful or negligent acts of the insured. For example, a mechanic's lien that develops out of work that the insured has had performed on his property but for which he has not paid, is not covered by title insurance; however, the insured may be protected from undiscovered mechanics' liens that exist from the previous owner's action. In this respect, title insurance is a retrospective policy which protects the insured from losses caused by undiscovered encumbrances or defects in the title which exist at the date of the policy.

Importance of Underwriting

Because of the retrospective nature of title insurance, a very important part of title insurance is the underwriting of the policy. Thus title insurance is much like boiler and machinery insurance, a primary purpose of both being the reduction of risk and the avoidance of loss. The insurer, prior to accepting an application for title insurance, conducts a title search to ascertain whether there are discoverable defects (actual or potential) in the chain of title. In effect, the insurer acts as a factfinding body for the prospective insured in searching for and recording the ascertainable facts involved in a real estate transaction.

The insurer, in striving to protect itself, also protects the purchaser and/or mortgagee by making an exhaustive search of all public records showing every instrument which affects the given title. Sometimes applicants are more interested in what the company examination of title discloses than they are in obtaining insurance coverage.

For underwriting purposes, some title insurers have developed elaborate sets of

[4] Gray, Warren T., "Title Insurance" a lecture published by the New York State Title Insurance Association, New York, N.Y., 1954.

records based upon the real estate records of the territory in which they operate. These records, consisting of atlases, indexes, surveys, and title folders, are kept up to date by a continual review of the public records. The whole process is referred to as the *abstract plant.*

The completeness of the records is illustrated by the fact that on occasion, when public records have been destroyed by fire, public officials have used the abstract plant as a principal means of reconstructing the lost public records. Other companies, rather than maintain an abstract plant, maintain only past searches and examinations of title, which serve as the starting point for future searches in the public records.

Because of the critical importance of a title search, a major portion of the title insurance premium is for the services rendered at the time of purchase. As much as 40 to 50 per cent of the total premium is devoted to the search, abstract, and opinion of title. In contrast, only 3 to 5 per cent of earned premium is paid out in losses and loss adjustment expenses.

It is sometimes said that, as in bonding, the title insurer does not really anticipate any loss, and the ideal property to insure is one with no risk involved. This misconception, which persists in title insurance literature (as it does in bonding literature) probably arose because of the extensive examination and underwriting of a title prior to the issuance of a policy and the lack of understanding of insurance principles by those who have written about title insurance.

The no-risk ideal seldom can be achieved in the practical matter of transferring real property since experts will differ in their opinions concerning the effects of certain legal instruments and court proceedings in the chain of title. In addition, abstracts may be imperfect or inaccurate, and factors external to the record may cause a title to be defective. Title insurers will often disregard or assume many of the technical objections that would be raised by an attorney examining an abstract. A title insurance company, however, is no more likely to insure a bad title than a fire insurance company will issue a policy on a burning building. There is no doubt that a risk transfer is involved in title insurance.

Services of Title Insurance

In addition to the basic benefit of indemnification against loss in the event of defective title, title insurance provides the insured with two additional services: a title report, or opinion of title, and defense in legal suits. Prior to the issuance of the policy, the insurer provides the applicant with a title report which notifies the insured-applicant of the insurer's opinion of the title, including all defects or objections that have been discovered by the title insurance company at the time of underwriting the contract.

The company's conclusions are not actually expressed as a legal opinion of title, but merely represent the basis upon which it is willing to insure. Often this report is in the form of an insurance binder, obligating the title insurance company to issue its policy with any discovered defects, such as unpaid back taxes, listed as exclusions. When the policy is issued, any remaining defects or objections to title, liens, charges, or encumbrances that have not been removed are listed in the policy in a schedule of exclusions (Schedule B in the American Land Title Association policy forms) as exceptions to the insurance coverage.

Such defects may be so serious as to restrict severely the insurance protection. Thus it is advisable to have the insured's own attorney pass upon any objections made by the title insurance company prior to accepting either the title to the realty or the policy. Often it is possible to have the seller remove the defects or to persuade the title insurance company to waive its objections. However, the defects may be of such an adverse nature that the title insurer will refuse to accept the risk unless they are completely removed.

The second service is the agreement to defend the title. The company promises to defend the insured in any legal action based on a claim of title or encumbrance prior to the effective policy date. Examples of such actions are the defense of the title against an adverse suit by another claiming to have title, or a court action to test the validity of an objection by a buyer because of a defect or encumbrance.

As in liability insurance, the payment of legal fees is not conditioned on the validity of the claim, and there is no limit on the amount of legal services which will be provided. This should be recognized as an attractive and important feature of title insurance, since nuisance litigation affecting real estate is common and expensive to defend against, even though the claim may not be well founded.

The company has the right to settle any suit based upon a claim of title to the real property insured. This might involve a payment to the claimant in exchange for a quitclaim deed to the insured, plus the expenses of recording it. Since such a settlement in no way reduces the insured's right to use of the realty, and actually improves his rights, the insured's permission to settle claims out of court is not required.

Indefinite Term

Another unusual feature of title insurance is that the policy does not have an expiration date. Rather, it has a perpetual term which provides permanent protection to the insured. A single premium is paid by the insured; once paid, the premium is considered completely earned, whether the insured owns the property for one year or he and his heirs own it for a hundred years.[6]

The policy, however, does not cease to protect the insured when he sells the property. The policy continues protection if a future loss occurs under warranties or covenants of title made by the insured in a warranty deed to a purchaser, provided such loss is based on some claim of title, lien, or encumbrance against which the policy originally insured. Title insurance coverage continues as long as the insured or heirs (estate) can suffer any loss from the risks covered by the policy. Coverage for the original insured would end, however, if he passed a quitclaim deed or assigned a title policy to a purchaser of the real estate. Assignment is not usual and is explained subsequently.

Insured Parties

Because title insurance has an indefinite term, the insured parties include not only the named insured, but also his estate, heirs, devisees, and personal representatives. If the insured is a corporation, protection continues for the corporate successor or successors of the insured.

Amount of Insurance

The face value of an owner's contract is usually set at the purchase price of the property. Thus protection is not available for any increase in value due to inflation, changing land value, or owner-installed improvements. Also, because of the perpetual term of title insurance, the insured is not reminded at renewal dates to increase his protection in recognition of any increased property value. Should the insured desire to increase the amount of his insurance protection, he can have the policy endorsed for an increase in the face value by paying an additional fee. However, the period of coverage is not extended to the date of endorsement, but re-

[6] A few companies limit their policies to a period of 25 years.

mains only on defects up to the original date of issue.

Title insurance differs from many other forms of property and liability insurance in that it does not contain a loss clause or automatic reinstatement clause. Instead, the amount of insurance protection is reduced by the amount of any loss payment made to the insured or on his behalf. Payments made to the insured's vendee or to a person holding a mortgage or a deed of trust are examples of payments that would be deemed made to the insured.

Contract of Indemnity

Title insurance is a contract of indemnity rather than a contract of guarantee, as is sometimes assumed. The insured does not have the right to collect the face of the contract just because a defect is discovered in the title. The insured must show that he actually suffered a loss. When the insured loses title to the real estate, or, more accurately, when it is established that the insured is without title, the measure of damages would be the purchase price of the property, or the face of the contract, if less.

In the insured has increased the amount of his title insurance protection, he may be able to recover more than the purchase price. In such a case it would be necessary to evaluate the insured's supposed interest in the realty at the time the defect was discovered. The typical arrangement of providing for three outside parties to make the valuation, in the event of a dispute, is used.

When the insured actually retains his title, but a lien is established which was not excepted in the schedule of exclusions, the measure of damages is the cost of discharging the lien. When the defect is in the form of an encroachment or a covenant in the deed, the measure of damages is the difference between the value of the property unencumbered and the value with the encumbrance. If a court should relieve a purchaser of his obligations under the buy-and-sell contract, because of some encumbrance or defect not listed among the exceptions, the settlement would be the agreed-upon purchase price or face of the contract, if less.

Subrogation

Title insurance policies make provision for subrogation of the insurer for the insured. Thus, when the company settles a claim covered by the policy, it is entitled to all the rights and remedies which the insured would have against any other person or property in respect to such claim. The insured must permit the insurer to use his name for the recovery or defense of such rights, if the company wishes. The insured also warrants that no act of his shall adversely affect the rights of the company. Of course, any net sums collected by the insurer that are over and above the amount of loss paid to the insured belong to the insured.

Subrogation is an important feature in the title insurance operation since the insured, if he suffers a loss, often will have recourse against the party who sold him the real estate. In many instances where the title is defective, the insurer can, with time and effort, make a full recovery.

Some mortgage policies do not contain subrogative provisions. They accomplish the same results with a salvage clause which provides that if the insurer pays the full amount of the debt to the insured-mortgagee, the mortgage and indebtedness shall be assigned to the insurer.

Noncancellable

A title insurance policy cannot be cancelled by either party. The company cannot cancel the contract if it later discovers a major defect in the title. The insured cannot cancel the policy and recover a pro rata share of his premium when he sells the property, no matter how soon he sells his interest after acquiring title.

Assignment

The title insurance policy is treated as a personal contract and, therefore, is not transferable to a subsequent purchaser of the real estate. Instead, a new policy, often referred to as a reissue policy, must be obtained. As a rule, title insurers do not allow the assignment of policies by equity owners, for a number of reasons. If the property has been held for a considerable period of time, the new owner might be misled as to the extent of coverage. He might feel that he had protection from the date of assignment, whereas the policy actually pertains solely to the title prior to the original date of issue.

It would, of course, be a mistake for the insurer to attempt to protect the assignee from defects that might develop after the policy was issued without first re-examining the title chain, and perhaps conducting a complete title search. A buyer who wishes to obtain complete and full protection must purchase a new policy or have the current policy brought up to date.

Assignments are permitted in a few situations. A mortgagee (or owner of other encumbrances) who owns a title policy may transfer the policy to a new lender. The policy may be transferred to the purchaser at a sale under foreclosure, where the property sold is bought by, or for, the insured. Also the policy is allowed to follow a new interest when the nature of the mortgagee's status has been changed by foreclosure or other transaction. In such cases the new interest is not really an assignment, but is the continuation of coverage for essentially the same interest.

In cases where the contract permits an assignment by an insured-owner, the company will stipulate that the assignment cannot become valid without company consent endorsed to the policy and that the company reserves the right to refuse the assignment. Under such conditions, the company can point out to the new policyholder the limitations of the assignment prior to accepting it.

Reissue Policies

Many applicants for title insurance ask why, once a title has been examined, it should cost so much merely to continue the title date from the previous examination. A subsequent purchaser may wonder why he should have to pay the same premium rate where it would appear that little additional underwriting must be done. There are several reasons. Often the continuation of title involves as much work as the original examination. Every factor that has affected the title since it was last examined must be scrutinized and abstracted. Often more defects are found in the continuation period than in the original examination. The original examination may need to be reviewed to determine whether, in the light of recent court decisions, the old title is as good as it was thought to be when first examined. Finally, a whole new set of undiscovered defects may exist which could, if not discovered and corrected, result in a total loss for the insurer.

In recognition of some duplication in underwriting and the lower cost of a limited search and examination, some carriers have begun to provide for a discount when insurance on realty is applied for by a new owner within a specified period of time. For example, one carrier will give as much as a 20 per cent discount for a reissued and updated policy if the original policy was issued within the previous year. This discount reduces to zero after ten years. Another large carrier charges 70 per cent of its original rates for reissue policies. To be eligible for the discount, the original policy must have been issued by the same carrier within five years. The reissue discount applies only to the amount of insurance originally granted and not to any increase in the face of the policy.

Types of Title Insurance Policies

Two general kinds of title insurance policies are written. A buyer or owner of real estate either purchases or has the seller provide an owner's policy (sometimes called a fees policy), while a creditor or mortgagee can protect his interests with a mortgage policy or a loan policy. The mortgage policy assures the lender that the person to whom he is making a loan has title to the realty being offered as security and that the mortgage is a valid first lien.

In some areas, California for example, it is the custom to combine the owner's and mortgage policies into a joint protection policy which covers both types of interest. In many parts of the country, banks, savings and loan associations, and other mortgage institutions require a mortgagor-owner to provide, at his own expense, either a joint protection or mortgage policy as a condition for obtaining a mortgage.

The face amount of a mortgage policy would be the amount of the mortgage. The policy period would expire when the mortgage is paid off and the mortgagee's interest in the property terminated. On the other hand, if the mortgagee becomes the owner of the property through foreclosure proceedings or purchase in settlement of the debt, then the mortgage policy would continue in force and provide for continuing coverage, as in the owner's policy.

Although the usual title insurance policies are issued to protect either the rights to ownership of real estate or a mortgagee's position as a possessor of a valid first lien, special title policies are available for other interests. For example, it is becoming increasingly common for a long-term tenant to obtain a leasehold policy which assures the tenant that the lessor-landlord has a good, clear title to the leased premises. A tenant might seek such assurances prior to signing a long-term lease and making a substantial investment in remodeling.

Easement policies are available to assure a prospective purchaser of realty that a valuable easement is valid. Similarly, title policies have occasionally been used to insure against loss from laws concerning building lines and building restrictions that may affect the land.

Title insurance may also be obtained in connection with equities, covenants, fractional interests, encroachments, completed improvements, and reversion clauses in deeds.

Not only is title insurance written on an individual basis, the form used for a homeowner when he purchases property, but a group or franchise form has also been developed for the convenience of large users of title insurance policies, e.g., lending institutions. These are simply facultative arrangements under which a master policy is used to spell out the insurance clause and the various policy provisions. Each title or risk is then covered by a certificate, once the title insurer has had the opportunity to underwrite it.

This procedure has the same advantages found in other lines of insurance where facultative arrangements are used. A mortgagee does not have to examine each title policy to determine the coverages and exclusions; he knows that the precise coverage and terms of the contract that he acquires are provided by the master policy.

Premium Rates and Reserves

Although, by regulation, title insurance rates must be adequate, reasonable, and nondiscriminatory, title insurers have never used strictly technical or scientific methods in rate making. Gray explains that this is mainly because of the costs involved in collecting and analyzing data.[6] Other writers suggest that the careful and detailed actuarial risk studies used in computing many other kinds of insurance rates

[6] Gray, *op. cit.*, p. 7.

would be of limited value because of the lack of data on uninsured losses, inconsistencies among insurers in computing losses, and unstandardized coverage practice of insurers. It would seem that, with the headway that has been made toward uniform accounting procedures and with the use of the annual convention statement blanks, more progress could be made in the rating techniques of title insurance.

Rates are essentially based on schedules which have been in effect for many years and which have been adjusted from time to time as the business transacted under them proved profitable or unprofitable.

Insurers using a pure premium technique of constructing rates must consider a number of factors in the premium rate determination of title insurance. Some of these factors are:

(1) The type of policy—i.e., the type of title being insured. For example, a mortgage policy normally will have a lower rate than an owner's policy because it usually terminates more quickly, the risk decreases as the debt is paid, and the insurer has a stronger chance to salvage losses through debt assignments. (Of course, most mortgagees, since they are larger lending institutions, also have a strong bargaining position.) If an owner's policy is issued at the same time as a mortgage policy, the cost of the latter is often nominal (one company charges only $10) because there is very little additional risk (if any) for the title insurer. If the title should prove to be defective and the title insurance company is obligated to make payment on the mortgage policy, the insurer will, by subrogation, receive any rights under the debt instrument and mortgage that the mortgagee has against the mortgagor.

(2) Loss and loss adjustment expense. The loss and loss adjustment expense includes not only the payments on successful claims, but also sums paid to third parties to cure defects, the overhead which is chargeable to loss activities, the amounts spent on court costs, and the amounts spent for defense. One authority points out that the amounts spent on defense may total ten times as much as the reported losses.[7]

(3) Legal reserves. A number of states require that title insurers establish a liability reserve comparable to the unearned premium reserve of property and casualty insurance. This creates some unique problems for title insurers because of the indefinite term of the policy and the low expected losses.

Normally the legal reserves are set as some precentage of the gross premiums written or, as in some states, the risk rate (i.e. the net premium) charged. This reserve can then be recovered at some specified rate or percentage of the original premium, so that the entire credit is recovered after a specified period of time. For example, the insurer may be required to set aside 10 per cent of the gross premium in an unearned premium reserve, which can be recovered at the rate of 5 per cent of the reserve per year, being fully recovered by the insurer at the end of 20 years.

(4) Cost of production. This represents primarily the costs of the search and underwriting. The title insurer must include in the premium rate a charge for survey, physical inspection of the premises, title search, and title opinion. The cost of a search and opinion of title is a relatively fixed item, i.e., it is not in direct proportion to the value of the property rights. A $10,000 policy may have the same underwriting cost as a $50,000 policy. Of course, like any other insurance operation, title insurers must pay commissions, premium taxes, policy printing costs, etc.

(5) Overhead expenses. This is a fairly stable item for title insurers, regardless of

[7] Riegel, Robert and Miller, Jerome S. *Insurance Principles and Practices*, 4th Edition. (Englewood Cliffs, N.J.: Prentice-Hall, Inc. 1959), page 837.

the premium volume. Much of the home office operating expense arises from the cost of maintaining and keeping the abstract plant updated. Because this is a fixed cost, the larger insurers have an advantage.

These factors and the profit margin are combined in the gross premium rate, with the ultimate cost to the insured contingent upon two prime factors: (1) the amount of insurance to be purchased and, (2) the location of the realty. Although most companies do not use a graded premium structure, a few have begun to provide for some reduction as the amount of coverage increases. Since the charge for the insurance has been estimated variously from 5 per cent to 50 per cent of the total, the rate per $1,000 should show substantial decreases as the amount of insurance increases.

The common practice is to express the premium rate as a single rate; i.e., $8.50 per $1,000 for an owner's policy. Some carriers express the title insurance premium in two sections: (1) a risk premium rate to cover the title insurance risk element only and (2) an underwriting expense for the examination of the title—e.g., a risk premium of $4 per $1,000, plus an underwriting or policy fee of $70.

Premium rates seldom change, which suggests that they are matters of custom. Nevertheless, considerable variation exists in the rating structures of the various carriers. For example, at the time the writer purchased his home in Connecticut, he was quoted title insurance premiums that ranged from $67 to $175.

A criticism can be directed at the legal reserve requirements of some states. If premiums are structured on such an indefinite basis, it does not seem wise to base the legal reserve requirements upon them. Instead, some formula that would make the legal reserve a function of loss experience over a period that would encompass the real estate cycle, approximately 20 years, and the volume of insurance in force would make more sense. Such a formula should also give more weight to the more recently acquired business where losses are the greatest. Such a legal reserve requirement would provide more protection to the policyholder.

Casualty Insurance Operation

In recent years, metropolitan areas have witnessed a new type of competition in title insurance. New title insurance companies have been formed which operate on a relatively low overhead basis by not maintaining a title plant. Such companies have been able to bear the heavier losses that they incur from defective titles because of the lower costs in underwriting. Rather than a complete title search, they search back only to the date of the last previous policy issued (or if no previous policy, perhaps fifteen years) by use of the public records. Many of these companies are branches of large national casualty companies and thus have strong financial backing.

These companies have caused concern for executives of the more traditional title insurance companies. Broadly applied, their techniques could have disastrous effects on the strength of titles. If title insurance becomes generally written without a thorough search or examination, it seems logical to conclude that there would be a gradual deterioration in the certainty of titles. This would occur because the curative action currently taken by real property purchasers, as a result of the insurer's title reports, would be largely discontinued. Elimination of the title search would remove most of the basis for such action; and, consequently, titles would gradually become less certain, losses would increase, and insurance rates would rise.

This apparent trend toward adoption of the casualty insurance approach in title insurance underwriting should be watched with great care even though it has stimulated the traditional title insurers to provide some rate and coverage modifications favorable to the consumer.

Alternatives to Title Insurance

Abstract Companies

In some parts of the country real estate purchasers rely solely upon an abstract of title as an alternative to title insurance. An abstract should not be considered as evidence of title, but rather as a statement of the recorded history for the title. The abstract is often prepared by a non-lawyer, and the abstracter's activities are sometimes referred to as the title search.

As the system of title records became more complex, the abstracter's services became specialized, and the abstracter began to serve several lawyers. Ultimately he dealt directly with the public. In areas where the commercial abstract system is in more general use, the practice is for the seller of a title to furnish the buyer with an abstract of title.

At the time that the commercial abstract system developed, the corporate form of doing business replaced the sole proprietor and partnership forms. The necessity for greater permanency and financial responsibility can be cited as reasons for this change in business organization. This necessity, with the growing complexity of title records, stimulated the improvement of title plant methods and the resulting need for larger capital investments.

Originally, the abstracter was liable only to his employer—the lawyer or seller who hired his services. Seldom could the buyer of realty successfully hold the abstracter legally responsible for injuries suffered because of the abstracter's errors or omissions. It is now common, however, to hold that the abstracter is liable to a buyer or mortgagee for mistakes or omissions if the abstract was prepared with the knowledge that such party intended to rely on it. In fact, a number of states have enacted legislation which makes the abstracter responsible not only to the purchaser, but to all persons who purchase land or extend credit thereon in reliance upon the abstract.[8]

It should be recognized that the abstract company does not undertake to indemnify against loss by reason of defective title, as title insurers do. The abstracter does not guarantee title or render an opinion as to title. Rather, the abstract company is liable only if negligence can be established in regard to errors or omissions in the abstract itself. If the abstract discloses a fatally defective title, the abstracter has fully discharged his responsibilities; thus it is normally necessary to have a lawyer's opinion as to the quality of the title disclosed by the abstract. It can be noted that many title insurance companies evolved from the corporate abstract operation, when the abstract firm agreed to indemnify its clients for losses resulting from defective titles it had abstracted.

Lawyer's Opinion

A more common alternative to title insurance for the purchaser of real estate, faced with the question of clear title, is reliance upon the accuracy of the title search and the opinion of title issued by an attorney-at-law. Although both title insurance and an attorney's opinion of title provide a competent title search, a sound legal opinion, and an accurate description of the property, and while both include exceptions (i.e. point out possible defects or types of claims for which assurances are not provided), there are important differences.

Perhaps the most important difference between title insurance and a lawyer's opinion of title is the basis for reimbursement in the event of a loss. If a defect is discovered after the purchase is completed

[8] Roberts, *op. cit.*, pp. 22-23.

and a loss is suffered, the purchaser may have recourse against either the abstracter or lawyer. If the abstract is negligently performed, the owner would still have to proceed against the abstracter, as indicated previously. In order to recover on an opinion of title, however, the owner must prove negligence or professional malpractice on the part of the lawyer issuing the opinion or certificate.[9] As in all cases of legal liability, and particularly in law suits involving questions of judgment, establishing gross negligence in issuing an opinion of title may well be a very difficult and expensive procedure. Johnstone points out that it is difficult to secure a judgment against a lawyer for negligence in title examinations.[10]

In addition, title insurance supplements or goes beyond the protection provided by an attorney's complete and diligent search prior to his issuing an opinion of title. While both methods can provide a competent title search and a sound legal opinion, a title insurer is liable not only for errors in the conduct of the search, but for hidden defects and recording errors which could not have been discovered by the most careful examination of title, and for which the abstracter or attorney could not be held liable. Thus title insurance provides broader protection than an attorney's opinion of title.

Although it is not intended, a certificate of title may be so drafted by a lawyer that it includes a guarantee against loss occasioned by defects in title not mentioned in the certificate. Such certificates are not certificates of title, but for practical purposes are title insurance policies which provide much more protection than a mere title certificate. However, the security behind such a certificate is still severely limited compared to a title policy issued by an insurance company.

In addition, if upon examination a title is found to contain defects that are of such a nature that they cannot be readily removed by a lawyer, often an attorney will refuse to issue an attorney's certificate of title on the real estate, rather than list such adverse exceptions, particularly when in his opinion the title is not "good and merchantable." On the other hand, after underwriting the risk and appraising these defects, a title insurer may still be willing to issue a title insurance policy on the real estate, without listing the defects as exceptions because of their relatively minor nature. In effect, the title insurer is willing to recognize his role as a risk bearer and insure a doubtful title. In such cases the purchaser receives a clearcut advantage from title insurance that is not provided by an attorney's certificate.

Furthermore, the parties protected by title insurance and by an opinion of title are different. The attorney's opinion of title generally protects only the named party for whom the opinion was prepared. In a few cases, innocent third parties who have relied upon the opinion, to their detriment, have been successful in recovering from a negligent attorney, but these are the exceptions. Title insurance, on the other hand, protects the designated insured and his legal heirs. As a result, the policy provides broader protection.

An additional benefit of title insurance is the length of the period of protection. To obtain a judgment against a lawyer for a negligently issued attorney's certificate, a legal action must be initiated within the time established by the statute of limitations. This period of time is measured from the date of issuance of the opinion. Therefore, a defect must be discovered and legal action started within a relatively short period after the opinion of title is issued. In some states, the period covered by the statute of limitations is as short as two

[9] Although there are legal technicalities which differentiate an "opinion of title" from a "certificate of title," for the purposes of this paper the two terms will be used interchangeably.

[10] Johnstone, *op. cit.*, pp. 498.

years (for negligence suits against attorneys-at-law). In contrast, title insurance provides continuing protection, because the time period for the initiation of legal action against the insurer is measured from the date of discovery of a defect and claim against the insured, rather than from the date of issuance of the insurance policy. Thus, while the opinion of title provides a limited period of protection, title insurance protection is continuing.

The financial backing of a lawyer's opinion extends only as far as the personal funds and resources of the lawyer, including any professional liability insurance. In the case of title insurance, the title insurance company has extensive reserves established to provide for payments in the event of loss claims.

Finally, as has been pointed out, title insurance contracts to defend the insured against all claims, even invalid claims, at no cost to the insured. The lawyer's opinion of title provides no such benefit. When the purchaser relies upon an opinion of title, if a claim is raised jeopardizing that title, he can retain the attorney who issued the opinion of title to defend his claim; but an additional charge would be made for such service.

These factors help explain why title insurance has competed so successfully with lawyer's opinions. In many instances, lawyers are not interested in searching or examining titles; the service is not adequately remunerative and requires a specialized knowledge. In addition, title insurers have developed mass production techniques, and they can advertise and solicit business which lawyers are proscribed from doing.

Title insurers have not been so successful in small towns and rural areas where the public records are relatively easy to use and opinion of title is part of a lawyer's bread and butter routine. The abstract plant is not an economical operation for the insurer when the volume of transfers is relatively small. Whatever success title insurance enjoys in these areas is due primarily to the demands for it by national lending institutions as a condition to their making mortgage loans. It is also used as a device for resolving questions about the marketability of title in sale or mortgage transactions.

In most urban areas today the predominant method of title protection is title insurance, the direct successor of the lawyer's certificates. In many areas of the Midwest and continental Europe, however, the lawyer's examination, taken in conjunction with the commercialization of abstract business, is standard.

Lawyer's Title Guarantee Funds

A form of title insurance operation that has developed recently in a few states may be the lawyers' answer to the inroads title insurance has made in the opinion-of-title business. In these states lawyers have organized lawyers' title guarantee funds as a cooperative common law business trust.[11] These funds operate on much the same basis as a Lloyds insurance association. When members join the fund, an original contribution or membership fee is required. The member lawyers may issue conventional title insurance policies to their clients. These policies are underwritten by the fund.

When the policies are written, additional contributions, or premiums, are made by the clients-insureds. The contributions are credited to the members' accounts; and at the end of the year, expenses are allocated among the members in proportion to their contributions made that year. Losses on insured risks are allocated among all the members as expenses, except that losses caused by the gross negligence of a member in issuing a policy are charged only to that mem-

[11] Lawyer's title guarantee funds have been established in Florida, Colorado, and North Carolina; and efforts are under way in a number of states, including Connecticut.

ber's account. Provisions are made for withdrawal of a member's unimpaired credit balance that has been in the fund after a definite period of time, such as seven years.

For the Lawyers Title Guarantee Fund of Orlando, for example, the gross rates charged the insured for the protection are the same rates as those charged by commercial title insurance companies. However, the member lawyer retains 75 per cent of the premium to cover his expenses in conducting the search and opinion of title and he pays the remaining 25 per cent into the fund.

Torrens System[12]

Perhaps the Torrens system is the most logical alternative to title insurance as a method of handling the risk of defective title. This system of title registration is designed to eliminate the difficulties connected with the usual methods of confirming title. Basically, the Torrens system is a social insurance method of confirming titles, since it provides for the conclusive public confirmation (with certain exceptions) and registration of title in eligible applicants and the subsequent transfer of title only by recourse to the public registry. The Torrens system does on a public or governmental basis what insurance companies do on a private basis; i.e., once a property is properly registered, the state guarantees title.

The system provides that an owner may make application for registration of title to a duly elected or appointed registrar. The title is carefully investigated, and the registrar institutes public court proceedings in order that any claims against the property may be made. All persons known to have an interest in the real estate are given personal notice of the proceedings, if they can be located. All other interested parties are given notice by publication. Any interested party may appear and state his claim. If none is made, or such as are made are settled, the title is decreed to rest with applicant, a decree is entered in a book of registry, and a certificate of ownership is issued to the owner(s).

At the time of registration the owner pays a fee, part of which (usually 0.1 per cent of the value of the property) is deposited in an insurance fund available to indemnify those who may subsequently appear with a valid claim to or interest in the property, but whose interest has been defeated by the process of the title registration. In three states—Massachusetts, Ohio, and North Carolina, the title insurance fund currently is operated at the state level. In other states, the fund is operated at the county level.

Future transfers of a registered title involve delivering the deed or mortgage and the original Torrens certificate of registration to the grantee or mortgagee. He presents them to the registering officer who will issue a new certificate when he is satisfied that the deed is valid. Then the transfer is entered on the original certificate of registration which is kept in the office of the register. No transfer of the real estate is binding or complete until the transaction has been registered.

When land is sold, the deed itself does not pass title to the land. Rather it is the registration of title that puts title in the grantee. It should be pointed out that the Torrens certificate of registration is treated as conclusive evidence of the rights in the real estate with the exception of a few types of claims—i.e., claims arising from short-term leases, claims for current taxes, and claims arising under the laws of the United States.

There are some important differences between the Torrens system and title insurance. In the case of title insurance,

[12] For an excellent discussion of the Torrens system, its advantages and limitations, see Nelson L. North and Alfred A. Ring, *Real Estate Principles and Practices*, (Prentice-Hall, Inc., Englewood Cliffs, N.J., 1960), pp. 105-112.

every time real estate is transferred, it theoretically is subject to a complete title search. However, under a Torrens system of land registration, once the real estate is registered, it is not necessary to go beyond or further than the most recent registration to effect transfers. In effect, registration makes the title irrevocable, except in the case of fraud. Thus, with the Torrens system, there is no need for title insurance (after the title is registered) other than that provided by the registration system.

The speed and safety with which transfers with registered titles can be accomplished tends to make real estate more marketable. After the initial cost of registration is absorbed, the expense of transferring titles to realty and of securing mortgages on it are reduced because there is no need to repeat a full search and to purchase title insurance covering the real estate.

The preceding should not be interpreted as suggesting that all problems are solved by the Torrens system. The system has some definite limitations. First, the initial registration is neither easy, speedy, nor inexpensive. Title must be examined and legal proceedings must be conducted before registration is complete. Although subsequent transfers are rapid, initial registration is not. Because of the expense and time involved, the owner of a clear and marketable title has little incentive to go through the whole procedure.

As long as title registration is not compulsory, the system does not attract sufficient registrations to operate successfully. The only properties that are registered tend to be those with questionable titles. Thus the guarantee funds may be inadequate because of the adverse selection involved in registration of properties. In states where the assurance fund lacks state or county government backing, those who have been deprived of rights in the land may not be able to recover compensation should the fund prove inadequate.

A major issue concerning the Torrens system is whether it deprives a person of his property without due process of law, and thus violates a constitutional guarantee. Theoretically, once a piece of real estate is registered, a person with a valid claim against the title cannot recover the real estate. By the nature of the system, he is deprived of his rights in the property itself. If his claim is valid, he is compensated for his loss from the assurance fund.

The justification for allowing property rights to be defeated in this way is based on the concept of eminent domain, i.e. the government has the right to appropriate private realty rights without the owner's consent, by due process of law, upon just compensation. The weakness in such a position is that the Torrens system, in defeating such rights, is not acquiring them for public use, an inherent requirement of eminent domain acquisition.

On the other hand, where title insurance is used, in the event of a valid claim, the claimant can take possession of the real estate or sell his interest to the insured. If he takes the reality, the insured is indemnified by the title insurance.

Finally, the Torrens certificate does not require that the registrar assume the cost of defense of litigation attacking the title of the registered owner. The property owner must still defend the litigation at his own expense. If he is successful, he cannot obtain reimbursement from the registrar for the expenses of the litigation, although he may be able to recover such expenses from the claimant.

The Torrens system has had only moderate success in this country. Its use has been largely confined to a few metropolitan areas such as Boston, Chicago, Duluth, Minneapolis-St. Paul and New York, and it has been used also to clear imperfect title to large pieces of land that are scheduled for tract developments.

At one point, at least 20 states had adopted laws establishing Torrens systems; however, several states have repealed their laws for the reasons presented previously. Thirteen states currently operate Torrens registration systems, but the laws are evidently of no practical use in a number of these states because of the lack of registrations. No state has established a compulsory Torrens system; instead the systems operate on a voluntary basis in addition to the standard method of title recording.

Conclusions

Title insurance represents a contract on the part of the title insurance company to reimburse the insured party for any loss that may arise from any undisclosed defect in the insured's title to real estate. In addition, the title insurance company agrees to defend the insured in any claim, valid or not, against the property.

Title insurance is a single-premium, perpetual policy. It is based on the sound insurance principle of assuring the policyholder that for a relatively small, definite premium, the title insurance company will absorb the financial expense of an indefinite but potentially catastrophic financial loss.

Like other insurance, title insurance assumes unusual but serious perils for the real estate owner. Unlike other insurance, however, it represents protection against hidden defects already in existence, rather than against future events. Consequently, compared with other insurance, a much higher portion of the title premium is devoted to underwriting costs because of the legal fees incurred in conducting a title search. In fact, title insurers in their advertising stress this service of risk delineation rather than risk coverage.

In some regions of the United States, little title insurance is sold. Buyers of realty rely instead upon certificates of title issued by attorneys. However, the certificate of title involves only a title search and investigation of records; thus it does not afford the buyer the same degree of protection that title insurance provides.

Title insurance in the United States has grown for three reasons. Title insurers have demonstrated great efficiency in the operation of their title plants and in the speed with which they can complete a title search, especially in large cities. Title insurance companies have also conducted aggressive promotion campaigns for their service. Finally, financial institutions have shown a strong preference for the use of title insurance in their lending operations.

Because these factors are likely to exist and even become more important in the future, title insurance will probably continue to be successful. Lawyers have shown little opposition to title insurance. Indeed their lawyer's title guarantee funds represent acceptance of the principle. The Torrens system, with its own limitations, offers no serious competition in most areas. Further, it should be recognized that title insurance assures the safety of many transactions that might otherwise be blocked by minor objections to title.

While the use of title insurance is increasing, it has not been developed or improved to the extent necessary to keep pace with today's financial requirements. This is due partly to the fact that most individual owners of property are not yet convinced of the need for title protection, because the public seldom hears about the payment of a title loss.

In addition, the development of contract improvements is usually slow in any line of insurance in which losses are few. Conversely, development is rapid in those lines in which claims and legal actions are frequent, and public interest high, for example, health insurance and automobile insurance. Nevertheless, although title insurance constitutes only a small portion of the total insurance business, the role it plays is greater than its dollar volume suggests.

A.M. BEST

SPECIAL REPORT **OCTOBER 2005**

Clouds on Horizon After Title Industry's Bright Year

Industry Overview

The title industry reported near-record results in 2004, following a record-setting year in 2003. Overall underwriting performance in 2004 was almost as strong as in 2003, fueled by favorable economic conditions marked by the continuing housing boom. The industry's operating revenue declined slightly from the historically high 2003 levels, while performance was driven by continuing favorable loss experience and enhanced operating efficiencies.

Following record earnings generated in the previous year, the title industry reported robust earnings in 2004 for the ninth consecutive year. The industry's 2004 net income of approximately $1.1 billion was almost at par with the record-breaking year of 2003. Pretax underwriting gains, while significant, nevertheless declined somewhat from 2003, whereas both net investment income and net realized capital gains compared favorably with the prior year. The favorable performance was driven by strong underwriting results and an increase in net realized capital gains attributed to favorable equity markets in 2004. Operating revenue was nearly equal to the historical high posted in 2003 and reflected sustained high demand for title products, as continued favorable long-term interest rates fueled refinance activity and strong home sales. The industry was able to absorb more efficiently this large influx of new business over the past several years, primarily due to technological advancements.

As the broader economy continued its recovery in 2004, the housing sector, which included a demand for new mortgages as well as refinancing activity, remained favorable even as the Federal Reserve initiated a policy of gradually increasing short-term interest rates from the historically low levels witnessed in 2002 and 2003.

Exhibit 1

Key Elements of Title Insurance Compared With P/C Insurance

Key elements of title insurance that distinguish it from personal-lines classes of property/casualty insurance.

Features	Title Insurance	P/C Insurance
Protects Against	Past Events	Future Events
Scope of Coverage	Specific	Broad
Actuarially Defined Rates	Evolving	Yes
Administrative/ Acquisition Costs	High	Low
Loss Costs	Low	High
Policy Term	Potentially Unlimited	Finite
Premium (GAAP)	Fully Earned at Issuance	Earned Over Policy Term
Rate Regulation	Varies	High
Rate Activity	Varies	Tied to Inflation and Underwriting Business Cycles
Loss Frequency	Low to Moderate	High
Loss Severity	Low	Moderate
Distribution	Agents/Direct	Agents/Direct/Mass Market
Marketing Success	Based on Service	Based on Rates
Competition	Semi-Concentrated Market	Fragmented Market

While the housing affordability index dropped by 5.8 points to 132.6 in 2004, largely reflecting rapid appreciation in real estate prices, it still remained well above historical levels, as long-term rates, which are the primary determining factor behind mortgage rates, continued to trend lower. There are some troubling trends on the horizon, however, which could result in greater risk for the housing sector in the months and quarters ahead, with potential negative implications for housing-dependent sectors such as the title insurance industry. These include the development of what many in the housing industry refer to as a real estate "bubble," as home prices continue to increase at rates far above the growth in personal income.

The title industry also was the subject of several investigations in 2004 and continuing into 2005. The actions were initiated by the regulatory agencies of states such as California and Colorado, as well as by the U.S. Department of Housing and Urban Development (HUD), the federal

The report was written by Neil DasGupta, financial analyst in the property/casualty division of A.M. Best Co., and Richard McCarthy, director of research for the American Land Title Association.

agency with oversight of the housing industry and related practices. The primary focus of the investigations at the state level are so-called captive reinsurance agreements, whereby several major title insurance companies ceded nearly 50% of the premium to captive reinsurance companies set up by homebuilders and developers. The investigations have centered on whether these payments were in effect "kickbacks" in return for referral of title business from the developers, and whether these arrangements raised the cost of procuring title insurance for the homebuyer. As of this writing, several of the major title insurers have promised to end these practices; have refunded part or all of the premiums involved in these arrangements back to policyholders; and have paid fines and penalties to the regulatory agencies as part of an overall settlement. Another area of inquiry for both HUD and some state regulators has been affiliated business arrangements (ABAs). The issue is whether affiliates set up by the title insurers are truly distinct entities with a separate physical presence and adequate staffing, or whether they are effectively "shell" companies designed to funnel kickbacks to joint-venture partners such as developers or real estate brokerage firms in return for referral of volume business. While affiliated business arrangements are legal under the Real Estate Settlement Procedures Act (RESPA), the investigations are looking into whether these arrangements meet with specific guidelines under the Act relating to possible illegal activity, including payment of kickbacks.

The title insurance industry has unique characteristics compared with other property/casualty insurers. Since title insurers are required by law to be monoline writers, their revenue is susceptible to more volatility than that of multiline writers and is dependent on regional and national economic conditions. In addition, the title industry has state-mandated reserves to protect policyholders in the event of insolvency. These reserves, called statutory premium reserves, must be funded by each title insurer with segregated funds based on state statutes. The manner in which the statutory premium reserve funds are invested also may be mandated by state statutes. At the end of 2004, total policyholder protection for the industry (the sum of statutory premium reserves, known claim reserves and surplus) totaled nearly $7.5 billion, compared with slightly more than $7 billion in the previous year.

The industry evolved rapidly in recent years due to several factors, which included: consolidation activity; introduction of new and expanded products; technology advancements; entry into new lines of business; and national and international expansion. As the industry continues to evolve by diversifying its products and services and enhancing its utilization of technology, the potential for volatility in revenue and earnings will be somewhat mitigated by economic cycles.

Industry History and Purpose

This report begins with a historical overview of the title industry and its function as an integral part of the real estate industry. The report

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examines title industry attributes; economic results and issues; the regulatory environment; business risks; and unique challenges the industry faces in the rapidly changing real estate and insurance markets.

The title industry has played, and continues to play, a critical role in the U.S. economy by facilitating the growth of the secondary mortgage market, thus enabling Americans to have one of the highest home ownership rates in the world. The process of insuring the proper transfer of real estate from seller to buyer is critical to the real estate transfer process.

The title assurance industry is composed of abstractors, attorneys, title insurance agents and title insurance companies. At any real estate closing, the parties involved must be assured that the title of the subject real property is as represented and expected. Members of the land title assurance industry are instrumental in helping to deliver and guarantee this assurance.

The functions of search and examination of title provide the basic information concerning the legal interest affecting the title to real property. The title search and examination are more than an attempt to confirm the placement on the record of a subject mortgage; they are the underwriting process that distinguishes between significant and insignificant conditions affecting title. The search and examination very often include the curing of defects to title necessary to complete the transaction. It is acknowledged that there are few properties with perfect title conditions and, as such, title insurance was developed to guarantee the current status of title based on search and examination.

Depending on the jurisdiction, the title search and examination can require the search of numerous public documents, including tax, court judgment, deed, encumbrance, federal and state records and the evaluation of real property characteristics such as flood zone, location and construction type by title industry personnel.

To assure that real property rights as represented are conveyed, most transactions are covered by title insurance to guarantee the condition of ownership and property rights as represented. The policy of title insurance provides indemnification of the insured who has a fee, leasehold, or mortgage lien interest in a specified parcel of property for any covered loss caused by a defect in title that existed as of the effective date of the policy.

Title insurance involves the acceptance of past transactional events rather than future occurrence events associated with all other property and catastrophe exposures. In addition, title insurance, unlike most other property/casualty exposures, has no termination date and no time limitation on filing claims.

Since title insurance usually involves the acceptance of prior transaction-related risk rather than future risk, the underwriting process in the title insurance industry differs markedly from the typical property/casualty underwriting process. The title underwriting process is designed to limit risk exposure through a thorough search of the recorded documents affecting a particular property. The insurance component of a title product only indemnifies for existing, but unidentified, or

Exhibit 2

Key Economic Figures

Gross domestic product from 1972 through 2004, along with the unemployment rate, the inflation rate and disposable income.
($ Billions)

Year	Gross Domestic Product	Percent Change	Civilian Unemployment Rate (%)	Rate of Inflation	Disposable Personal Income	Percent Change
1972	$4,105.0	5.3	5.6	3.2	$3,046.5	4.8
1973	4,341.5	5.8	4.9	6.2	3,252.3	6.8
1974	4,319.6	-0.5	5.6	11.0	3,228.5	-0.7
1975	4,311.2	-0.2	8.5	9.1	3,302.6	2.3
1976	4,540.9	5.3	7.7	5.8	3,432.2	3.9
1977	4,750.5	4.6	7.1	6.5	3,552.9	3.5
1978	5,015.0	5.6	6.1	7.6	3,718.8	4.7
1979	5,173.4	3.2	5.8	11.3	3,811.2	2.5
1980	5,161.7	-0.2	7.1	13.5	3,857.7	1.2
1981	5,291.7	2.5	7.6	10.3	3,960.0	2.7
1982	5,189.3	-1.9	9.7	6.2	4,044.9	2.1
1983	5,423.8	4.5	9.6	3.2	4,177.7	3.3
1984	5,813.6	7.2	7.5	4.3	4,494.1	7.6
1985	6,053.7	4.1	7.2	3.6	4,645.2	3.4
1986	6,263.6	3.5	7.0	1.9	4,791.0	3.1
1987	6,475.1	3.4	6.2	3.6	4,874.5	1.7
1988	6,742.7	4.1	5.5	4.1	5,082.6	4.3
1989	6,981.4	3.5	5.3	4.8	5,224.8	2.8
1990	7,112.5	1.9	5.6	5.4	5,324.2	1.9
1991	7,100.5	-0.2	6.8	4.2	5,351.7	0.5
1992	7,336.6	3.3	7.5	3.0	5,536.3	3.4
1993	7,532.7	2.7	6.9	3.0	5,594.2	1.0
1994	7,835.5	4.0	6.1	2.6	5,746.4	2.7
1995	8,031.7	2.5	5.6	2.8	5,905.7	2.8
1996	8,328.9	3.7	5.4	3.0	6,080.9	3.0
1997	8,703.5	4.5	4.9	2.3	6,295.8	3.5
1998	9,066.9	4.2	4.5	1.6	6,663.9	5.8
1999	9,470.3	4.5	4.2	2.2	6,861.3	3.0
2000	9,817.0	3.7	4.0	3.4	7,194.0	4.8
2001	9,890.7	0.8	4.7	2.8	7,333.3	1.9
2002	10,048.8	1.6	5.8	1.6	7,562.2	3.1
2003	10,320.6	2.7	6.0	2.3	7,741.8	2.4
2004	10,775.7	4.4	5.5	2.7	8,004.3	3.4

Notes/Source. All data are annual averages. Gross domestic product (GDP) and disposable personal income (DPI) are adjusted for inflation, reported in billions of chained 2000 dollars by the Bureau of Economic Analysis. The unemployment rate is the number of unemployed as a percentage of the civilian labor force as reported by the Bureau of Labor Statistics.

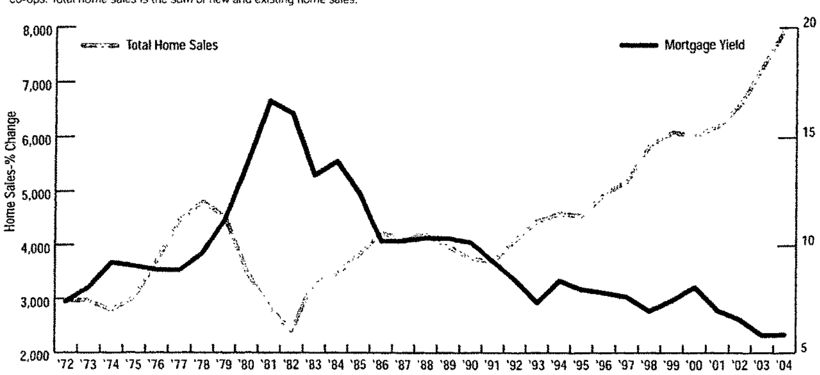
Exhibit 3

Housing and Construction Activity vs. Mortgage Rates

Data show an inverse relationship between the cost of borrowing money and activity for all types of real estate.

Year	30-Year Fixed Mortgage Yield (%)	Basis Point Change	Housing Starts (Thousands)	Percent Change	New Home Sales (Thousands)	Existing Home Sales (Thousands)	Total Home Sales (Thousands)	Percent Change	Nonresidential Structures ($ Billions, 2000)	Percent Change
1972	7.38	-36	2,357	14.8	718	$2,252	$2,970	11.1	$191.7	3.1
1973	8.04	66	2,045	-13.2	634	2,334	2,968	-0.1	207.3	8.2
1974	9.19	115	1,338	-34.6	519	2,272	2,791	-6.0	202.9	-2.1
1975	9.04	-15	1,160	-13.3	549	2,476	3,025	8.4	181.6	-10.5
1976	8.86	-18	1,538	32.5	646	3,064	3,710	22.6	186.0	2.4
1977	8.84	-2	1,987	29.2	819	3,650	4,469	20.5	193.7	4.1
1978	9.63	79	2,020	1.7	817	3,986	4,803	7.5	221.6	14.4
1979	11.19	156	1,745	-13.6	709	3,827	4,536	-5.6	249.7	12.7
1980	13.77	258	1,292	-26.0	545	2,973	3,518	-22.4	264.2	5.8
1981	16.63	286	1,084	-16.1	436	2,418	2,854	-18.9	285.2	8.0
1982	16.08	-55	1,062	-2.0	412	1,991	2,403	-15.8	280.4	-1.7
1983	13.23	-285	1,703	60.3	623	2,697	3,320	38.2	250.1	-10.8
1984	13.87	64	1,750	2.7	639	2,828	3,467	4.4	285.1	14.0
1985	12.42	-145	1,742	-0.4	688	3,132	3,820	10.2	305.4	7.1
1986	10.18	-224	1,805	3.7	750	3,475	4,225	10.6	271.9	-11.0
1987	10.20	2	1,621	-10.2	671	3,437	4,108	-2.8	264.1	-2.9
1988	10.34	14	1,488	-8.2	676	3,512	4,188	1.9	265.9	0.6
1989	10.32	-2	1,376	-7.5	650	3,324	3,974	-5.1	271.2	2.0
1990	10.13	-19	1,193	-13.3	534	3,220	3,754	-5.5	275.2	1.5
1991	9.25	-88	1,014	-15.0	509	3,186	3,695	-1.6	244.6	-11.1
1992	8.40	-85	1,200	18.3	610	3,479	4,089	10.7	229.9	-6.0
1993	7.33	-107	1,288	7.3	666	3,787	4,453	8.9	228.3	-0.7
1994	8.35	102	1,457	13.2	670	3,917	4,587	3.0	232.3	1.8
1995	7.95	-40	1,354	-7.1	667	3,886	4,553	-0.7	247.1	6.4
1996	7.80	-15	1,477	9.1	757	4,197	4,954	8.8	261.1	5.7
1997	7.60	-20	1,474	-0.2	804	4,382	5,186	4.7	280.1	7.3
1998	6.94	-66	1,617	9.7	886	4,970	5,856	12.9	294.5	5.1
1999	7.43	49	1,641	1.5	880	5,205	6,085	3.9	293.2	-0.4
2000	8.06	63	1,569	-4.4	877	5,152	6,029	-0.9	313.2	6.8
2001	6.97	-109	1,603	2.2	908	5,296	6,204	2.9	306.1	-2.3
2002	6.54	-43	1,705	6.4	973	5,631	6,604	6.4	253.8	-17.1
2003	5.82	-72	1,848	8.4	1,086	6,183	7,269	10.1	243.1	-4.2
2004	5.84	2	1,956	5.9	1,203	6,784	7,987	9.9	248.4	2.2

Notes/Source. All data are annual averages. Mortgage yield from Federal Home Loan Mortgage Corp. (Freddie Mac) Survey of Major Lenders. Housing starts, new home sales and nonresidential structures from Department of Commerce, Census Bureau and Bureau of Economic Analysis. The residential structure series includes commercial but not government construction. Existing home sales are from the National Association of Realtors and include single-family, condos and co-ops. Total home sales is the sum of new and existing home sales.



specifically underwritten, defects in the condition of a property's title. In other words, title insurance, unlike typical property/casualty insurance, usually does not respond to future occurrences but only to past defects that were in place at the time the property was sold and were not recognized as a problem until after the property was transferred or was insured over.

Property/casualty underwriters are concerned with determining the probability of loss based on the characteristics of the insured, while title underwriters are concerned with reducing the possibility of loss by discovering as much information as possible about the past through extensive searches of public records and stringent examinations of title. Some state title insurance codes provide that no policy or contract of title insurance shall be written unless it is based upon a reasonable examination of title, and unless a determination of insurability of the title has been made in accordance with sound underwriting practices. For an iteration of differences between property/casualty underwriters and title underwriters, please refer to Exhibit 1.

The general underwriting examination and search requirements, coupled with the disarray and geographical dispersion of records, has fostered the development of privately owned, indexed databases or title plants. These title plants must be maintained regardless of the level of real estate activity during any given period. The Financial Accounting Standards Board has ruled that a title plant is a unique asset that, if properly updated, does not diminish in value over time. The cost to maintain the economic life of a title plant and continuously update the records is extremely high. This is one factor adding to the higher overall fixed cost percentage for title insurers as compared with property/casualty insurers.

Both property/casualty insurers and title insurers must physically produce policies, but the processes and requirements have significant differences. A typical property/casualty policy may involve filling out a few blanks on a form, while the title policy may require the transcription of a complex legal description unique to the insured property, along with enumeration of often equally complex and unique terms of easements or other special property rights. In property and liability lines, agents' commissions are generally in the range of 10% to 25% of premium on policies that agents write. In title insurance, the agent retains a much larger proportion of the amount charged. Commissions for title insurance are more properly described as agent's retention or agent's labor or work charges.

Exhibit 4

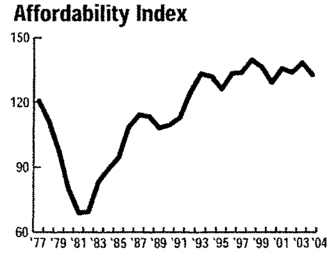
Housing Affordability

The housing affordability index measures the percentage of income the median-income family has toward qualifying for a median-priced home with a 20% down payment. A higher index reading means greater housing affordability. For 2004, the median-income family—with an income of $54,527—had 132.6% of the income needed to qualify for the median-priced home of $184,100.

Year	Affordability Index	Year	Affordability Index
1977	120.6	1991	112.9
1978	111.4	1992	124 7
1979	97 2	1993	133.3
1980	79 9	1994	131 9
1981	68.9	1995	126.1
1982	69 5	1996	133.3
1983	83.2	1997	133.9
1984	89.1	1998	139.7
1985	94 8	1999	136.3
1986	108 9	2000	129 2
1987	114.2	2001	135.7
1988	113 5	2002	133 9
1989	108.1	2003	138.4
1990	109 5	2004	132 6

Source: National Association of Realtors.

Affordability Index



The title insurance activity of search and examination generally is carried out locally, because the public records to be searched are usually only available locally. This activity may be done by directly-owned branch operations or title agents. Agent activities not only reflect a sales commission but incorporate underwriting, loss-prevention and administration costs that title insurers would incur if policies were issued directly. These unique characteristics of the title insurance industry, combined with the necessity of maintaining a title plant or searching public records, contribute to the high fixed costs, the high ratio of salaries to total expenses and the high percentage of total revenues retained by agents.

In addition, with the requirement that each real estate parcel be evaluated and insured based upon myriad, varying local laws, customs and records, the traditional insurance structure of local marketing and home-office underwriting cannot be maintained reasonably and cost-effectively in the title insurance industry. Since real estate laws, customs and practices vary at least on a state-by-state and sometimes on a county-by-county basis, it has not been practical for underwriting to be done on a national basis by a team of underwriters in the home office. Therefore, the economies of scale made possible by establishing a centralized, skilled technical support staff of actuaries and underwriters to price products and make underwriting decisions is absent in the title industry.

Exhibit 5

Title Industry Revenue and Home Sales Activity

Home sales, mortgage rates and title insurance revenues.

	Total Operating Revenue ($ Millions)	Percent Change	30-Year Fixed Mortgage Yield (%)	Basis Point Change	Home Sales (Thousands)	Percent Change
1972	$644.40	22.7	7.38	-36	2,970	11.1
1973	720.6	11.8	8.04	66	2,968	-0 1
1974	674.9	-6.3	9.19	115	2,791	-6 0
1975	684.9	1 5	9.04	-15	3,025	8 4
1976	899.7	31.4	8.86	-18	3,710	22 6
1977	1,181 80	31.4	8 84	-2	4,469	20.5
1978	1,509.20	27.7	9.63	79	4,803	7 5
1979	1,548.60	2 6	11.19	156	4,536	-5 6
1980	1,403 90	-9.3	13.77	258	3,518	-22 4
1981	1,496.50	6 6	16.63	286	2,854	-18.9
1982	1,445.80	-3.4	16.08	-55	2,403	-15.8
1983	2,181.90	50.9	13.23	-285	3,320	38 2
1984	2,612.80	19 8	13.87	64	3,467	4.4
1985	2,956.90	13.2	12.42	-145	3,820	10 2
1986	3,770.00	27.5	10.18	-224	4,225	10.6
1987	4,218.30	11 9	10.20	2	4,108	-2 8
1988	4,055.80	-3.9	10.34	14	4,188	1.9
1989	4,107 10	1 3	10.32	-2	3,974	-5.1
1990	4,092.90	-0.4	10.13	-19	3,754	-5.5
1991	4,231.30	3 4	9.25	-88	3,695	-1 6
1992	5,231.90	23.6	8.40	-85	4,089	10.7
1993	5,936.90	13 5	7.33	-107	4,453	8.9
1994	5,860.20	-1 3	8.35	102	4,587	3.0
1995	4,842.70	-17 4	7 95	-40	4,553	-0 7
1996	5,552.20	14.7	7.80	-15	4,954	8.8
1997	6,180.50	11.3	7.60	-20	5,186	4 7
1998	$8,276.80	33 9	6.94	-66	5,856	12.9
1999	8,496.00	2 6	7.43	49	6,085	3.9
2000	7,869.20	-7.4	8.06	63	6,029	-0.9
2001	9,751 20	23 9	6.97	-109	6,204	2 9
2002	12,625.90	30 1	6.54	-43	6,604	6.4
2003	16,529.30	30.9	5.82	-72	7,269	10.1
2004	16,355.90	-1.0	5.84	2	7,987	9.9

Source Title industry revenue from American Land Title Association and NAIC Form 9 Financial Reporting. Mortgage rates are from Freddie Mac. Total home sales is the aggregate of new home sales published by the U.S. Census Bureau and existing home sales per the National Association of Realtors.

Rate Regulation

Like the rates for other forms of insurance, rates for title insurance usually are regulated by state governments to ensure that premiums are not excessive, inadequate or unfairly discriminatory to the public. States have different methods of regulating title insurance rates. The types of rate regulation used are:

1. Promulgation—A state regulatory body sets the rates.

2. Prior Approval—Insurers propose rates, which must be reviewed formally and approved explicitly or deemed approved by the regulatory body before they can be charged.

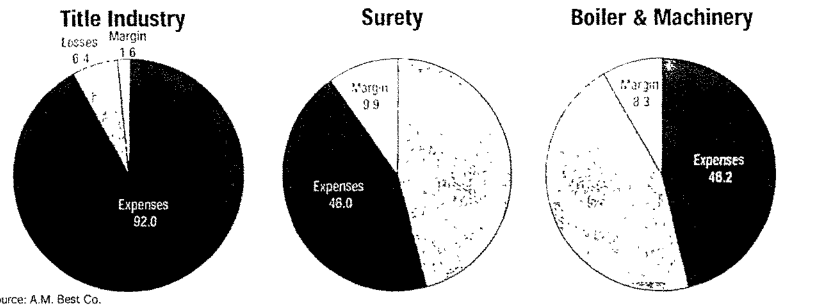
3. File and Use—Insurers set rates, but they cannot be charged until the regulator has been notified and allowed time for review and action if necessary. In some prior-approval states, almost the same result is achieved through a so-called deemer provision. Under a deemer, rates proposed by insurers are deemed approved if the regulatory body takes no action to disapprove a filing within a specified time and the filer notifies the state that the rates are being deemed approved.

4. Use and File—Insurers set rates that can be charged immediately, as long as the new rate schedule is filed with the regulatory body.

5. No Direct Rate Regulation—Insurers set rates that can be changed at an insurer's discretion. Even in this apparent unregulated situation, a regulatory body still is charged with overseeing the title insurance industry and can question the propriety of a rate that appears to be unfairly discriminatory or otherwise violates statutory standards.

Title Rates: Title insurance premium rates are determined largely by operating and acquisition cost factors, as compared with property/casualty rates that are based on the actuarial determination of expected losses. The risk of title loss is a function of many factors, which can vary considerably from jurisdiction to jurisdiction and transaction to transaction. Also, the services covered by the title insurance premium vary from state to state. It is difficult to compare a pure title insurance risk premium with an all-inclusive rate that covers not only the risk of loss but also the title search, examination, title opinion and closing.

Exhbit 6



Source: A.M. Best Co.

Rate Adequacy and Stability

Title insurance premium rates are based on five considerations: 1) the cost of maintaining current title information on property local to that operation, i.e., title plant; 2) the cost of searching and examining the title to subject properties; 3) the cost to resolve or clear defects to title; 4) the claims costs covering title defects; and 5) the allowance for a reasonable profit.

Loss Characteristics Among Companies

Title insurance loss experience varies considerably among individual companies, based on a wide array of factors, including:

1. Experience and technical competency of both a company's agents and title underwriters;
2. Quality and quantity of title documentation and evidence (both public and private) underlying the search-and-examination process;
3. Regional differences in title insurance customs and practices, underlying title insurance risks, the mix of residential sale, residential refinance and commercial business, and defalcation risks;
4. Adequacy and effectiveness of a company's underwriting controls and agency management systems;
5. Differences in the proportion of a company's agency vs. direct book of business;
6. Differences in the proportion of a company's commercial vs. residential book of business; and
7. Differences in companies' claim-administration processes in areas of claim recognition, evaluation, timing of settlement and recoupment.

The Economy

The recovery that began in late 2002 continued through all of 2004 at a much stronger pace. For the year 2004, GDP growth was a relatively strong 4.4%, an improvement over the downwardly revised growth rates of 2.7% and 1.6% in 2003 and 2002, respectively.

During 2004, the Federal Reserve began a policy of gradually increasing short-term interest rates from the historically low levels of 2002 and 2003. However, interest rates on mortgages, which more closely track long-term government debt, remained at record low levels in 2004. Thirty-year, fixed-rate mortgages were at 5.84% for the year 2004, only 2 basis points above 2003's mortgage rate, which was at a 40-year low of 5.82%.

Two dark clouds on the current and future economic environment are petroleum prices and interest rates. The 2005 increase of close to 50% in the price of crude oil, coupled with the continued increases in the federal funds rate, do not bode well for real estate in the future. Historically, after a time lag, changing interest rates tend to track closely with changes in the price of crude oil. It remains to be seen whether this relationship will hold in the future.

The housing sector in 2004 continued its spectacular performance. Housing starts, existing home sales and new home sales all were above previous years' figures. Since 2001, housing starts are up 22.0%, new home sales are up 32.5%, and existing home sales are up 28.1%.

The year 2004 was a record year for real estate transactions. Total home sales (new plus existing sales) were close to 8 million units, the largest number ever. During that year, existing home sales were 6.8 million units, and new home sales were 1.2 million.

The furious pace of real estate activity over the past three years has been matched by rising home prices. New and existing home prices increased in 2004 by 13.3% and 14.1% respectively, after rising by 3.9% and 7.5% in 2003. During the period from 2001 through 2004, median family income increased by 7.9%, while median existing home prices rose by 23.5%. For first-time home buyers, median income rose by 5.7% during this period, while first-time (starter) home prices rose 27.3%. The relatively large increases in median housing prices as compared with the modest increases in median incomes has outweighed the relatively low level of long-term interest rates, causing the housing affordability index to decrease to 132.6 for existing home sales and to 77.1 for first-time home buyers in 2004.

The Title Industry and Real Estate Economics

The title industry is highly dependent on real estate markets, which are, in turn, highly sensitive to interest rates and overall economic well being. There is an inverse relationship between changes in interest rates and operating revenue for title insures. As interest rates fall, operating revenue generally rises, reflecting increased demand for title products. The reverse occurs when interest rates rise. The relatively stable low-interest-rate environment, as reflected in the 2004 year end 30-year fixed-rate mortgage yield, which increased only 2 basis points from year end 2003, caused home-sale activity to continue at historically high levels, while refinancing activity declined as a share of total mortgages.

Based on the title insurers' correlation to real estate markets, as well as being required by law to be monoline writers, revenue and profitability are susceptible to volatility. This has been evident during the past 30 years as reflected in changes in interest rates compared with the corresponding fluctuation in total operating revenue and pretax operating gains. To dampen this volatility, title insurers have improved technology and work-flow processes and diversified their operating revenue by introducing new title products, entering new lines of business, and expanding nationally and internationally.

How Title Insurance Differs From Other Lines of Insurance

Since title insurance is an evidence-producing/loss-prevention line of insurance, its loss expense is less and its operating expense is greater than other property/casualty lines of business. Insurance expenses can be divided into two kinds: loss prevention/underwriting expenses and loss-related expenses.

A typical loss-prevention insurance line, such as title, boiler and machinery, or surety insurance, usually has higher operating costs and lower losses than other insurance lines. It should be noted that according to the statutory accounting rules for title insurance, only reported claims are reflected in the loss expense, while in other lines, both reported and unreported (incurred but not reported, or IBNR) claims are included in the loss expense. This different methodology causes timing differences in the reporting of losses and loss-adjustment expenses

Exhibit 7

Title Industry Pretax Operating Gains/Losses And Expenses

($ Millions)

Year	Pretax Operating Gain/Loss	Percent Change	Loss & Loss Adj. Expenses	Percent Change	Operating Expenses	Percent Change
1974	14.0	-83.1	43 6	29.0	617.3	2.2
1975	7.1	-49.3	59 2	35 8	618.6	0.2
1976	69.3	876.1	56 4	-4.7	773 9	25.1
1977	122 8	77 2	62.6	11 0	996 4	28.8
1978	94.4	-23.1	76.1	21.6	1,338 7	34 4
1979	59 2	-37 3	77 8	2.2	1,411 6	5 4
1980	-68 9	-216.4	92.2	18.5	1,380.6	-2.2
1981	-128.3	-86 2	120.6	30.8	1,504 2	9.0
1982	-140 5	-9.5	122.0	1.2	1,464.3	-2.7
1983	91.3	165 0	136.6	12 0	1,954.0	33 4
1984	23.5	-74.3	205 6	50.5	2,383.7	22.0
1985	29.6	26.0	227.5	10.7	2,699.7	13.3
1986	157.5	432.1	332.9	46.3	3,279.6	21 5
1987	58.8	-62.7	325.1	-2 3	3,834.4	16 9
1988	-111.9	-290.3	390.5	20.1	3,777.2	-1 5
1989	-153.8	-37 4	389 1	-0 4	3,871.8	2 5
1990	-210.4	-36.8	410.2	5 4	3,890.4	0.5
1991	-218.3	-3 8	424.4	3.5	4,025.3	3.5
1992	118.9	154.5	387.7	-8.6	$4,725.3	17.4
1993	267.3	124.8	343 0	-11.5	5,336.6	12 9
1994	91.1	-65.9	315.3	-8.1	5,453.5	2 2
1995	-33.4	-136.7	282.1	-10.5	4,594.0	-15.8
1996	78 7	335.6	271.1	-3.9	5,202.9	13.3
1997	104.6	32.9	287.0	5.9	5,788.9	11.3
1998	283.3	170.8	317.3	10.6	7,676.2	32.6
1999	275.7	-2.7	350 0	10 3	7,900.0	2 9
2000	32.7	-88 1	419 3	19.8	7,448 8	-5.7
2001	242.5	641.6	465.1	10.9	9,040 0	21 4
2002	479.1	97 6	580.9	24.9	11,563.6	27.9
2003	1,024.3	113 8	662.0	14.0	14,843 4	28.4
2004	755.0	-26 3	699.1	5 6	14,901 7	0 4

Source. Data developed from ALTA and NAIC Form 9 Financial Reporting for title insurance as compared with other lines. In addition to known claims, title insurers, unlike other lines, carry a statutory liability known as the statutory premium reserve, which provides ultimate policyholder loss protection. However, it is not counted as a loss statistic.

Because of the large service and underwriting component of title insurance, its closest counterparts in the property/casualty sector are service, underwriting and loss-control intensive lines of business. Lines of insurance that contain these features are surety and boiler and machinery.

Operating expenses are the largest component of a title company's costs. A title company's ability to expand its infrastructure and maximize operating profits in good market conditions, and contract and control costs in poor market conditions, is a critical factor to its long-term financial success and solvency. This isn't necessarily the case with property/casualty companies, where the control of loss costs is a more critical factor to success and solvency.

Investment Income Characteristics

Important differences exist in title insurers' and traditional property/casualty companies' ability to generate investment income. Property/casualty insurers collect premiums in advance and hold them until they must be paid out to indemnify claimants for losses. These premiums constitute a large cash flow that companies generally invest in intermediate and long-term, investment-grade assets. The investment income generated is reinvested, and a company's asset base grows at a compounded rate until losses on policies materialize and are paid. For long-tail casualty business lines, these claims may take decades to appear and can result in large accumulations of assets. As a property/casualty company increases its ratio of written premiums to surplus (equity), it automatically increases the fraction of its total assets that are financed by advanced premiums from policyholders. In other words, writing property/casualty insurance can create financial leverage.

These property/casualty reserves are debt, in that if the policy is canceled, they are owed to the former policyholder, yet they bear no rate of interest. Hence, this kind of financial leverage does not burden the property/casualty insurer with additional fixed charges and, as long as rates are adequate, provides all the conventional benefits of leverage without much of the downside risk.

Title companies collect premiums after the largest component of their costs—operating expenses—has been incurred. As shown in Exhibit 9, title companies' expense ratio typically averages more than 90%, while the property/casualty industry has an expense ratio of less than 30%. This results in a significant reduction in available cash flow for title companies to invest. Although the remainder of the title premium collected is available for investment, the relative percentage of premium collected and invested is significantly less. The title industry's financial leverage is relatively low.

Title insurers sell protection against losses

Exhibit 8

Loss and Loss-Adjustment Expense Ratios For Various Lines of Insurance

Title insurance has a much lower average loss and LAE ratio as compared with the general property/casualty industry. Property and casualty figures incorporate an IBNR approach, whereas title involves paid claims.

Year	Title Industry	Surety (Stock)	Property/ Casualty (Stock)	Property/ Casualty (Mutual)	Boiler/ Machinery (Stock)
1974	6.5	61.6	75 3	76 4	44.6
1975	8.7	68.8	78 8	80.2	43 8
1976	6.3	49 2	74 6	77.1	36.1
1977	5.3	44 6	70 1	72.4	33 3
1978	5.0	46 8	69 0	72.9	30.8
1979	5 0	39 6	71 7	76.3	20 8
1980	6.6	53.1	73.9	77.0	33.1
1981	8.1	34.1	75 5	79.8	33 2
1982	8 4	37.4	78 6	82 1	38.6
1983	6 3	39.9	81 0	81.9	40 5
1984	7 9	49.9	88 8	87.3	53.8
1985	7.7	77 7	88.8	88.6	41.5
1986	8.8	71.6	80.3	84.3	38.7
1987	7.7	66.1	76 2	82 2	32.7
1988	9.6	49 3	76 2	83 5	44.5
1989	9.5	42.9	80.4	85.9	38.6
1990	10 0	36.3	80 2	87.0	48.2
1991	10 0	26.2	80 1	82.8	57.1
1992	7 4	39 3	89.7	84.4	53.6
1993	5.8	23 0	78.9	81.4	58.1
1994	5.4	34.5	80.3	82.4	44 9
1995	5 8	33.9	78.1	80.7	48 1
1996	4 9	27.2	77.9	79.9	44.1
1997	4.6	25.6	72.3	74.7	45.2
1998	3 8	24.5	75.0	80.1	51.0
1999	4.1	25.0	77 3	81 7	60 6
2000	5 3	27.7	79.4	85 3	51.5
2001	4.8	47 2	87.3	90 8	50.2
2002	4 6	63.7	80.5	82.9	40.0
2003	4 0	72 1	74 4	75.4	28 4
2004	4.3	69.7	72.2	72 5	32.4
Averages					
All Years	**6.5**	**45.4**	**78.2**	**81.0**	**42.5**
Past 10 Years	**4.6**	**41.7**	**77.4**	**80.4**	**45.2**
Past 20 Years	**6.4**	**44.1**	**79.3**	**82.3**	**45.5**

Source: Title industry figures developed from ALTA and NAIC Form 9s. All other data from Best's Aggregates & Averages.

caused by problems with legal title to real property arising out of events that occurred before the effective date of the policy. Because most uncertainty about the past can be reduced by careful research, a title insurer can exert a great deal of control over the risks it underwrites.

For example, a title insurer can almost eliminate the possibility that a real estate title will become encumbered by a lien for past unpaid real estate taxes by looking up the property tax records of past years. However, hidden defects in a real estate title, such as errors in public records, will always cause losses. Because of the great importance of real estate titles, title insurers establish their underwriting criteria at a high level of stringency, eliminating all risks they possibly can through careful examination of title before issuing insurance.

Exhibit 9

Operating Expense Ratio For Various Lines of Insurance

Title insurance has a much higher average expense ratio as compared with traditional property/casualty lines.

Year	Title Industry	Surety (Stock)	Property/ Casualty (Stock)	Property/ Casualty (Mutual)	Boiler/ Machinery (Stock)
1974	91.5	52.1	29.7	24.8	59.0
1975	90.3	53 2	28.7	24.2	52.4
1976	86.0	53.8	27.4	22.5	57 6
1977	84 3	51.6	26.9	21.5	53 4
1978	88.7	50 3	27.6	21.7	53.3
1979	91.2	50.6	27 9	21.7	55.4
1980	98.3	52.8	28 5	22.1	57 7
1981	100 5	51 6	29 4	23.1	58 6
1982	101.3	51.7	30.1	23.5	62 1
1983	89.6	47 7	30 8	23 4	63 3
1984	91.2	45.6	30.1	23.3	64.5
1985	91 3	34.2	27.7	21.9	48 4
1986	87.0	45.5	26.6	21.8	48 2
1987	90.9	49.9	27.1	21 4	48 2
1988	93.1	51.2	27.8	21.1	52 6
1989	94 3	51.0	28 2	21.2	54.6
1990	95.1	51.1	28 2	21.5	52.8
1991	95.1	48.8	28 6	22 0	52 6
1992	90.4	45.4	28 7	22.3	49.5
1993	89.7	42 4	28 2	21.9	45.5
1994	93.1	48.3	27.8	22.4	43.1
1995	90 0	45 4	27.8	23.1	43.0
1996	93.6	44.0	27.8	23.1	41.9
1997	93 7	43 2	28.3	24 3	43.0
1998	92.7	43.5	29 0	24.9	44 0
1999	92 9	42.6	29.1	25.5	48 9
2000	94 7	44.1	28.6	25.2	41.8
2001	92 7	40.8	27 4	24 9	41.9
2002	91 6	51.6	25 7	24.9	39.7
2003	89 8	49.1	25 0	24 4	39 7
2004	89.2	47.2	26.3	24.4	43.7
Averages					
All Years	**92.1**	**47.8**	**28.1**	**23.0**	**50.3**
Past 10 Years	**92.1**	**45.2**	**27.5**	**24.5**	**42.8**
Past 20 Years	**92.0**	**46.0**	**27.7**	**23.1**	**46.2**

Source Title industry figures developed from ALTA and NAIC Form 9s. All other data from Best s Aggregates & Averages.

Consequently, title insurers operate by collecting premiums, much of which are used to cover the underwriting costs associated with the issuance of a title insurance policy. Therefore, in contrast to property and casualty insurers, title insurers expend premium dollars before collection and therefore do not retain most of the premium dollar before it is expended in the ordinary course of business.

On the other hand, the loss tail for title insurers is much longer than that for most other lines of insurance and constitutes a form of leverage in that some percentage of premiums is set aside and held for future claims. The loss-tail leverage constitutes only a small percentage of the premium, however.

Title Insurance Profitability

The financial strength and surplus for title companies, however, may be more critical than for property/casualty underwriters. The title industry's premium volume and profitability is highly dependent on real estate sales and mortgage refinancing activity. Since large infrastructures of personnel and title plants must be maintained to provide title services, a title company's profitability is highly sensitive to real estate market activity. A significant portion of a title company's cost structure is fixed, and the variable component largely is related to personnel. It is as difficult for a company to reduce its costs of doing business in the face of a downturn in real estate activity as it is to reacquire trained staff when activity rebounds. Surplus plays a critical role by providing a cushion that permits a title insurer to ride out poor real estate markets, since not all of its costs are variable and able to be reduced. Property/casualty companies have a built-in level of demand. Many property/casualty coverages are required by law or business judgment and have to be purchased annually.

As with every industry, the title industry has certain inherent risks that must be understood to properly evaluate an individual company's operational strengths and weaknesses, balance-sheet vulnerabilities and volatility of earnings. The major business risks a title insurer faces are: volatility of revenue, expense control, mix of business, distribution mix (agency or direct), defalcations, rate adequacy and stability, and legislative reform.

The title industry's revenue is more volatile than that of the property/casualty industry. Cyclicality in a line of insurance creates challenges but isn't always a negative quality, since it creates opportunities for well-managed companies. In such businesses, management must make sure the company's operating structure is flexible and responsive to adjust to both increases and decreases in revenue over a relatively short period. A well-managed company must be able to access trained staff to service business adequately when title insurance demand is rising. Likewise, when a downturn in real estate activity results in a sharp reduction in demand for title insurance, a company must be able to downsize its infrastructure and personnel in an efficient and orderly manner so servicing of its current orders is not interrupted.

The utilization of temporary personnel does not provide a total solution to this problem. Unskilled and part-time personnel can satisfy the need for an increase in title messengers or clerks, but they can't satisfy the need for the more highly skilled jobs of title searchers and underwriters.

A significant component of fixed costs also relates to title plants. Title plants are important because they represent the raw material of the underwriting process. Title plants require both an initial investment and constant updating of various records. Even in slow markets, title plants must be current, with each day's recordings entered into the plant's database. If a title plant becomes outdated, it will ultimately become a source of errors and lead to title insurance losses.

The acquisition and maintenance of title plants gradually is becoming more cost effective as the business becomes computerized. Modern title insurance companies feature the computerization of order taking, title search and examinations, and policy issuance. These advances have permitted companies to increase capacity for premium volume dramatically with only a modest increase in personnel. This capability not only enhances the profitability of a title company but also makes it easier to manage expense levels during slow real estate markets.

Title insurance provides coverage for a number of basic types of real estate transactions: residential mortgage refinancing or equity lines; residential resale or new construction, and commercial resale or new construction. These are listed in ascending order of underwriting complexity. Each successive product requires a significantly increased effort to market, underwrite and administer claims. The production costs necessary to generate each of these products also varies significantly.

Residential refinancing business is a classic, high-volume, commodity business. It tends to come in waves, based on the relative level and trend of mortgage interest rates. When rates go down quickly, such as occurred in 1992-93, 2001 and 2003, a dramatic increase in the volume of new title orders occurs. Companies within the title industry must hire large numbers of workers to service orders to maintain market share. However, the level of title orders can contract as quickly as it surges, and well-managed companies must adjust their personnel (cost) levels

Exhibit 10

Combined Ratios for Various Lines of Insurance

Although the components of the combined ratio are markedly different among the various insurance lines, the average combined ratios are similar.

Year	Title Industry	Surety (Stock)	Property/ Casualty (Stock)	Property/ Casualty (Mutual)	Boiler/ Machinery (Stock)
1974	98.0	113.7	105.0	101.2	103.6
1975	99.0	122.0	107.5	104.4	96.2
1976	92.3	103.0	102.0	99.6	93.7
1977	89.6	96.2	97.0	93.9	86.7
1978	93.7	97.1	96.6	94.6	84.1
1979	96.2	90.2	99.6	98.0	76.2
1980	104.9	105.9	102.4	99.1	90.8
1981	108.6	85.7	104.9	102.9	91.8
1982	109.7	89.1	108.7	105.6	100.7
1983	95.9	87.6	111.8	105.3	103.8
1984	99.1	95.5	118.9	110.6	118.3
1985	99.0	111.9	116.5	110.5	89.9
1986	95.8	117.1	106.9	106.1	86.9
1987	98.6	116.0	103.3	103.6	80.9
1988	102.7	100.5	103.9	104.6	97.1
1989	103.8	93.9	108.6	108.0	93.2
1990	105.1	87.4	108.4	98.5	101.0
1991	105.2	75.6	109.5	106.4	109.8
1992	97.7	84.2	119.1	108.4	103.3
1993	95.5	65.8	107.9	104.8	103.7
1994	98.5	83.2	108.9	106.8	88.1
1995	95.8	79.7	106.7	105.4	91.2
1996	98.5	71.5	106.3	104.6	86.0
1997	94.1	69.2	101.4	101.9	88.3
1998	96.6	68.4	104.7	108.0	95.0
1999	97.1	68.1	107.0	109.2	109.5
2000	100.0	72.3	108.5	113.8	93.3
2001	97.5	88.7	115.1	116.9	92.1
2002	96.2	116.2	106.6	108.6	79.7
2003	93.8	122.3	99.7	100.4	68.0
2004	93.5	117.8	98.7	97.5	76.2
Averages					
All Years	**98.5**	**93.4**	**106.5**	**104.5**	**92.9**
Past 10 Years	**96.3**	**87.4**	**105.5**	**106.6**	**87.9**
Past 20 Years	**98.3**	**90.5**	**107.4**	**106.2**	**91.7**

Source: Title industry figures developed from ALTA and NAIC Form 9s. All other data from Best's Aggregates & Averages.

accordingly.

In underwriting refinance transactions, the title insurer or its agent performs a more limited title search than is necessary for a resale transaction. This less comprehensive title search occurs because only the position of the lender of the refinanced mortgage has to be determined to assure the lender of its priority. No owner's coverage arises from these transactions, since the original owner's title policy, whenever purchased, continues to protect the basic title in the name of the property owner.

In addition to the challenges of managing the surges and contractions of title orders, companies also face difficulties managing the claims process. Some companies believe the best practice to minimize claim losses is to settle claims early to minimize legal fees, which are a large component of most claims. Other companies litigate claims when possible, which incurs more upfront expense, to establish and maintain a deterrent against fraud and future nuisance claims.

This tactic can be particularly effective in those regions where a small number of law firms specialize in representing title claimants. Whether a company's approach is successful or not can be determined only when the results of that approach are compared with industry averages.

Companies must be responsive enough to recognize and realize when small-dollar claims must be settled quickly, vs. when certain claims must be litigated to establish an image or reputation within the legal community. Depending upon the region of the country and its local legal and claims environment, different claims approaches are needed.

Although residential business is more profitable than refinance orders, underwriting commercial transactions represents the highest profit margin for title insurers. In a typical sale/development of an office building, both buyers and sellers are generally knowledgeable and sophisticated and retain lawyers to represent their competing interests. Generally, both title insurers and lenders assign senior underwriters to manage and underwrite commercial transactions. This more intensive underwriting process, undertaken by both the buyer and seller, results in fewer mistakes and title defects and, consequently, reduces the risk of loss. Since title premiums are linked to property values, large-value commercial title business generally generates the highest underwriting profitability.

Exhibit 11

Net Investment Income as a Percentage of Premiums Earned

The average ratio of net investment income earned to premiums for property/casualty insurers is about three times larger than for title insurers.

Year	Title Industry	Property/ Casualty
1974	4.9%	8.3%
1975	4.6	8 2
1976	3.2	8.0
1977	2.9	8.5
1978	3.3	9 3
1979	3.5	10.7
1980	4.5	11.8
1981	5.4	13 6
1982	5.3	14.6
1983	4.1	14.9
1984	4.4	15 4
1985	4.2	14 6
1986	4.7	13.2
1987	5.0	12 7
1988	4.1	13.9
1989	5.1	15.1
1990	4.7	15.2
1991	4.4	15.4
1992	5.6	14 9
1993	4.8	13.9
1994	3.8	13.8
1995	5.7	14 5
1996	5 0	14.4
1997	4 6	15.3
1998	4.3	14.4
1999	3.1	13 7
2000	4.7	13 8
2001	3.8	12 1
2002	2.6	11.2
2003	2 9	10 2
2004	2.5	9.7
Averages		
All Years	**4.2**	**12.9**
Past 10 Years	**3.9**	**12.9**
Past 20 Years	**4.3**	**13.6**

Source: Title industry figures developed from ALTA and NAIC Form 9s. All other data from Best's Aggregates & Averages.

Loss Experience in the Title Industry

As can be seen from Exhibit 12, the average loss experience improved dramatically in the past 10 years as compared with the prior 20 years. This improvement is primarily due to better upfront underwriting, as well as more stringent monitoring of agents to help avoid defalcations.

Title insurance policies have no termination date and no limitation on filing claims. However, the only fees collected are the one-time charges when the policy is issued. Thus, losses reported in any one year will affect that year's profitability for statutory accounting purposes but are not, in the main, generated by that year's business activity. By the nature of the business, most title losses are reported and paid within the first five to seven years after policy issuance. However, the tail for title policies is at least 20 years.

All insurance companies require adequate loss reserves to cover all known and future losses, as well as adequate surplus levels to provide a cushion for reserve shortfalls, contingencies and unexpected losses from underwriting and investment activities. For title companies, the potential adverse loss-reserve development isn't as problematic as it is for casualty lines of business, since losses are a relatively small percentage of the total.

Although large title claims are infrequent, they do occur. They can arise in the context of the transfer of upscale, single-family residential properties, single-family or multifamily real estate developments, or office buildings, shopping centers or other commercial developments. Factors that lead to complicating these claims are the overlapping tasks and regulatory hurdles involved in completing these complex transactions. For instance, there are often entitlement issues, easement, ingress/egress issues and mechanic's lien risks associated with construction.

The term of a title policy generally ends upon the sale, transfer or refinancing of the underlying property. This activity results in title insurers being unable to determine policies in force. This anomaly results from the fact that the title insurer isn't advised of the existence of the new policy, unless that insurer is fortunate enough to have written both the new and old coverage. This feature provides for significant differences in the nature of claims and the reporting of financial information between the property/casualty business and that of the title insurer.

Title losses vary by a wide array of factors, including: the local patterns and practices of land holding; the local record-keeping system; the value of the actual property; and the length of time the property has been owned or encumbered by mortgages or liens. However, without the ability to pinpoint policies in force, translation of this loss/claims information into definitive reserving data is impossible. Instead, companies use assumptions and extrapolation methods that are detailed in the Loss Reserve and Surplus Characteristics section of this report.

Title claims experience has an emergence pattern similar to a property/casualty product line that has a moderate-length tail, such as personal automobile. Like personal auto claims, title insurance experiences a high frequency of low-dollar claims, occasionally generating a severe claim. Title underwriters have the ability to cure modest defects that occur frequently at a nominal cost. In many cases, the defect can be solved and the title loss averted simply by recording a document to correct, or confirm, the true property interests of the parties. However, a severe title defect or agent defalcation can result in a costly claim that may take years to settle.

The typical property/casualty company operates with a loss and loss-adjustment expense ratio between 70% and 80%, depending on its lines of business. This compares with a typical title company's loss and loss-adjustment expense ratio of 5% to 10%. On the surface, this difference appears dramatic and leads most property/casualty-oriented analysts to deduce that the business must be extremely profitable. However, the low loss and loss-adjustment expense ratio is the result of the large expense component associated with underwriting and servicing a title product. This brings the overall profitability of title insurance, as measured by the combined ratio, more in line with property/casualty products.

Much of the stability in the title industry's loss ratio stems from the relatively low risk inherent in title insurance. The bulk of title insurance claims occur shortly after closing and represent low-dollar costs. In these instances, the title company or its agent amends or corrects the title documentation and makes any required re-filings and notifications. The policyholder may not be made aware of these technical corrections and doesn't receive any cash payment. Typically, the title company uses its own staff underwriter or counsel to correct the problem, and the loss cost is relatively small.

Title companies that service multifamily real estate developments must have a well-trained and knowledgeable staff. Some of the larger title insurers have specialized departments dedicated to servicing these large-scale developments. In this way, title insurers limit risk by controlling the transaction at the outset and taking it through each step of the process—from acquisition work to construction disbursements to closing. Substantial costs are expended in these projects. The more sophisticated title insurers have relationships with developers that give the company insight into whether the transaction will be problematic at the outset. Although the magnitude of these losses can be higher than the typical title claim, the frequency of this type of loss is small.

Some of the most severe and difficult types of claims involve agent defalcations. Defalcation is the act of diverting fiduciary escrow funds without authority and without applying those funds to satisfy or pay off the existing mortgages, liens and encumbrances on the property that is the subject of the escrow. Defalcation losses are similar to catastrophe losses experienced by property/casualty insurers. Agent defalcation claims are

Exhibit 12

Title Industry Loss And Loss-Adjustment Expense as a Percentage Of Operating Revenue

Year	Percent
1974	6.46
1975	8.65
1976	6.27
1977	5.30
1978	5.04
1979	5.02
1980	6.57
1981	8.06
1982	8.44
1983	6.26
1984	7.87
1985	7.69
1986	8.83
1987	7.71
1988	9.63
1989	9.47
1990	10.02
1991	10.00
1992	7.41
1993	5.78
1994	5.33
1995	5.83
1996	4.88
1997	4.64
1998	3.83
1999	4.11
2000	5.30
2001	4.77
2002	4.60
2003	4.00
2004	4.27
Average	
All Years	**6.5**
Past 10 Years	**4.6**
Past 20 Years	**6.4**

Source: Title industry figures developed from ALTA and NAIC Form 9s. All other data from Best's Aggregates & Averages.

the only shock-loss type of claim that has concentrated geographic reach, depending upon the region controlled by the defrauding agent.

Because the title industry's loss reserves are more stable, have less adverse development and represent less exposure to the industry's surplus, it logically follows that less surplus is required to protect against unexpected or catastrophic underwriting events. This differs significantly from the experience of property/casualty companies, which require a relatively larger surplus cushion to protect property underwriters from catastrophes or casualty underwriters from adverse loss-reserve development.

Reserving Characteristics

Title insurance companies file annual financial statements (National Association of Insurance Commissioners Form 9) with their respective state insurance regulators in accordance with statutory accounting principles. Statutory accounting principles are more conservative than generally accepted accounting principles (GAAP), because assets and liabilities are valued on a liquidation basis vs. a GAAP ongoing-concern basis. As a result, all statutory accounting principles balance-sheet items are valued as though the company intended to discontinue its business and discharge all liabilities immediately, including claims, before a final distribution of remaining assets to its shareholders.

By virtue of this liquidation accounting, only assets that consist of cash, or those that can be converted into cash in a relatively short time, generally are allowed to be admitted to a company's statutory accounting principles financial statement. Assets that are contingent in nature, whose value is uncertain or whose collectibility is questionable have no assigned value and are classified as nonadmitted assets.

By statute, title insurers are required to carry two liability reserves, the known claims reserve and the statutory premium reserve. The known claims reserve is the aggregate estimated amount that is required to settle all claims submitted to the company and unpaid as of the balance-sheet date. The known claims reserve is similar to the property/casualty industry's case reserve. Over the decades, most title insurers established reasonable baseline case reserves by tracking and analyzing historical claims data. Based on these data, individual known claims reserves are estimated by a company and are modified for special circumstances. These estimates must be reviewed at least annually and adjusted as necessary.

The statutory premium reserve is a liquidation reserve, the amount of which is determined by state-mandated formulas that establish a liability reserve and a charge to income based on the amount of business written. Defined by a formula, the initial reserve is reduced gradually, with an offsetting gain to income over a stated period, generally 10 to 20 years, depending on the rules of the domiciliary state.

Since title policies have no termination date, the statutory premium reserve is required and gradually reduced to reflect the long-tail nature of the company's liability. The statutory premium reserve is equivalent to the property/casualty industry's incurred-but-not-reported (IBNR) reserve, which also is established and held for

Exhibit 13

Pretax Underwriting Margin (%)

The title industry has, on average, a higher underwriting margin than property/casualty underwriters.

Year	Title Industry	Property/ Casualty
1974	2.1	-6.1
1975	1.0	-8.8
1976	7.7	-3.8
1977	10.4	1 6
1978	6.3	1.7
1979	3 8	-1 5
1980	-4.9	-3.6
1981	-8 6	-6 5
1982	-9.7	-10.1
1983	4.2	-12 4
1984	0 9	-18.8
1985	1.0	-18.8
1986	4.2	-10.0
1987	1.4	-5.4
1988	-2.8	-5.9
1989	-3.7	-10.1
1990	-5.1	-10.0
1991	-5 2	-9.2
1992	2.3	-16.0
1993	4.5	-7 7
1994	1.5	-9.0
1995	-0.6	-6 8
1996	1.4	-6.5
1997	1.7	-2 2
1998	3.4	-6.0
1999	2 9	-8 6
2000	0.0	-10.5
2001	2 5	-16.5
2002	3 8	-9 0
2003	6.2	-1.3
2004	6.5	1.2
Average	**1.3**	**-7.6**
Standard Deviation	**4.61**	**5.38**

Source: Title industry figures developed from ALTA and NAIC Form 9s. All other data from Best's Aggregates & Averages.

many years for long-tail liabilities. The major difference is that statutory premium reserve is determined and reduced by prescribed state formulas, whereas a property/casualty company has more discretion in establishing and reducing its IBNR reserves.

Statutory premium reserve is considered a liquidation reserve, since state statutes also require a company to segregate investment-grade assets in an amount equal to its statutory premium reserve. If a title insurer becomes insolvent, such segregated assets can be used only to pay future claims or purchase reinsurance to settle future claims. These segregated assets may not be used to pay current claims, operating expenses or distributions to shareholders. This feature is unique to the title industry. In contrast, the assets of a property/casualty company aren't segregated and are available to pay any claims.

The required segregation of assets to support reserves assures policyholders that the company won't utilize these funds to pay losses or other expenses in the ordinary course of business or make distributions to shareholders. This provision and its protections are part of the title insurance regulatory framework, and much of the industry's financial structure is built around these statutory reserves.

As shown in Exhibit 14, statutory premium reserve formulas vary significantly from state to state and reflect a state's underlying title framework and customs, but not necessarily its loss experience.

Under GAAP, the statutory premium reserve is not recognized as an expense and isn't included as part of a title insurer's liability. It does, however, exist as restricted equity. Title insurers that are required to file GAAP financial reports, or are part of a consolidated group of companies that are required to file under Securities and Exchange Commission rules, normally develop an IBNR component like any other insurance line and include it as part of their GAAP liabilities.

For the property/casualty industry, IBNR is derived from actuarial predictions of future occurrences based on current loss data, and it is an unsecured liability. The title industry's statutory premium reserves are set by statute at a rate that is somewhat arbitrary. Few states, if any, currently can support the establishment or change of their statutory premium reserving levels based upon their title industries' actual loss experience. This situation has created inconsistent statutory premium reserves among companies across the country.

Additionally, since the statutory premium reserve is a charge to income, variances for individual title insurers' operating results (operating gain or loss) often reflect different statutory premium reserve requirements rather than actual differences in operations.

In addition to the statutory premium reserve and the known claims reserve, the title insurers' statutory financial statements provide for a supplemental reserve. Title insurers are required to have an actuarial certification of the adequacy of their reserves. If the actuary indicates that the statutory premium reserve plus the known claims reserve is less than the estimated dollar value of known plus expected future claims, plus expected loss-adjustment expenses, the title company would have to fund the shortfall in the supplemental reserve. Since the supplemental reserve is not tax-deductible, the best interest of title insurers is to have the statutory premium reserve as close as possible to actuarial estimates, if not actually more than the estimates.

In regions that experience significant real estate appreciation, turnover of homes is higher as owners sell their homes and use their realized gains on more expensive homes. Depressed regions of the country generally experience slower real estate activity as homeowners wait for the turnaround and try to avoid losing the equity in their homes.

Although faster claims development may be one byproduct of a higher turnover rate, a property becomes a better title insurance risk the more it is bought and sold, because a property's title and tax records are searched each time it is sold. Frequent examination of a property's title records increases the odds of perfecting the property's title. The benefit, of course, comes from the fact that the new policy not only supersedes and effectively terminates the old policy but also generates new revenue. The term "perfecting" is the removal of any discovered potential defects in the title to real property, prior to closing.

Exhibit 14

State-by-State Rate Filing Statutes

States (1)	Section	Promulgate	Prior Approval	Deemer Period (if any)	File and Use	Waiting Period (if any)	Use and File	RT-Filing Provisions
Alabama								X
Alaska	21 66 370 & Order *81-3				X (2)	30+30		
Arizona	20-376				X (2)	15+15		
Arkansas					X			
California	12401 1&2&4, 12414 27				X	30		
Colorado	10-11-118, Reg 63-5-F				X (4)	30		
Connecticut	38-201x (3)				X (2)	30+30		
Delaware	18-4501				X			
Dist. Columbia								X
Florida		X						
Georgia								X
Hawaii	431:20-120							X (4), (5)
Idaho	41-2706		X (2)	60+60				
Illinois								X
Indiana								X
Iowa	-9							
Kansas	40-1111(d) 1&2				X (8)			
Kentucky	304-22-020 & Bulletin 82-DM-004				X			
Louisiana	1.89375				X (2)	45		
Maine	2304				X (2)	30+60		
Maryland	242A		X	15+30 (2)				
Massachusetts								X
Michigan	500-2406 &2408				X (2)	15+15		
Minnesota	70A 06				X			
Mississippi					X			
Missouri	381.181, Reg 190 20.01, 1				X (2), (9)	30		
Montana	33-25-212				X			
Nebraska	44-1911 & 1912		X	60				
Nevada	692A.140 & 130		X	304				
New Hampshire	416-A:17		X					
New Jersey	17:46B-42, 17 46B-45		X (2)					
New Mexico	59A-30-6, Rule 12-2-1	X						
New York	6409 & 2305				X			
North Carolina	58-36-30				MODIFIED X	60		
North Dakota	26 1-25 04				X (2)	60+15		
Ohio	3935.04				X (2)	15+15		
Oklahoma								X
Oregon	737 205, 737.320				X (2)	15+ (3)		
Pennsylvania	40-61-137				X (2)	30+30		
Puerto Rico	1205&1206				X (2)	30+60		
Rhode Island	27-9-7&27-9-10				X (2)	30+30		
South Carolina	38-75-980			60+60 (2)				
South Dakota	58-25-7,58-25-10		X (2)	15+30				
Tennessee	56-35-111 & Reg.0780-1-12-03				X (2)	60		
Texas		X						
Utah	31A-19-203, 31A-19-209				X (2)	30		
Vermont	4688(a) & Reg. 85-1						X (2), (7)	
Virgin Islands	1160				X	15		
Virginia					X	15		
Washington	48 29.140				X	15		
West Virginia								
Wisconsin	625.13						X (5)	
Wyoming	26-23-326		X	30+30				

Notes:
1 West Virginia and Iowa do not recognize title insurance as a product.
2 Subject to disapproval.
3 Waiting period indicates initial and possible extension.
4 Requires posting in local offices.
5 Must post five days before becoming effective.
6 Within 30 days.
7 Within 15 days.
8 Only for property located in counties having a population of 10,000 or more.
9 Rates cannot be used prior to effective date, and such rates have to be publicly displayed for a period of less than 30 days in each office.
10 Title insurance is not permitted in Iowa.
Source: Insurance Department Web pages and confirmation requests.

Exhibit 15

Insurance Statutory Premium Reserve by State

State (1)	SPR at Policy Inception	SPR Release to Income	Maximum Years of Reserves
Alabama	10% of risk rate	5% per year	20
Alaska	10% of risk rate	5% per year	20
Arizona	10¢ per $1,000 of liability	10% per year	10
Arkansas	10% of risk rate	5% per year	20
California	4 5% of all gross title income	10% each for years 1-5; 9% for years 6-10; 1/2% for years 11-20	20
Colorado	$1 per policy and 15¢ per $1000 of liability	10% first 5 years; 3 33% thereafter	20
Connecticut	15¢ per $1000 of liability	10% first 5 years; 3 33% thereafter	20
Delaware	9% of risk rate	5% per year	20
Dist. of Columbia	N/A	N/A	N/A
Florida	.25x.30 of net retained liability	Declining % based on policy incept date	20
Georgia	10% of risk rate	5% per year	20
Hawaii	15¢ per $1000 of net retained liability	10% first 5 years; 3.33% thereafter	20
Idaho	10% of risk rate	All released after 10 years or policy termination	10
Illinois	12.5¢ per $1000 of liability	10% first 5 years; 3.33% thereafter	20
Indiana	10% of risk rate until reserve reached $50,000	No amortization	N/A
Iowa			
Kansas	$1 50 per pol. 12.5¢/$1000 of net retained liability	Above aggregate released 20%	5
Kentucky	10% of risk rate	5% per year	20
Louisiana	N/A	N/A	N/A
Maine	10% of risk rate	5% per year	20
Maryland	Aggregate requirements policy incept date	Above aggregate requirement 20% per year	5
Massachusetts	N/A	N/A	N/A
Michigan	5% of gross charge to customer	No release years 1-10; 10% thereafter	20
Minnesota	10% of risk rate	5% per year	20
Mississippi	10% of risk rate	No amortization; all released after 15 years	15
Missouri	15¢ per $1000 of liability	10% first 5 years; 3.33% thereafter	20
Montana	10% of risk rate	5% per year	20
Nebraska	(6% DPW)12.0¢ per $1000 of net retained liability	5% per year	20
Nevada	5% of gross charge to customer	5% per year	20
New Hampshire	$1 per policy and 15¢/$1000 of net retained liability	10% first 5 years; 3.33% thereafter	20
New Jersey	$1 50 per policy and 12.5¢ per $1000 of liability	5% per year	20
New Mexico	10% of risk rate	5% per year	20
New York	$1 50 per policy 12 5¢/1000 net retained liability	5% per year	20
North Carolina	10% of risk rate	5% per year	20
North Dakota	N/A	N/A	N/A
Ohio	10% of risk rate	5% per year	20
Oklahoma	N/A	N/A	N/A
Oregon	3% of gross charge to customer	No amortization; all released after 15 years	15
Pennsylvania	$1 per pol. and 10¢/$1000 of net retained liability	No amortization; all released after 20 years	20
Rhode Island	N/A	N/A	N/A
South Carolina	$1.50 per pol. & 12.5¢/ $1000 of net retained liability	10% first 5 years; 3.33% thereafter	20
South Dakota	10% of risk rate	5% per year	20
Tennessee	10% of risk rate	10% first 5 years; 5% thereafter	15
Texas	.25x.30 of net retained liability	Declining % based on policy incept date	20
Utah	10¢ per $1000 of liability	5% per year	20
Vermont	N/A	N/A	N/A
Virginia	$1.50 per policy and 12 5¢ per $1000 of liability	10% first 5 years; 3.33% thereafter	20
Washington	N/A	N/A	N/A
West Virginia	N/A	N/A	N/A
Wisconsin	N/A	N/A	N/A
Wyoming	20¢ per $1000 of liability	10% first 5 years; 3.33% thereafter	20

(1) West Virginia and Iowa do not recognize title insurance as a product.
N/A - Not applicable.
Source: Insurance Department Web pages and confirmation requests.

Association Research, Inc.

2005
Abstracter and Title Agent Operations Survey

conducted for the

AMERICAN LAND TITLE ASSOCIATION

1828 L Street, N.W. – Suite 705
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April 2006

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APPENDIX A: (CONTINUED)

I. INTRODUCTION

This American Land Title Association (ALTA) survey analyzes operating statistics and other characteristics of abstracter and title agent members. These annual surveys allow companies to track operating results, perform peer company analysis, and evaluate changes in the industry. This, the ninth consecutive survey, was conducted online. All abstracter and title agent members of ALTA were invited to participate. A total of 2,207 invitations to participate in the survey were e-mailed, and after a second attempt, 310 bounced back as undeliverable. Of the 1,897 survey instruments successfully distributed, 422 were completed and returned—a 22.2% response rate. This is a higher response rate and a higher absolute number of responses than the last survey. The participants in this survey (see section III) make the results a credible and reliable snapshot of abstracter and title agent company characteristics. Participants receive a complimentary copy of these results.

Each survey focuses on a topical issue in addition to operating statistics. The current survey focuses on the various curative actions that abstracters and title agents undertake to clear titles prior to closing.

This report describes types of business activities, gross revenue, operating expense, and other operating statistics. The characteristics reported are comparable with similar information reported in previous surveys.

ALTA expresses its gratitude to the members of the Abstracter-Agent Research Committee for their guidance and oversight of this survey. The quality of the survey results is ultimately dependent on the conscientious effort of each respondent to report appropriate and accurate information on the topics surveyed and ALTA expresses its deepest appreciation to the 422 member companies whose responses made this report possible. Participants are listed alphabetically by company in Section III.

The last page of this report is a feedback form. Users of this report are invited to forward their comments and suggestions. Member comments and suggestions have been invaluable in keeping this survey relevant to the needs and interests of ALTA members and are strongly invited.

Association Research Inc. (ARI) conducted the survey. ARI is an independent survey research company whose clients are exclusively nonprofit organizations. Maintaining total confidentiality, ARI handled all data collection, tabulation, analysis, and reporting. Data are reported as received and without modification or adjustment to account for any inconsistencies or variations attributable to respondent choices.

RESPONDENT DEMOGRAPHICS

The primary demographic characteristic of all responding companies is gross revenue. Respondents are grouped into four categories of 2004 annual revenue. The proportion of the respondents in each revenue category in the current survey (based on gross revenue in 2004) and in four previous surveys is:

GROSS REVENUE	1999	2000	2001	2003	2004
Less than $500,000	58%	60%	51%	54%	55%
$500,000-$999,999	14%	17%	21%	16%	21%
$1million-$3 million	18%	14%	19%	19%	14%
More than $3 million	10%	10%	9%	11%	10%

Overall, the companies reporting 2004 revenue were a little smaller than those in 2003, while the share of smallest and largest companies stayed the same.

Respondents to the current survey typically received fewer orders during 2004 than the previous year. The distribution of companies by orders received for 1999 through 2004 is shown below:

ORDERS RECEIVED	1999	2000	2001	2003	2004
Fewer than 500	18%	20%	13%	27%	28%
500-1,099	24%	23%	23%	21%	29%
1,100-2,499	20%	19%	22%	26%	22%
2,500-4,999	12%	12%	12%	14%	12%
5,000 or more	11%	9%	11%	12%	9%
Not reported	16%	17%	20%	—	—

Company size, measured by number of full-time employees, was smaller in 2004 than the previous year. This parallels the data for revenue and orders.

The median number of full-time employees was five, the same as 2002 and 2003. The percent of survey participants in each staff size category is:

FULL-TIME EMPLOYEES (AT ALL LOCATIONS)	1999	2000	2001	2002	2003	2004
1-2	18%	20%	20%	13%	29%	31%
3-5	23%	33%	34%	23%	22%	26%
6-10	26%	17%	22%	22%	21%	18%
11-25	21%	19%	15%	12%	17%	15%
More than 25	9%	10%	9%	11%	11%	10%
Not reported	3%	2%	1%	20%	—	—

For 2004, the number of full-time employees ranged from an average of 3.4 in companies with revenue less than $500,000 to an average of 50.3 in companies reporting revenue greater than $3 million. The median number of full-time employees varied from 3.0 in the smallest revenue category to 40.0 in the largest revenue category.

The Survey Results Section covers other demographic characteristics, including percent of revenue generated from typical activities, operating expenses and payroll, population of counties in which the company conducts business, transactions recorded daily in these counties and the way the company is organized for accounting and tax purposes.

FORMAT OF TABLES—EXPLANATION OF STATISTICS

Several conventions are followed in all tables in this report:

zero percent, "0%,", indicates the response was less than 0.5% of the column total,
a dash, "-", indicates there was no response to report, and
a blank, " ", indicates there were too few values to calculate a median or a percentile.

The first row in a table is labeled "Total" and reports the total number of survey responses. The number of responses reported by a table may be less than 422 companies when the table reports the responses of various groups. When a table reports categorical responses such as "Yes' and "No" answers, the response is represented by two rows. The first row reports the number of respondents who gave that answer. The second row reports the percent of all respondents in that column who gave that answer.
In tables that report numbers—offices, employees, annual revenue, operating expense, payroll, and orders—responses may be summarized and described by an average, a median, a 25th percentile, and a 75th percentile. The average is the simple arithmetic mean of all the numbers or values reported.

When all the numbers (values) are listed from lowest to highest, the median is the middle of the distribution. The median is calculated when three or more values were reported and is interpolated when an even number of values was reported. The 25th percentile identifies the point on the list that is equal to or greater than 25 percent of all reported numbers. The 75th percentile identifies the point on the list equal to or greater than 75 percent of all reported numbers. The 25th and 75th percentiles are calculated when at least five values were reported.

II. SURVEY RESULTS

OPERATING CHARACTERISTICS OF SURVEYED COMPANIES

Gross revenue and orders are both measures of output and, consequently, are highly correlated. The median number of orders received for companies with sales below $500,000 was 500. The median value increases with higher sales, reaching a median of 6,496 orders at companies with more than $3 million in gross revenue.

Title insurance accounted for an average of 54% of 2004 revenue, three percentage points lower than 2003. In 2003 and 2004, abstracts accounted for an average of 22% of revenue. Revenue from escrow/closing functions increased in 2004 to an average of 19% of total revenue. Revenue from law practice averaged 2% of total revenue.

The share of revenue from title insurance in 2004 did not vary much based on the number of orders received.

On the other hand, revenue from abstracts was more likely to be reported by companies with less than $500,000 total revenue. For this size group, revenue from abstracts averaged 29% of total revenue versus 9% of total revenue for the largest companies.

Revenue from escrow/closing functions, as a percent of total revenue, was slightly higher among larger companies.

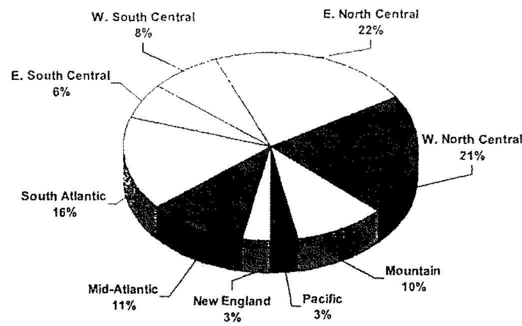
Table 1a and 1b describe relationships between total revenue, orders received, and sources of revenue.

The geographic distribution of responding companies in 2004 was very similar to the previous year. One-fifth of responses (22%), the largest number from any region, were from the East North Central region with the West North Central region right behind (21%). Another 16% of responses represent the South Atlantic region, while the Middle Atlantic region accounts for 11%. The Mountain, West South Central, East South Central, New England, and Pacific regions produced 10%, 8%, 6%, 3%, and 3% of the respondents, respectively.

The geographic distribution of respondents in the last six surveys is:

REGION	1999	2000	2001	2002	2003	2004
New England (ME, NH, VT, MA, RI, CT)	1%	2%	3%	1%	3%	3%
Mid-Atlantic (NY, NJ, PA)	5%	7%	6%	6%	12%	11%
South Atlantic (DE, MD, DC, VA, WV, NC, SC, GA, FL)	4%	6%	4%	6%	12%	16%
East South Central (KY, TN, AL, MS)	2%	2%	1%	1%	4%	6%
West South Central (AR, LA, OK, TX)	11%	11%	11%	15%	11%	8%
East North Central (OH, IN, IL, MI, WI)	23%	20%	26%	19%	19%	22%
West North Central (MN, IA, MO, ND, SD, NE, KS)	33%	33%	33%	33%	24%	21%
Mountain (MT, ID, WY, CO, NM, AZ, UT, NV)	12%	13%	13%	14%	12%	10%
Pacific (WA, OR, CA, AK, HI)	6%	5%	4%	5%	3%	3%

GEOGRAPHIC DISTRIBUTION OF RESPONDENTS

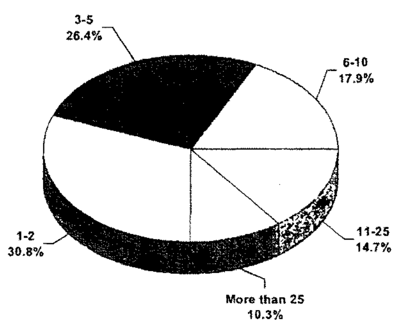


Source: 2005 ALTA Operations Survey

Table 2 shows the relationships between revenue, orders received, and location. The number of employees is found in **Tables 3a and 3b.**

More than half (57.2%) of respondents had fewer than five full-time employees. The average number of full-time employees at the responding locations was 10.6; the average number of part-timers was 1.2.

NUMBER OF PEOPLE EMPLOYED AT THE RESPONDING LOCATION

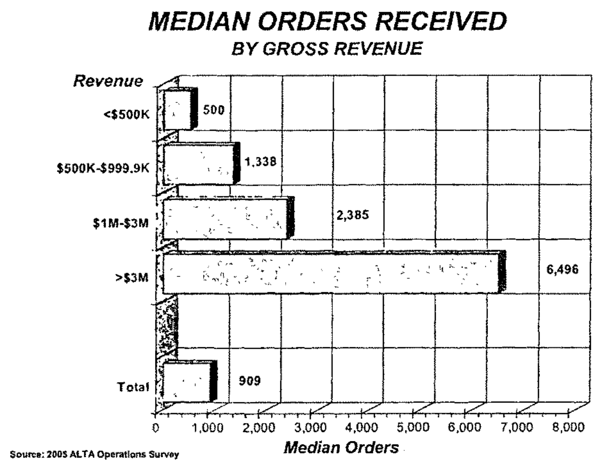


Source: 2005 ALTA Operations Survey

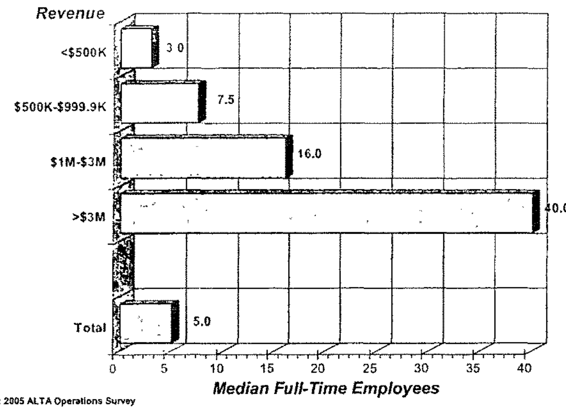
Within each category of orders received, the median number of all full-time employees reported for 2004, compared with the median reported to the 2000 through 2003 surveys, was:

	MEDIAN FULL-TIME EMPLOYEES				
ORDERS RECEIVED	2000	2001	2002	2003	2004
Fewer than 500	2	2	2	2	2
500-1,099	4	5	5	4	4
1,100-2,499	7	7	8	7	7
2,500-4,999	16	18	16	13	18
5,000 or more	28	28	35	35	38

Part-time staff averaged 1.2 employees for all respondents, ranging from an average of .8 part-time employees at companies with less than $500,000 revenue to 2.8 part-time employees at companies with more than $3 million revenue.



MEDIAN FULL-TIME EMPLOYEES
BY GROSS REVENUE



Source: 2005 ALTA Operations Survey

TYPE OF COMPANY

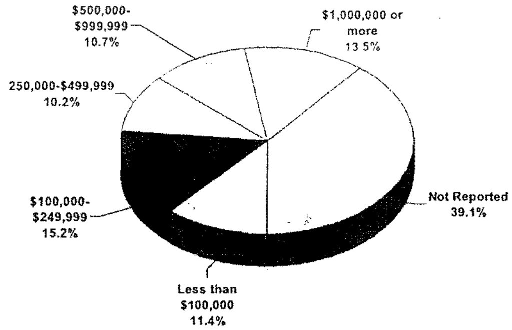
As in 2003, the most prevalent type of organization (43.6%) was Subchapter S. About half as many companies (22.9%) were organized as C corporations. Limited liability corporations (LLC) comprised 20.1% and sole proprietorships made up 11.0%.

Table 4 describes relationships between revenue, orders received, and how the company is organized.

OPERATING EXPENSE AND PAYROLL

Six of 10 respondents provided operating expense data, and most of these were larger companies. Operating expense for 2004 averaged $962,262, compared with an average of $1,383,173 reported in the previous survey.

OPERATING EXPENSE



Source: 2005 ALTA Operations Survey

Average operating expense ranged from $227,239 for companies with less than $500,000 revenue to an average of $5,050,123 for those with more than $3 million in revenue. One-half of the smallest companies, measured by revenue, reported 2004 operating expenses of $179,564, compared with $125,000 reported for 2003. One-half of the largest companies reported 2004 operating expenses of $4,200,000 compared with $3,835,708 for 2003.

Operating expenses vary directly with orders received, ranging from an average of $169,633 for companies with fewer than 500 orders, to an average of $617,464 for companies with 1,100 to 2,499 orders, and an average of $4,463,012 at companies with 5,000 or more orders.

Within each category of orders received, median operating expense per order received, as reported in the last five surveys, was:

	MEDIAN OPERATING EXPENSE PER ORDER RECEIVED				
ORDERS RECEIVED	**1999**	**2000**	**2001**	**2003**	**2004**
Fewer than 500	$418	$239	$383	$328	$500
500-1,099	$240	$292	$348	$417	$383
1,100-2,499	$333	$256	$273	$268	$283
2,500-4,999	$440	$406	$257	$320	$549
5,000 or more	$462	$412	$319	$441	$372

Based on 254 respondents, total payroll in 2004 averaged $549,118, lower than the average payroll of $791,766 for the previous year. Payroll ranged from an average of $123,374 for companies with less than $500,000 revenue to an average of $2,713,316 for those with $3 million or more in revenue.

One-half of the smallest companies, measured by revenue, reported payroll of $195,343 or less. One-half of the largest companies reported payroll of $2,138,500 or more.

On average, as a percent of operating expense, payroll was virtually the same in 2004 and 2003. The median value of payroll as a percent of operating expense was 54%, unchanged from 2003.

	1998	1999	2000	2001	2003	2004
Payroll/operating expense (median)	62%	56%	59%	49%	53%	54%

Within each revenue category, 2004 payroll averaged between 51% and 61% of 2004 operating expense.

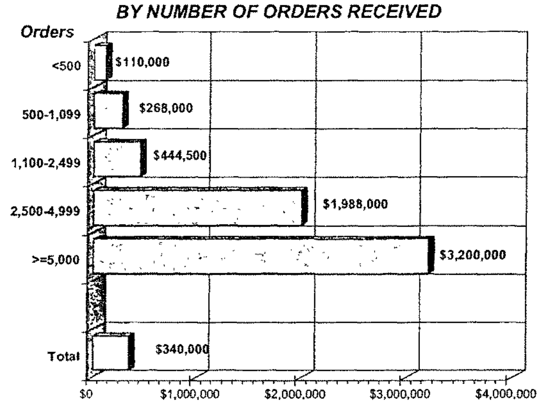
Payroll per order received averaged $285 in 2004, higher than the $258 reported in 2003. The trend of median payroll per order, since 1999, is shown below.

	MEDIAN PAYROLL PER ORDER RECEIVED				
ORDERS RECEIVED	**1999**	**2000**	**2001**	**2003**	**2004**
Fewer than 500	$214	$161	$210	$200	$286
500-1,099	$140	$194	$179	$244	$216
1,100-2,499	$189	$139	$152	$156	$178
2,500-4,999	$227	$208	$145	$178	$247
5,000 or more	$275	$213	$130	$209	$227

Tables 5a-5d and 6d describe operating expense and payroll in relation to revenue and orders received.

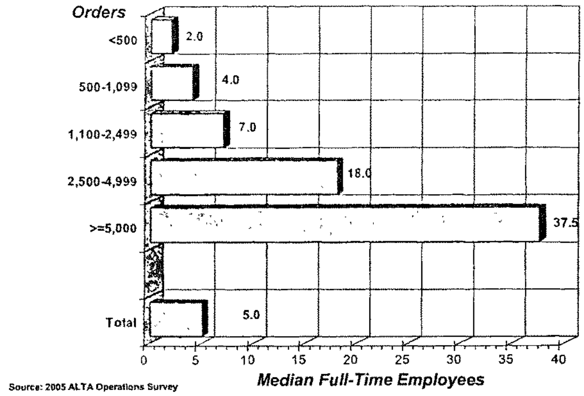
MEDIAN OPERATING EXPENSE

BY NUMBER OF ORDERS RECEIVED



Source: 2005 ALTA Operations Survey

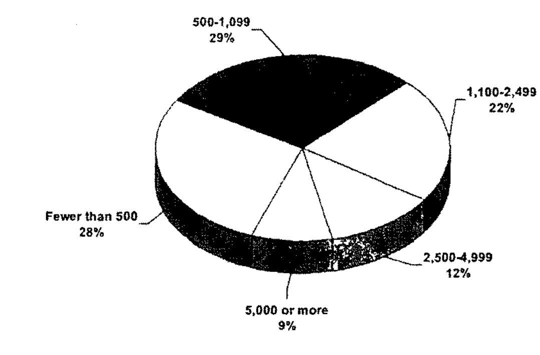
MEDIAN FULL-TIME EMPLOYEES
BY NUMBER OF ORDERS RECEIVED



ORDERS RECEIVED IN 2004

Seventy percent of responding companies provided data on orders received. Orders averaged 2,159 among these 297 companies, significantly below the 2003 average of 3,064 orders. One-half of the respondents reported between 407 and 2,000 orders for 2004.

TOTAL ORDERS RECEIVED



The smallest companies, measured by revenue, reported an average of 931 orders in 2004, higher than 2003 (893 orders). An average of 9,310 orders was reported in 2004 by the largest companies, significantly lower than 2003. In each revenue category, median orders reported in the last five years were:

	MEDIAN ORDERS RECEIVED				
REVENUE	1999	2000	2001	2003	2004
Less than $500,000	600	600	750	570	500
$500,000-$999,999	1,200	1,200	1,500	1,195	1,338
$1million-$3 million	3,059	3,000	2,875	2,400	2,385
More than $3 million	7,000	7,791	7,625	6,578	6,496

It is interesting to note that while average orders vary from year to year, the median values for all respondents, and revenue categories, were very stable. One of the characteristics of the median value is that as the middle value, it is not subject to bias from very larger numbers as the average value is.

Order by company size are shown in **Tables 6a-6c and 6e.**

POPULATION OF COUNTIES IN WHICH COMPANY OPERATES

Respondents in 2004 serviced larger population areas than in 2003. The average population served in 2004 was 763,077, more than twice as large as the 2003 average of 312,122. Even the median population—120,000 in 2004 and 50,000 in 2003—was more than double.

The number of companies not reporting population—41%—was considerably higher than 2003.

	POPULATION PER ORDER RECEIVED					
ORDERS RECEIVED	1999	2000	2001	2002	2003	2004
Fewer than 500	36	33	33	16	121	189
500-1,099	30	38	31	25	36	72
1,100-2,499	30	32	24	39	45	59
2,500-4,999	46	40	19	65	41	78
5,000 or more	76	118	67	600	42	54

Tables 7a, 7b, and 8 describe relationships between number and population of counties, annual revenue, and orders received.

INSTRUMENTS RECORDED DAILY

Only three out of 10 companies surveyed (28%) reported the number of instruments recorded daily in all of the counties in which the company does business, similar to 2003. Since the majority of survey respondents do not have this number or do not report it, statistics derived from instruments reported daily may not be representative for all companies.

For 2004, an average of 225.1 instruments were recorded daily, based on 119 respondents. This average ranged from 78.7 instruments daily, reported by companies with less than $500,000 revenue, to 824.1 instruments daily, for companies with $3 million or more revenue.

Median instruments recorded daily, as reported in the past five surveys, are:

	MEDIAN INSTRUMENTS RECORDED DAILY					
REVENUE	1999	2000	2001	2002	2003	2004
Less than $500,000	30	25	30	30	15	21
$500,000-$999,999	65	50	63	40	40	40
$1million-$3 million	140	150	182	163	130	183
More than $3 million	835	500	821	1,500	210	70

Total orders received in the year, as a multiple of instruments recorded daily, provides a rough estimate of each company's market share. Within each revenue category, median orders per year as a multiple of median instruments recorded daily in all of the counties in which the company has offices, was:

	ORDERS PER YEAR/ INSTRUMENTS RECORDED DAILY				
REVENUE	1999	2000	2001	2003	2004
Less than $500,000	24	20	25	50	39
$500,000-$999,999	24	19	38	39	37
$1million-$3 million	20	17	18	27	28
More than $3 million	14	10	5	58	169

Tables 9a-9c present relationships between number of instruments recorded daily, annual revenue, and orders received.

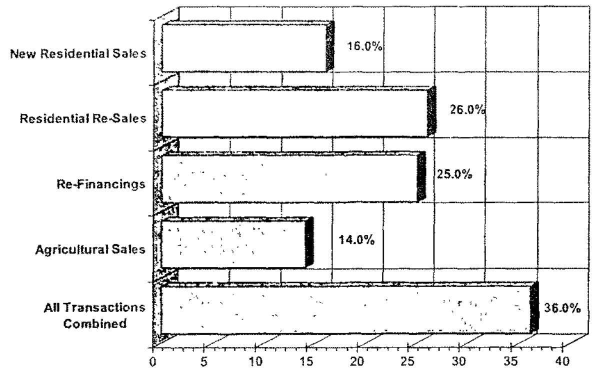
CURATIVE ACTIONS

Responding companies were asked what percentage of orders require curative actions prior to closing or policy issuance. They were asked to exclude current real estate taxes and known existing liens for new residential sales, residential re-sales, re-financings, and agricultural sales.

Many companies only reported all transactions combined and the average value was 36%. Across revenue size, the averages were similar except for gross revenue over $3 million where the average was 43%.

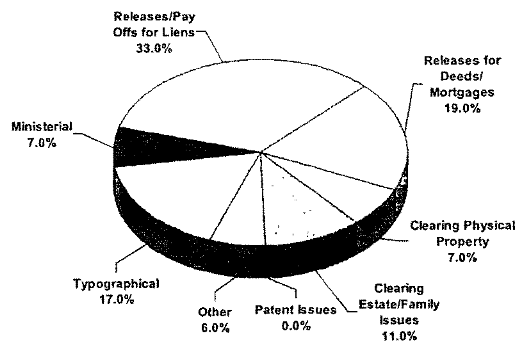
The most likely activity to require curative actions was residential re-sales, where the average value was 26%. Close behind were re-financings, with an average of 25%, and new residential sales at 16%. For residential re-sales and re-financings, the percent was significantly higher for the largest companies.

AVERAGE PERCENT OF ORDERS REQUIRING CURATIVE ACTIONS PRIOR TO CLOSING OR POLICY ISSUANCE



Source: 2005 ALTA Operations Survey

AVERAGE ALLOCATION OF CURATIVE ACTIONS BY TYPE

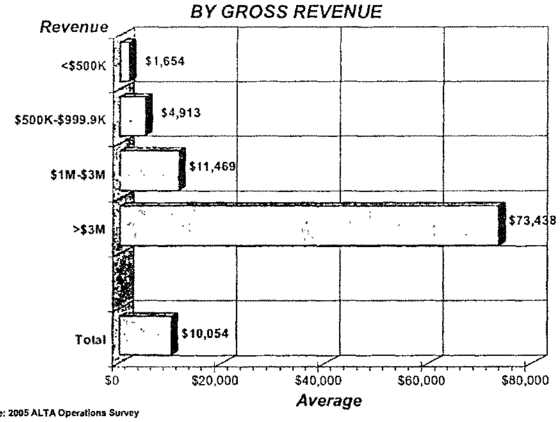


Source: 2005 ALTA Operations Survey

The single-most frequent curative action taken was obtaining releases and/or obtaining pay-offs for discovered liens (equity credit-line mortgages, child and spousal support liens, judgment liens, federal or state tax liens, etc.). Of the 261 companies that answered the question, the average percent of all curative action for this was 33%. The next most frequent issue was obtaining releases for assignment on deeds of trust and/or mortgages, 19%, followed closely by typographical issues (correcting names, addresses, or legal descriptions), 17%. There were no obvious variations in actions based on company size. See **Table 11** for additional details on actions taken.

AVERAGE TOTAL ANNUAL DOLLAR AMOUNT OF TITLE-RELATED LOSSES PAID OUT-OF-POCKET

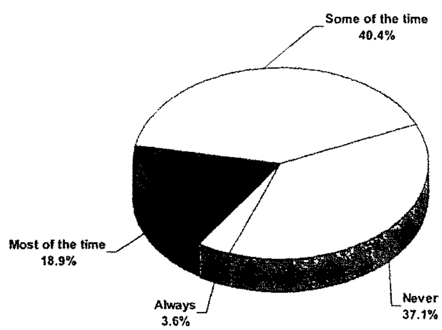
BY GROSS REVENUE



Source: 2005 ALTA Operations Survey

Title-related losses paid out-of-pocket were positively correlated with company size, measured by gross revenue or orders received. The average value for 273 participants was $10,054, and it increased with size, reaching $73,438 for companies with gross revenues over $3 million (**Table 12**).

RELY ON PREVIOUS POLICY ON DEEDS OF TRUST/MORTGAGES



Source: 2005 ALTA Operations Survey

When asked how often they rely on a previous policy in lieu of assignments on deeds of trust and/or mortgages, four of 10 said some of the time, a little over a third (37.1%) said never, and 18.9% said most of the time. The largest companies were significantly more likely to say most of the time.

III. PARTICIPANTS

1st Denver Title, Inc.
Abbey Title Company
ABC Standard Settlements
Abstract & Title Co. of Mesa County
Abstract Guaranty Company
Abstracts Incorporated
Advanced title Group, Inc.
Aegis Title Associates, LLC
AlabamaTitleSearch.com LLC
All Ohio Title Agency, LLC
Alliance Title Corporation
Alpine Title
American Title Guaranty, Inc.
American Title of Ulysses, Inc.
American Title Services
American Veteran Title, Ltd
Amphibian Title, LLC
Andrea Boland Title Examiner
Antrim County Title, Inc.
Apex Title Agency, Ltd.
Assurance Title LLC
Austin-Logan Title Agency, Ltd.
Battlefield Title Agency, Inc.
Bay title & Escrow Company
Bayvista Title, Inc.
B-D-R Title Corp.
Bell Abstract & Title, Inc.
Bidwell Title & Escrow Company
Bi-State Title Search
Black Hawk County Abstract & Title
Boone-Central Title Company
Broadway Title Agency
Buckeye Title Corporation
C C B Researchers
Cape Fear Title Agency, Inc.
Cape Girardeau County Abstract and Title Company, Inc.
Capital Title & Closing Services
Cattaraugus Abstract Corp.
Cave Springs Title, LLC
CB Title
Central Montgomery Abstract Co.
Chambers County Abstract
Charlson & Wilson Bonded Abstracters, Inc.
Chautauqua Abstract Company
Cheyenne County Abstract Company
City Insurance Professionals
Clay County Abstract & Title Co.
Clayton County Abstract Co. Inc.
Clear Creek - Gilpin Title
ClearTract Title Agency
Clove Valley Abstract Ltd.
Coalition Title Agency, Inc.
Coastal Title Agency
Coffelt Land Title, Inc.
Coffey County Land Title Co., Inc.
Colby D. Welch & Associates
Commerce Title Services, Inc.
Commerece Title, L.L.C.
Commonwealth Bergen Title Agency, L.L.C.
Community Title Agency, Inc.
Community Title Company
Compass Mountain Land Use, LLC
Competitive Title
Complete Title Services, LLC
Consumer Real Estate Title, Inc.
Continental Title
Continental Title Company
Cornerstone Title, Inc.
Covenant Title, LLC
Cowling Title Company
Crittenden Title & Settlement Co., LLC
Crossland Title Services
Crossroads Title
Curry County Title
D. D. Hamilton Title
Dan Cochran Enterprises, Inc.
Dealey Abstract & Title Company
Dearborn Title Insurance, Inc.
Delaware County Abstract Company, Inc.
Dunn County Abstract & Title, Inc.
Eastern Oregon Title Inc
Eclectic Title Company
Edina Realty Title, Inc.
Elliott & Waldron Abstract Company
Enterprise Title Agency, Inc.
Esquire Title Services, LLC
Evergreen Land Title
Fidelity Abstract & Title Co
Fidelity Home Abstract, Inc.
First Montana Title
First Oregon Title Company
First Priority Services LLC
First Title & Escrow Company
Foundation Title Inc
Fowler Abstract & Title, Inc.
Freedom Settlement Group, LLC
Freedom Title Agency Services
Genesis Abstract
Glenda's Information Service
GRAHAM TITLE COMPANY
Grant Reporting Service
Green Bay Title Company, Inc.
Gulf South Title Services, LLC
Guthrie County Abstract Company
H B Wilkinson Title Company
H D National Title Group, LLC
Hallmark Title Agency, LLC
Hardin County Abstract Company
Harding County Abstract & Title
Harris Title & Escrow, LLC
Hartford National Title, Inc.
Haskell County Abstract & Title Co.
Hayward Land Title Company

Helena Abstract and Title Company
Hexagon Title Company, Inc.
Home Title Guaranty Co.
IBT Title and Insurance Agency, Inc.
Infinity Land Services LLC
Inter-County Abstract
Internet Title Services, Inc.
Intrastate Property Corp
Iroquois Title Company
JCTTitle Services
Jenny Martin Enterprises
Johns and Lee Real Estate Service, LLC
Kiefer Title Company
Kim Eboch-Lawson, Abstractor
Krause & Ferris, Attorneys
Kunzman Title Company
Lake County Abstract Co. Inc.,
Land Star Title
LAND TITLE AND ESCROW, INC.
Land Title Co. of Livingston
Land Title Company
Land Title Company of Kitsap County
Landmark Title Corp.
LaSalle County Title Co
Lawrence M. Kramer, PC
Lenders Escrow and Title Agency, LLC
Liberty title agency
Liberty Title Agency, LLC
Lighthouse Title, Inc. Agency
Lincoln County Title Co.
Linn County Abstract Company
Logan County Title Company
Loomis Abstract Co., Inc.
Mahaska Title Johnson Abstract
Marshall Land and Title Co., Inc.
Maximum Title Services, LLC
McKesson Title
Mena Title Co. Inc.
Mercury Title Company LLC
Meridian Title Corporation
Metro National Title
Mid America title
Mid-State Title & Escrow, Inc.
Missaukee Title Co.
Monitor Title
Monroe County Title, Inc.
Moscow Title Inc.
Mountain Abstract Company Inc.
Muro Title Agency, Inc.
Nashville Title Insurance Corporation
National Title
NC Closing & Title Services
New Millennium Abstract Inc
North Dakota Guaranty & Title Co
North Vernon Abstract Co
Northeast Colorado Title Company LLC
Northern California Title Co
Northern Colorado Title Services Co., Inc.
Northern IL Title Research
Northern Preferred Title Company
Northstar Title
Nostaw Title and Closing
Oceanside Title & Escrow, Inc.
Ohio Valley Title, Inc.
O'Keefe-Wilson Abstracting
Ouren Title, Inc.
Park Avenue Title Agency
Park County Title
Penn Title Inc.
Pioneer National Title Insurance Agency of Sweetwater County
Powers Abstract Company, Inc.
Prairie Title
Precision Closing Services
Preferred Land Title Company
Priority Title services, Inc.
Pro Forma Title, Inc.
Rattikin Title Company
Red Stone Title & Abstract, LLC
Regional Title & Land Services, Inc
Reliant Title
Retro, Inc.
Robert R. Montalvo Appraisal & Title
S&A Title Services, Inc.
Security Title & Escrow Services, Inc.
Security Title Company Of McPherson
Security Title Company of Montana
Security Title Insurance Agency, Inc.
Security Title Services
Security Title Services, LLC
Seit Co.
Shady Creek Title Services
Signature Settlement Services
Signature Title Co.
Single Source Real Estate Services, Inc.
Sisters and Brothers Title Services, LLC
Skamania County Title Company
South Beach Title Group, LLC
Southeast Missouri Title Company
Southside Title Services
Southwest Abstract & Title Co.
Southwest Florida Title Services, Inc.
Southwest Title Company
Southwest Title Company
St. George Title Agency, Inc.
Standard Title Guaranty Company
Starke County Abstract
Steelman Abstract
Stok & Associates, P.A.
Strecker Title Agency, Inc.
Sullivan County Abstract, Inc.
Summit Title Services
Superior Land Title, Inc.
Superior Title & Escrow, Inc.
Taramark Title Company
Tennessee Abstractors
Terry Abstract Company
Teton County Abstract Company
The Closing Advantage
The Closing Agency LLC
The R.M. Jaqua Abstract Company

The Title Company, Inc.
The Title Factory LLC
Tiger Title, LLC
Timberline Title & Escrow, Inc.
Timely Titles
Title Centers of America
Title Insurers Agency, Inc.
Title Professionals Inc.
Title Rite Title Services, LLC
Title Services of New Jersey, Inc.
Title Services, LLC
Towne Title and Escrow LLC
Traill County Abstract & Title Company
Trans-Louisiana Abstract & Title, LLC
Transworld Title Company, LLC
Trinity Abstract Inc.
Trinity Title
Trinity Title Insurance Agency, Inc.
Twin Falls Title & Eescrow Co
U.S. Title
Union Title, Inc.
Universal Title, LLC
Van Buren County Abstract & Title
Van Horn Title Agency, Inc.
Virginia Title Company
Wallowa Title Company
Washington County Title co
Washington Title & Gty Co
Wayne Abstracting, LLC.
Weber Abstract Company
Weston County Title
Wright County Land & Title Company
Wyandotte Title/Kansas Secured
Yuma County Abstract Company

APPENDIX A

Respondent Characteristics

		Total	
		Count Percent	Count
All Respondents		100.0%	422
Gross Revenue	Less than $500,000	55.2%	216
	$500,000- $999,999	20.7%	81
	$1-$3 million	14.1%	55
	More than $3 million	10.0%	39
U.S. Census District	New England	3.6%	15
	Middle Atlantic	10.9%	45
	South Atlantic	16.1%	66
	East S. Central	6.3%	26
	West S. Central	7.8%	32
	East N. Central	21.7%	89
	West N. Central	21.2%	87
	Mountain	9.7%	40
	Pacific	2.7%	11
All Fulltime Employees	1-2	30.8%	105
	3-5	26.4%	90
	6-10	17.9%	61
	11-25	14.7%	50
	More than 25	10.3%	35
Orders Received	Fewer than 500	28.6%	85
	500- 1,099	29.0%	86
	1,100- 2,499	21.5%	64
	2,500- 4,999	11.8%	35
	5,000 or more	9.1%	27
Operating Expense	Less than $100,000	11.4%	48
	$100,000-$249,999	15.2%	64
	$250,000-$499,999	10.2%	43
	$500,000-$999,999	10.7%	45
	$1,000,000 or more	13.5%	57
	Not Reported	39.1%	165
Total Payroll	Less than $100,000	18.7%	79
	$100,000-$249,999	17.5%	74
	$250,000-$499,999	9.2%	39
	$500,000 or more	14.7%	62
	Not Reported	39.8%	168

Respondent Characteristics

		Total	
		Count Percent	Count
How is this company organized?	Sole Proprietorship	11.0%	36
	Subchapter S Corporation	43.6%	143
	C Corporation	22.9%	75
	Partnership	2.1%	7
	Limited Liability Company (LLC)	20.1%	66
	Other (Specify)	.3%	1
Population of all counties in which company has offices	Fewer than 20,000	11.8%	50
	20,000-49,999	7.6%	32
	50,000-149.999	13.5%	57
	150,000 or more	26.5%	112
	Not Reported	40.5%	171
Instruments recorded daily in all counties in which company has offices	Fewer than 25	10.9%	46
	25-49	5.7%	24
	50-149	5.2%	22
	150 or more	6.4%	27
	Not Reported	71 8%	303

Table 1a. Gross Revenue in 2004

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500-1,099	1,100-2,499	2,500-4,999	5,000 or more
Total		391	216	81	55	39	74	83	64	35	27
		100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Gross Revenue in 2004	Less than $250,000	127	127	0	0	0	47	29	10	1	1
		32.5%	58.8%	.0%	.0%	.0%	63.5%	34.9%	15.6%	2.9%	3.7%
	$250,000-$499,000	89	89	0	0	0	24	21	14	3	0
		22.8%	41.2%	.0%	.0%	.0%	32.4%	25.3%	21.9%	8.6%	.0%
	$500,000-$999,999	81	0	81	0	0	2	26	24	9	3
		20.7%	.0%	100.0%	.0%	.0%	2.7%	31.3%	37.5%	25.7%	11.1%
	$1-$3 million	55	0	0	55	0	1	6	15	13	7
		14.1%	.0%	.0%	100.0%	.0%	1.4%	7.2%	23.4%	37.1%	25.9%
	$3.1-$5 million	18	0	0	0	18	0	1	0	4	5
		4.6%	.0%	.0%	.0%	46.2%	.0%	1.2%	.0%	11.4%	18.5%
	$5.1-$10 million	15	0	0	0	15	0	0	1	5	5
		3.8%	.0%	.0%	.0%	38.5%	.0%	.0%	1.6%	14.3%	18.5%
	More than $10 million	6	0	0	0	6	0	0	0	0	6
		1.5%	.0%	.0%	.0%	15.4%	.0%	.0%	.0%	.0%	22.2%

Table 1b. Percent of Gross Revenue Generated from Title Insurance and Abstracts

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500- 1,099	1,100-2,499	2,500-4,999	5,000 or more
Title Insurance Percent of Gross Revenue	Number Reporting	410	214	80	54	39	84	86	63	35	27
	25th percentile	31%	10%	48%	50%	50%	40%	26%	25%	45%	42%
	Median	60%	50%	69%	66%	65%	65%	60%	65%	65%	60%
	75th percentile	80%	78%	80%	79%	78%	84%	80%	75%	80%	71%
	Average	54%	49%	62%	63%	62%	58%	52%	54%	60%	53%
Abstracts Percent of Gross Revenue	Number Reporting	410	214	80	54	39	84	86	63	35	27
	25th percentile	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
	Median	1%	5%	1%	0%	0%	1%	3%	2%	0%	4%
	75th percentile	25%	64%	14%	10%	10%	15%	26%	55%	19%	30%
	Average	22%	29%	14%	9%	9%	17%	24%	27%	15%	22%
Escrow/ Closing Functions Percent of Gross Revenue	Number Reporting	410	214	80	54	39	84	86	63	35	27
	25th percentile	1%	0%	10%	10%	10%	0%	2%	1%	4%	6%
	Median	18%	15%	20%	20%	25%	15%	20%	18%	19%	22%
	75th percentile	30%	28%	30%	31%	34%	30%	35%	25%	31%	30%
	Average	19%	17%	21%	21%	24%	19%	19%	16%	20%	21%
Law Practice Percent of Gross Revenue	Number Reporting	410	214	80	54	39	84	86	63	35	27
	25th percentile	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
	Median	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
	75th percentile	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
	Average	2%	3%	0%	3%	3%	4%	1%	0%	0%	0%
All Other Sources Percent of Gross Revenue	Number Reporting	410	214	80	54	39	84	86	63	35	27
	25th percentile	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
	Median	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
	75th percentile	0%	0%	0%	6%	2%	0%	0%	3%	9%	5%
	Average	3%	2%	3%	4%	2%	3%	3%	3%	5%	3%

Table 2 Location of Responding Company

		Total	Gross Revenue: Less than $500,000	Gross Revenue: $500,000-$999,999	Gross Revenue: $1-$3 million	Gross Revenue: More than $3 million	Orders Received: Fewer than 500	Orders Received: 500-1,099	Orders Received: 1,100-2,499	Orders Received: 2,500-4,999	Orders Received: 5,000 or more
Total		411	214	77	54	39	83	84	63	34	27
		100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
U.S. Census District	New England	15	8	4	2	0	2	3	2	1	1
		3.6%	3.7%	5.2%	3.7%	.0%	2.4%	3.6%	3.2%	2.9%	3.7%
	Middle Atlantic	45	14	13	8	8	10	12	8	6	1
		10.9%	6.5%	16.9%	14.8%	20.5%	12.0%	14.3%	12.7%	17.6%	3.7%
	South Atlantic	66	48	5	4	5	23	11	6	3	3
		16.1%	22.4%	6.5%	7.4%	12.8%	27.7%	13.1%	9.5%	8.8%	11.1%
	East S. Central	26	16	4	0	3	3	7	4	0	1
		6.3%	7.5%	5.2%	.0%	7.7%	3.6%	8.3%	6.3%	.0%	3.7%
	West S. Central	32	20	7	2	2	7	5	5	0	3
		7.8%	9.3%	9.1%	3.7%	5.1%	8.4%	6.0%	7.9%	.0%	11.1%
	East N. Central	89	44	13	18	8	12	21	14	9	7
		21.7%	20.6%	16.9%	33.3%	20.5%	14.5%	25.0%	22.2%	26.5%	25.9%
	West N. Central	87	46	15	12	5	19	14	16	8	8
		21.2%	21.5%	19.5%	22.2%	12.8%	22.9%	16.7%	25.4%	23.5%	29.6%
	Mountain	40	16	12	5	6	7	7	7	4	1
		9.7%	7.5%	15.6%	9.3%	15.4%	8.4%	8.3%	11.1%	11.8%	3.7%
	Pacific	11	2	4	3	2	0	4	1	3	2
		2.7%	.9%	5.2%	5.6%	5.1%	.0%	4.8%	1.6%	8.8%	7.4%

Table 3a. How many people are employed at the responding location?

		Total	Gross Revenue: Less than $500,000	Gross Revenue: $500,000-$999,999	Gross Revenue: $1-$3 million	Gross Revenue: More than $3 million	Orders Received: Fewer than 500	Orders Received: 500-1,099	Orders Received: 1,100-2,499	Orders Received: 2,500-4,999	Orders Received: 5,000 or more
Total		341	175	70	46	31	84	85	64	35	26
		100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
All Fulltime Employees	1-2	105	86	1	1	0	56	23	8	1	0
		30.8%	49.1%	1.4%	2.2%	.0%	66.7%	27.1%	12.5%	2.9%	.0%
	3-5	90	61	21	5	1	19	36	19	1	3
		26.4%	34.9%	30.0%	10.9%	3.2%	22.6%	42.4%	29.7%	2.9%	11.5%
	6-10	61	24	29	7	1	8	20	14	8	2
		17.9%	13.7%	41.4%	15.2%	3.2%	9.5%	23.5%	21.9%	22.9%	7.7%
	11-25	50	4	16	23	7	1	6	21	12	5
		14.7%	2.3%	22.9%	50.0%	22.6%	1.2%	7.1%	32.8%	34.3%	19.2%
	More than 25	35	0	3	10	22	0	0	2	13	16
		10.3%	.0%	4.3%	21.7%	71.0%	.0%	.0%	3.1%	37.1%	61.5%

Table 3b. All Employees at the Responding Location

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500-1,099	1,100-2,499	2,500-4,999	5,000 or more
All fulltime employees	Number Reporting	341	175	70	46	31	84	85	64	35	26
	25th percentile	2.0	2.0	5.0	8.8	20.0	1.0	2.0	4.0	9.0	20.3
	Median	5.0	3.0	7.5	16.0	40.0	2.0	4.0	7.0	18.0	37.5
	75th percentile	10.5	4.0	11.0	25.0	56.0	3.0	6.0	12.8	30.0	61.0
	Average	10.6	3.4	9.3	17.1	50.3	2.7	4.7	8.9	20.9	50.1
All parttime employees	Number Reporting	341	175	70	46	31	84	85	64	35	26
	25th percentile	.0	.0	.0	.0	1.0	.0	.0	.0	.0	.8
	Median	1.0	.0	1.0	1.0	2.0	.0	1.0	1.0	2.0	2.5
	75th percentile	2.0	1.0	2.0	3.0	4.0	1.0	2.0	2.0	3.0	4.0
	Average	1.2	.8	1.2	1.7	2.8	.7	1.0	1.2	2.0	2.5

Table 4. How is this company organized?

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500-1,099	1,100-2,499	2,500-4,999	5,000 or more
Total		328	169	65	45	28	83	84	61	35	27
		100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
How is this company organized?	Sole Proprietorship	36	26	0	0	0	15	11	2	0	1
		11.0%	15.4%	.0%	.0%	.0%	18.1%	13.1%	3.3%	.0%	3.7%
	Subchapter S Corporation	143	71	35	20	12	33	34	32	17	9
		43.6%	42.0%	53.8%	44.4%	42.9%	39.8%	40.5%	52.5%	48.6%	33.3%
	C Corporation	75	29	20	15	9	8	19	18	10	12
		22.9%	17.2%	30.8%	33.3%	32.1%	9.6%	22.6%	29.5%	28.6%	44.4%
	Partnership	7	2	2	2	0	3	1	0	0	1
		2.1%	1.2%	3.1%	4.4%	.0%	3.6%	1.2%	.0%	.0%	3.7%
	Limited Liability Company (LLC)	66	40	8	8	7	24	18	9	8	4
		20.1%	23.7%	12.3%	17.8%	25.0%	28.9%	21.4%	14.8%	22.9%	14.8%
	Other (Specify)	1	1	0	0	0	0	1	0	0	0
		.3%	.6%	.0%	.0%	.0%	.0%	1.2%	.0%	0%	.0%

Table 5a. Operating Expense in 2004

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500-1,099	1,100-2,499	2,500-4,999	5,000 or more
Total		422	216	81	55	39	85	86	64	35	27
		100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Operating Expense	Less than $100,000	48	39	0	0	0	32	13	1	1	1
		11.4%	18.1%	.0%	.0%	.0%	37.6%	15.1%	1.6%	2.9%	3.7%
	$100,000-$249,999	64	54	6	1	0	24	22	17	1	0
		15.2%	25.0%	7.4%	1.8%	.0%	28.2%	25.6%	26.6%	2.9%	.0%
	$250,000-$499,999	43	25	14	3	1	12	16	11	2	0
		10.2%	11.6%	17.3%	5.5%	2.6%	14.1%	18.6%	17.2%	5.7%	.0%
	$500,000-$999,999	45	8	27	8	2	1	20	13	7	4
		10.7%	3.7%	33.3%	14.5%	5.1%	1.2%	23.3%	20.3%	20.0%	14.8%
	$1,000,000 or more	57	3	5	27	22	1	1	12	21	21
		13.5%	1.4%	6.2%	49.1%	56.4%	1.2%	1.2%	18.8%	60.0%	77.8%
	Not Reported	165	87	29	16	14	15	14	10	3	1
		39.1%	40.3%	35.8%	29.1%	35.9%	17.6%	16.3%	15.6%	8.6%	3.7%

Table 5b. Operating Expense in 2004

		Total	Gross Revenue: Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Orders Received: Fewer than 500	500-1,099	1,100-2,499	2,500-4,999	5,000 or more
What was this company's operating expense in 2004?	Number Reporting	257	129	52	39	25	70	72	54	32	26
	25th percentile	$133,000	$79,000	$405,379	$864,000	$2,750,000	$40,000	$133,000	$216,750	$514,625	$1,569,668
	Median	$340,000	$179,564	$562,056	$1,500,000	$4,200,000	$110,000	$268,000	$444,500	$1,958,000	$3,200,000
	75th percentile	$862,000	$299,000	$771,250	$2,200,000	$6,488,602	$205,177	$528,391	$870,000	$2,536,691	$6,350,301
	Average	$962,262	$227,239	$615,926	$1,511,602	$5,050,123	$169,633	$345,743	$617,464	$1,843,347	$4,463,012

Table 5c. Total Payroll in 2004

		Total	Gross Revenue: Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Orders Received: Fewer than 500	500-1,099	1,100-2,499	2,500-4,999	5,000 or more
Total		422	216	81	55	39	85	86	64	35	27
		100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Total Payroll	Less than $100,000	79	66	2	1	0	47	23	8	0	0
		18.7%	30.6%	2.5%	1.8%	.0%	55.3%	26.7%	12.5%	.0%	.0%
	$100,000-$249,999	74	49	20	4	1	16	32	19	5	1
		17.5%	22.7%	24.7%	7.3%	2.6%	18.8%	37.2%	29.7%	14.3%	3.7%
	$250,000-$499,999	39	7	25	7	0	3	12	17	5	2
		9.2%	3.2%	30.9%	12.7%	.0%	3.5%	14.0%	26.6%	14.3%	7.4%
	$500,000 or more	62	2	5	30	25	0	3	12	23	22
		14.7%	.9%	6.2%	54.5%	64.1%	.0%	3.5%	18.8%	65.7%	81.5%
	Not Reported	168	92	29	13	13	19	16	8	2	2
		39.8%	42.6%	35.8%	23.6%	33.3%	22.4%	18.6%	12.5%	5.7%	7.4%

Table 5d. Total Payroll in 2004

		Total	Gross Revenue: Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Orders Received: Fewer than 500	500-1,099	1,100-2,499	2,500-4,999	5,000 or more
What was this company's total annual payroll in 2004?	Number Reporting	254	124	52	42	26	66	70	56	33	25
	25th percentile	$80,000	$51,100	$200,000	$483,382	$1,126,000	$40,000	$73,624	$150,000	$462,500	$839,553
	Median	$195,343	$95,000	$285,840	$804,760	$2,138,500	$64,090	$151,500	$250,000	$827,600	$1,428,000
	75th percentile	$490,882	$160,000	$366,370	$1,200,000	$3,021,451	$106,000	$237,744	$480,000	$1,433,500	$2,791,968
	Average	$549,118	$123,374	$326,680	$861,814	$2,713,316	$87,358	$179,421	$399,995	$979,097	$2,384,039

Table 6a. Number of Orders Received in 2004

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500- 1,099	1,100-2,499	2,500-4,999	5,000 or more
Total		422	216	81	55	39	85	86	64	35	27
		100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Orders Received	Fewer than 500	85	71	2	1	0	85	0	0	0	0
		20.1%	32.9%	2.5%	1.8%	.0%	100.0%	.0%	.0%	.0%	.0%
	500- 1,099	86	50	26	6	1	0	86	0	0	0
		20.4%	23.1%	32.1%	10.9%	2.6%	.0%	100.0%	.0%	.0%	.0%
	1,100- 2,499	64	24	24	15	1	0	0	64	0	0
		15.2%	11.1%	29.6%	27.3%	2.6%	.0%	.0%	100.0%	.0%	.0%
	2,500- 4,999	35	4	9	13	9	0	0	0	35	0
		8.3%	1.9%	11.1%	23.6%	23.1%	.0%	.0%	.0%	100.0%	.0%
	5,000 or more	27	1	3	7	16	0	0	0	0	27
		6.4%	.5%	3.7%	12.7%	41.0%	.0%	.0%	.0%	.0%	100.0%
	Not reported	125	66	17	13	12	0	0	0	0	0
		29.6%	30.6%	21.0%	23.6%	30.8%	.0%	.0%	.0%	.0%	.0%

Table 6b. Number of Orders Received in 2004

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500- 1,099	1,100-2,499	2,500-4,999	5,000 or more
How many orders did this company receive in 2004?	Number Reporting	297	150	64	42	27	85	86	64	35	27
	25th percentile	407	250	847	1,275	3,600	150	550	1,292	2,845	6,105
	Median	909	500	1,338	2,385	6,496	240	741	1,517	3,500	8,100
	75th percentile	2,000	1,000	2,000	4,335	12,000	351	918	1,897	4,065	17,000
	Average	2,159	931	1,858	3,034	9,310	249	747	1,623	3,449	12,265

Table 6c. Operating Expense per Order Received in 2004

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500- 1,099	1,100-2,499	2,500-4,999	5,000 or more
Operating Expenses per Order Received	Number Reporting	252	125	52	38	25	68	72	54	32	26
	25th percentile	189	146	257	361	458	217	200	134	307	136
	Median	414	300	426	594	558	500	383	283	549	372
	75th percentile	674	601	655	892	1,030	834	672	578	711	543
	Average	515	476	485	638	697	687	469	385	542	431

Table 6d. Payroll as a Percent of Operating Expense in 2004

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500- 1,099	1,100-2,499	2,500-4,999	5,000 or more
Payroll as a Percent of Operating Expenses	Number Reporting	239	118	49	39	24	62	66	52	31	25
	25th percentile	41.4%	41.5%	40.5%	40.6%	42.1%	40.0%	40.7%	40.5%	50.0%	42.2%
	Median	53.6%	53.2%	53.2%	53.7%	50.0%	51.8%	49.9%	56.1%	54.5%	50.0%
	75th percentile	66.7%	70.2%	64.3%	61.8%	58.6%	75.5%	67.2%	70.2%	63.7%	58.9%
	Average	58.9%	61.1%	58.1%	52.8%	50.8%	62.6%	57.6%	62.7%	55.2%	50.8%

Table 6e. Payroll per Order Received in 2004

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500- 1,099	1,100-2,499	2,500-4,999	5,000 or more
Payroll per Order Received	Number Reporting	248	120	52	41	25	64	70	56	33	25
	25th percentile	$124	$98	$147	$180	$215	$183	$116	$94	$158	$78
	Median	$223	$190	$215	$292	$313	$286	$216	$178	$247	$227
	75th percentile	$361	$316	$337	$466	$544	$447	$365	$283	$407	$311
	Average	$285	$260	$245	$379	$357	$382	$246	$250	$281	$227

Table 7a. What is the approximate total number of people in all counties in which this company has offices?

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500- 1,099	1,100-2,499	2,500-4,999	5,000 or more
Total		422	216	81	55	39	85	86	64	35	27
		100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Population of all counties in which company has offices	Fewer than 20,000	50	34	7	0	0	23	16	7	0	0
		11.8%	15.7%	8.6%	.0%	.0%	27.1%	18.6%	10.9%	.0%	.0%
	20,000-49,999	32	19	11	1	0	4	11	10	2	0
		7.6%	8.8%	13.6%	1.8%	.0%	4.7%	12.8%	15.6%	5.7%	.0%
	50,000-149.999	57	28	10	16	1	15	10	17	6	4
		13.5%	13.0%	12.3%	29.1%	2.6%	17.6%	11.6%	26.6%	17.1%	14.8%
	150,000 or more	112	45	23	22	19	22	26	21	18	19
		26.5%	20.8%	28.4%	40.0%	48.7%	25.9%	30.2%	32.8%	51.4%	70.4%
	Not Reported	171	90	30	16	19	21	23	9	9	4
		40.5%	41.7%	37.0%	29.1%	48.7%	24.7%	26.7%	14.1%	25.7%	14.8%

Table 7b. What is population in all counties in which this company has offices?

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500- 1,099	1,100-2,499	2,500- 4,999	5,000 or more
What is the approximate total number of people in all counties in which this company has offices?	Number Reporting	251	126	51	39	20	64	63	55	26	23
	25th percentile	25,000	16,750	26,000	118,000	312,500	10,500	19,500	26,000	114,750	200,000
	Median	120,000	80,000	100,000	210,000	1,141,966	92,500	75,000	80,000	325,000	671,098
	75th percentile	550,000	256,500	750,000	1,200,000	4,000,000	237,500	800,000	550,000	1,309,425	4,000,000
	Average	763,077	404,821	553,982	947,382	3,658,097	250,474	625,357	467,135	1,332,187	1,873,461

Table 8 Population per Order Received in 2004

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500- 1,099	1,100-2,499	2,500-4,999	5,000 or more
Population per Order Received	Number Reporting	214	101	49	34	17	55	58	54	24	23
	25th percentile	24	25	19	24	27	28	25	17	25	21
	Median	73	100	51	83	159	189	72	59	78	54
	75th percentile	438	683	368	499	367	1,000	388	363	372	233
	Average	342	400	265	381	262	554	357	242	198	185

Table 9a. How many instruments are recorded daily—from all sources—in all of the counties in which this company has offices?

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500- 1,099	1,100-2,499	2,500-4,999	5,000 or more
Total		422	216	81	55	39	85	86	64	35	27
		100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Instruments recorded daily in all counties in which company has offices	Fewer than 25	46	29	8	0	2	17	17	4	4	0
		10.9%	13.4%	9.9%	.0%	5.1%	20.0%	19.8%	6.3%	11.4%	.0%
	25-49	24	15	6	3	0	4	8	8	1	0
		5.7%	6.9%	7.4%	5.5%	.0%	4.7%	9.3%	12.5%	2.9%	.0%
	50-149	22	8	5	4	3	2	4	7	4	3
		5.2%	3.7%	6.2%	7.3%	7.7%	2.4%	4.7%	10.9%	11.4%	11.1%
	150 or more	27	5	8	11	2	1	2	9	6	6
		6.4%	2.3%	9.9%	20.0%	5.1%	1.2%	2.3%	14.1%	17.1%	22.2%
	Not Reported	303	159	54	37	32	61	55	36	20	18
		71.8%	73.6%	66.7%	67.3%	82.1%	71.8%	64.0%	56.3%	57.1%	66.7%

Table 9b. Orders in 2004 divided by instruments recorded daily

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500- 1,099	1,100-2,499	2,500-4,999	5,000 or more
Orders in 2004 divided by instruments recorded daily	Number Reporting	107	50	27	17	6	24	31	28	15	9
	Median	35.9	38.8	37.3	27.8	168.8	28.3	43.3	30.2	35.9	48.5
	Average	62.9	62.2	65.9	31.6	193.9	41.3	84.9	35.0	77.7	107.0

Table 9c. How many instruments are recorded daily?

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500- 1,099	1,100-2,499	2,500-4,999	5,000 or more
How many instruments are recorded daily - from all sources - in all of the counties in which this company has offices?	Number Reporting	119	57	27	18	7	24	31	28	15	9
	25th percentile	10.0	6.0	12.0	57.5	20.0	5.0	5.0	30.0	21.0	72.5
	Median	30.0	21.0	40.0	182.5	70.0	9.0	15.0	50.0	100.0	165.0
	75th percentile	100.0	45.0	200.0	285.0	550.0	25.0	45.0	275.0	225.0	1,360.0
	Average	225.1	78.7	441.4	214.6	824.1	21.9	39.5	263.2	190.4	975.6

Table 10 Percent of Orders Requiring Curative Actions Prior to Closing or Policy Issuance

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500-1,099	1,100-2,499	2,500-4,999	5,000 or more
New Residential Sales	Number Reporting	183	87	38	28	20	52	45	39	22	14
	25th percentile	3%	5%	2%	3%	4%	2%	2%	3%	3%	1%
	Median	10%	10%	5%	10%	8%	10%	5%	10%	10%	10%
	75th percentile	20%	25%	16%	24%	19%	20%	20%	18%	15%	25%
	Average	16%	17%	12%	18%	21%	17%	15%	13%	15%	20%
Residential Re-sales	Number Reporting	190	86	42	31	21	53	46	41	24	14
	25th percentile	10%	9%	8%	10%	18%	7%	10%	5%	10%	10%
	Median	20%	20%	15%	18%	38%	20%	20%	15%	28%	23%
	75th percentile	36%	40%	26%	35%	50%	30%	50%	23%	40%	50%
	Average	26%	24%	22%	28%	40%	23%	29%	20%	29%	33%
Re-financings	Number Reporting	197	92	42	30	22	55	48	41	24	15
	25th percentile	5%	5%	3%	7%	8%	5%	10%	5%	5%	6%
	Median	15%	20%	10%	10%	23%	25%	20%	10%	15%	10%
	75th percentile	35%	40%	25%	33%	50%	50%	35%	20%	45%	40%
	Average	25%	26%	21%	26%	30%	29%	26%	15%	24%	26%
Agricultural Sales	Number Reporting	120	56	27	18	10	36	27	32	11	8
	25th percentile	1%	1%	1%	0%	0%	0%	0%	1%	3%	1%
	Median	5%	10%	5%	5%	8%	10%	5%	5%	5%	5%
	75th percentile	20%	15%	20%	18%	60%	20%	20%	20%	10%	74%
	Average	14%	10%	11%	18%	28%	13%	11%	14%	6%	28%
All Transactions Combined	Number Reporting	239	117	54	35	22	63	63	52	26	18
	25th percentile	12%	12%	10%	15%	19%	10%	10%	15%	10%	14%
	Median	25%	25%	22%	25%	35%	30%	20%	25%	35%	20%
	75th percentile	50%	50%	50%	38%	70%	75%	50%	38%	74%	42%
	Average	36%	37%	33%	32%	43%	40%	35%	29%	44%	33%

Table 11 Allocation of Curative Actions by Type

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500-1,099	1,100-2,499	2,500-4,999	5,000 or more
Typographical issues (correcting names, address, or legal descriptions)	Number Reporting	261	130	55	41	23	71	65	56	30	20
	25th percentile	5%	5%	5%	5%	5%	5%	5%	7%	5%	3%
	Median	10%	10%	15%	10%	10%	10%	15%	15%	10%	15%
	75th percentile	25%	25%	25%	25%	15%	25%	28%	25%	21%	20%
	Average	17%	18%	19%	17%	12%	17%	19%	22%	13%	14%
Ministerial issues (obtaining missing signatures on documents or obtaining affidavits for missing notarizations)	Number Reporting	261	130	55	41	23	71	65	56	30	20
	25th percentile	0%	0%	1%	2%	1%	0%	1%	1%	1%	0%
	Median	5%	5%	5%	5%	5%	5%	5%	5%	5%	3%
	75th percentile	10%	10%	10%	10%	10%	15%	13%	10%	10%	10%
	Average	7%	8%	7%	7%	5%	8%	9%	7%	5%	7%
Obtaining releases and/or obtaining pay-offs for discovered liens (equity credit-line mortgages, child and spousal support liens, judgment liens, federal or state tax liens, etc.)	Number Reporting	261	130	55	41	23	71	65	56	30	20
	25th percentile	15%	15%	10%	25%	10%	15%	18%	12%	14%	16%
	Median	25%	25%	25%	35%	30%	25%	25%	30%	33%	30%
	75th percentile	47%	45%	40%	50%	65%	45%	40%	47%	60%	58%
	Average	33%	32%	30%	37%	38%	33%	30%	32%	36%	39%
Obtaining releases for assignment on deeds of trust and/or mortgages	Number Reporting	261	130	55	41	23	71	65	56	30	20
	25th percentile	5%	2%	5%	5%	0%	2%	5%	0%	10%	3%
	Median	10%	10%	10%	12%	25%	10%	10%	10%	25%	13%
	75th percentile	25%	25%	25%	30%	35%	25%	25%	20%	40%	32%
	Average	19%	18%	19%	20%	21%	18%	16%	16%	29%	17%
Clearing Physical Property issues (resolving boundary disputes, solving easement/rights of way problems, etc.)	Number Reporting	261	130	55	41	23	71	65	56	30	20
	25th percentile	1%	1%	2%	1%	5%	1%	1%	2%	1%	4%
	Median	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%
	75th percentile	10%	10%	10%	10%	10%	10%	10%	10%	10%	16%
	Average	7%	7%	9%	6%	9%	7%	8%	8%	6%	9%
Clearing estate and/or family issues	Number Reporting	261	130	55	41	23	71	65	56	30	20
	25th percentile	3%	2%	2%	3%	5%	2%	5%	3%	3%	5%
	Median	10%	10%	10%	7%	5%	10%	10%	10%	5%	5%
	75th percentile	15%	15%	15%	15%	10%	15%	20%	15%	10%	15%
	Average	11%	11%	11%	10%	9%	9%	12%	13%	7%	10%
Patent issues	Number Reporting	261	130	55	41	23	71	65	56	30	20
	25th percentile	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
	Median	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
	75th percentile	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
	Average	0%	0%	0%	0%	1%	0%	0%	1%	0%	1%
Other	Number Reporting	261	130	55	41	23	71	65	56	30	20
	25th percentile	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
	Median	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
	75th percentile	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
	Average	5%	5%	4%	3%	5%	8%	5%	2%	2%	3%

Table 12 Total annual dollar amount of title-related losses (or pre-claim losses) paid out-of-pocket

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500-1,099	1,100-2,499	2,500-4,999	5,000 or more
Annually, what is the total dollar amount of title-related losses (or pre-claim losses) that you pay out-of-pocket?	Number Reporting	273	136	58	41	24	73	67	57	31	21
	25th percentile	$0	$0	$0	$3,000	$10,000	$0	$0	$0	$1,000	$10,000
	Median	$1,000	$0	$2,500	$8,600	$27,500	$0	$100	$2,500	$5,000	$25,000
	75th percentile	$5,000	$1,150	$5,000	$17,500	$71,250	$2,500	$2,500	$7,750	$20,000	$87,500
	Average	$10,054	$1,645	$4,913	$11,469	$73,438	$2,489	$2,116	$4,948	$13,608	$79,890

Table 13 How often do you rely on a previous policy in lieu of assignments on deeds of trust and/or mortgages?

			Gross Revenue				Orders Received				
		Total	Less than $500,000	$500,000-$999,999	$1-$3 million	More than $3 million	Fewer than 500	500-1,099	1,100-2,499	2,500-4,999	5,000 or more
Total		280	142	57	41	24	74	72	58	31	19
		100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
How often do you rely on a previous policy in lieu of assignments on deeds of trust and/or mortgages?	Always	10	4	2	3	1	2	4	2	1	1
		3.6%	2.8%	3.5%	7.3%	4.2%	2.7%	5.6%	3.4%	3.2%	5.3%
	Most of the time	53	16	10	11	14	10	9	8	10	12
		18.9%	11.3%	17.5%	26.8%	58.3%	13.5%	12.5%	13.8%	32.3%	63.2%
	Some of the time	113	53	27	23	6	30	33	26	13	4
		40.4%	37.3%	47.4%	56.1%	25.0%	40.5%	45.8%	44.8%	41.9%	21.1%
	Never	104	69	18	4	3	32	26	22	7	2
		37.1%	48.6%	31.6%	9.8%	12.5%	43.2%	36.1%	37.9%	22.6%	10.5%

APPENDIX B

AMERICAN LAND TITLE ASSOCIATION

ALTA 2005 ABSTRACTER & TITLE AGENT OPERATIONS SURVEY

Association Research, Inc (ARI), an independent survey research organization, is conducting this confidential survey for ALTA **All responses will be kept completely anonymous.**

This survey will take approximately 10 minutes to complete.

Please complete your questionnaire no later than **December 30, 2005,** either online or by fax to (240) 268-1267
If there is a problem, please e-mail Association Research, Inc., at *info@associationresearch.com*

We encourage you to complete the survey online by going to the following Web site:
www.ari-surveys.com/run/altaoperations2005

Thank you in advance for your time and commitment to ALTA and the industry

COMPANY CHARACTERISTICS

The following information is intended to describe operating characteristics of groups of companies. All data will be handled in strict confidence.

1. **Approximately what percent of gross revenue in 2004 was generated from each of the following activities?** (Answers should total 100%.)
   a. Title Insurance ________%
   b. Abstracts ________%
   c. Escrow/Closing Functions ________%
   d. Law Practice ________%
   e. Other *(Specify)* ________ ________%
   f. Other *(Specify)* ________ ________%
   g. Other *(Specify)* ________ ________%
   TOTAL **100%**

2. **What was this company's gross revenue in 2004?** ________ or *(Check only one)*
   ☐ 1. Less than $250,000
   ☐ 2. $250,000-$499,999
   ☐ 3. $500,000-$999,999
   ☐ 4. $1-$2.9 million
   ☐ 5. $3.0-$4.9 million
   ☐ 6. $5.0-$9.9 million
   ☐ 7. $10 million or more

3. **In which state is your primary location?** ________

4. **What is the Zip Code of the primary location responding to the survey?** ___ ___ ___ ___ ___

5. **How many people are employed at the location responding to the survey?:**
   Full-time ________ Part-time ________

6. **How many orders did this company receive in 2004?** ________

7. **What was this company's operating expense in 2004?** $________

8. **What was this company's total annual payroll in 2004?** $________

9. How is this company organized? *(Check only one)*

- ❑ 1. Sole Proprietorship
- ❑ 2. Subchapter S Corporation
- ❑ 3. C Corporation
- ❑ 4. Partnership
- ❑ 5. Limited Liability Company (LLC)
- ❑ 6. Limited Liability Partnership (LLP)
- ❑ 7. Other *(Specify)* ____________________

10. What is the approximate total number of people in all counties in which this company has offices?
__________ Population

11. How many instruments are recorded daily—from all sources—in all of the counties in which this company has offices? (If unknown, please specify "unknown.") __________ Instruments daily

CURATIVE ACTIONS

12. Excluding current real estate taxes and known existing liens for new residential sales, residential re-sales, re-financings, and agricultural sales, what percentage of orders require curative actions prior to closing or policy issuance? (If you are unable to distinguish between types of transactions, provide an approximate answer for all types combined.)

		Percent of Orders Requiring Curative Actions
a.	New residential sales	________%
b.	Residential re-sales	________%
c.	Re-financings	________%
d.	Agricultural sales	________%
e.	All transactions combined	________%

13. Approximately what percent of curative actions do each of the following represent?
(Answers should total 100%.)

		Percent of all Curative Action
a.	Typographical issues (correcting names, address, or legal descriptions)	________%
b.	Ministerial issues (obtaining missing signatures on documents or obtaining affidavits for missing notarizations)	________%
c.	Obtaining releases and/or obtaining pay-offs for discovered liens (equity credit-line mortgages, child and spousal support liens, judgment liens, federal or state tax liens, etc.)	________%
d.	Obtaining releases for assignment on deeds of trust and/or mortgages	________%
e.	Clearing Physical Property issues (resolving boundary disputes, solving easement/rights of way problems, etc.)	________%
f.	Clearing estate and/or family issues	________%
g.	Patent issues	________%
h.	Other *(Specify)* ____________	________%
	TOTAL	**100%**

14. Annually, what is the total dollar amount of title-related losses (or pre-claim losses) that you pay out-of-pocket? $____________

15. How often do you rely on a previous policy in lieu of assignments on deeds of trust and/or mortgages?

- ❑ 1. Always
- ❑ 2. Most of the time
- ❑ 3. Some of the time
- ❑ 4. Never

16. What topics would you like ALTA to include on future surveys? Please specify: ________________

____

____

____

OPTIONAL:

Only participants can receive a free copy of the results. To receive your copy, please fill out the following information. Your data will remain confidential, and ARI will only provide ALTA with the names of those entitled to the free report. Survey results will be sold to companies that do not participate.

NAME

COMPANY

ADDRESS

E-MAIL ADDRESS

CITY/STATE/ZIP

ARI
Association Research, Inc.

THANK YOU VERY MUCH FOR COMPLETING THIS SURVEY.

If you are not completing the survey online, please fax your questionnaire directly to Association Research, Inc. (ARI), at (240) 268-1267 no later than December 30, 2005.

If you prefer to complete the survey online, please do so by going to this website:

www.ari-surveys.com/run/altaoperations2005

AMERICAN LAND TITLE ASSOCIATION

ALTA 2005 Abstracter & Title Agent Operations Survey

Comments & Suggestions

1. What sections of this 2005 report were most useful to you? Please identify by table numbers or titles the sections you found most useful. Use the back of this form if you need more space to respond to any of these questions.

2. What sections of the report did you skip over as probably not useful to you?

3. What sections of the report do you feel could be better presented, to make it easier to interpret and absorb the material presented?

4. What tables or topics, in your opinion, could be deleted from this report without reducing its overall usefulness to you and other users of the information?

5. What additional topics would enhance the value of this report for you?

Optional:

Your name: ____________________ Affiliation/Phone Number: ____________________

Please fax this form to (888) FAX-ALTA
Attn: Richard McCarthy, Director of Research
American Land Title Association
1828 L Street, NW Suite 705
Washington DC 20036-5104

THE ROLE OF THE MONOLINE REQUIREMENT IN ASSURING TITLE INSURANCE EFFECTIVENESS

By

Dr. Nelson R. Lipshutz
President
Regulatory Research Corporation
24 Radcliff Road
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Report to

The American Land Title Association

December 1, 2004

EXECUTIVE SUMMARY

A "monoline" requirement, i.e., the statutory restriction of companies writing a particular line of insurance to writing ***only*** that line, occurs today in just three property-casualty lines: title insurance, mortgage guaranty insurance, and financial guaranty insurance. In light of the current trend toward the elimination of specialization for all types of financial institutions, we have investigated whether the monoline restriction still makes sense for title insurance. Our principal findings are that:

- The cyclical history of monoline vs. multiline insurance practice demonstrates that these different modes of regulation are popular at different times. Monoline restrictions gain popularity as a "flight to safety" in the wake of some disaster. Multiline permissions gain popularity as a "flight to convenience" as the memory of disaster fades, and remain in effect until the next disaster strikes.

- Multiline authority is not universal. The separation between life insurance and property-casualty insurance continues today, and is universally recognized as good public policy.

- The term covered by the single premium collected for a title insurance policy is the duration of property ownership or the term of a real estate loan. The failure of a title insurance company affects not just insureds who have recently paid a premium, but all title insurance customers for decades past. In this respect, the title insurer is much more like a life insurer than a property-casualty insurer, and requires a similar level of solvency protection.

- ***Monoline*** title insurers have had about the same 1% to 2% insolvency rate as other property-casualty insurers. ***Mutliline*** title insurers, which wrote title and mortgage guaranty insurance, suffered a 72% insolvency rate during the Great Depression.

- A Great Depression is extremely unlikely to recur, but the experience of the 1980s shows that periods of financial instability and plunging real estate prices were not a one-time Depression occurrence. The relative debt load borne by today's economy is very close to that of the period immediately preceding the Depression. Foreclosure rates have increased by a factor of 3 since 1980. Bankruptcies per capita have increased by a factor of 4 since 1980. During the 1980s, mortgage guaranty insurers experienced a 190% loss ratio and a 72% drop in their contingency reserves. Accordingly, writing title insurance in conjunction with mortgage guaranty insurance under today's highly stressed financial conditions would put title insurers and their insureds at great risk.

- The non-title insurance companies who have attempted to offer title insurance products specialize in high-risk lines, have no title insurance underwriting experience, and have a much lower aggregate surplus than the title insurance industry. They can neither increase the insured's safety nor deliver the same quality of product as can a title insurer.

- In summary, the monoline restriction for title insurance continues to constitute sound economic and regulatory policy.

DR. NELSON R. LIPSHUTZ

Dr. Nelson R. Lipshutz has been a consultant to the title insurance industry for the past 32 years. A native of Philadelphia, Pennsylvania, Dr. Lipshutz was originally educated in theoretical high-energy physics, receiving a Bachelor's degree from the University of Pennsylvania and Master's and Doctoral degrees from the University of Chicago. After several years of teaching and research as an Assistant Professor of Physics at Duke University, Dr. Lipshutz joined the staff of the Management and Behavioral Science Center of the Wharton School of the University of Pennsylvania, and received an MBA in Finance from Wharton in 1972. For the next five years, Dr. Lipshutz was a member of the staff of Arthur D. Little, Inc., where he worked with the ALTA Research and Accounting Committees to develop the Uniform Financial Reporting Plan. In 1977, Dr. Lipshutz founded Regulatory Research Corporation, a consulting firm of which he is President.

His work in title insurance includes the development of statistical and financial reporting systems adopted as the basis of title insurance regulation in dozens of states. He has testified on title insurance issues before state insurance departments, legislative committees, and the US Department of Housing and Urban Development. During 1993, he served as Coordinator of industry and consumer advisors to the Title Insurance Working Group of the National Association of Insurance Commissioners. He also serves as a consultant to various individual title insurance underwriters and underwritten title companies in areas including loss control, reserve analysis, strategic planning, and mergers and acquisitions. He is a frequent contributor to ALTA publications, and is the author of a book on the industry, ***The Regulatory Economics of Title Insurance***, published in March of 1994 by Praeger Publishers and now in its second printing.

In addition to his work in the title insurance area, Dr. Lipshutz has studied the economics of many other industries, including the pulp and paper industry, the pesticide industry, the automobile industry, and the mortgage insurance industry. He has presented testimony on economic issues before the President's Council on Wage and Price Stability, the US International Trade Commission, the US Environmental Protection Agency, Federal and State courts, and the American Arbitration Association.

CONTENTS

I. INTRODUCTION

A "monoline" requirement, i.e., the statutory restriction of companies writing a particular line of insurance to writing ***only*** that line, occurs today in only two property-casualty lines: title insurance and mortgage guaranty/financial guaranty insurance. In light of the current trend toward the elimination of specialization for all types of financial intermediaries, from commercial banks to mortgage lenders to insurance companies to investment houses, it is important to examine whether the monoline restrictions still make sense. The present study examines this important question for the case of title insurance.

We first examine the evolution of monoline requirements over time in the context of the economic and institutional conditions prevailing then and now. We next identify the crucial factors that militate for or against monoline restrictions. We then project the consequences that would be likely to follow from the elimination of the monoline requirement for title insurance, drawing on historical experience in title insurance and in other financial industry sectors. Based on these analyses, we draw some conclusions on the advisability of maintaining the monoline requirement for title insurers.

II. HISTORY OF MONOLINE RESTRICTIONS

The number of different coverages that U.S. insurance companies have been permitted to offer exhibits a cyclical pattern over time, with alternating waves of specialization and generalization.

Until the end of the 18^{th} century, U.S. insurance was generally restricted to Lloyds-like underwriting syndicates to provide marine insurance. There were two exceptions. In 1736, the Friendly Society was organized as a mutual fire insurance company in Charleston, South

Carolina. The company failed and was unable to pay all its claims when a conflagration occurred in 1740. In 1752, the Philadelphia Contributorship for the Insurance of Houses from Loss by Fire was organized by Benjamin Franklin, and is still in business today.[1]

This initial monoline structure was quickly augmented by multiline companies. In 1792, the Insurance Company of North America was organized to insure fire and marine risks and also to provide life insurance.[2] In 1798, similar multiline charters were granted to the United Insurance Company of the City of New York and to the New York Insurance Company for Maritime Insurance, Houses, Goods, and Lives.[3] Over the next 37 years, a large number of multiline insurers were chartered as the U.S. economy grew.

The trend toward multiline insurers began to slow on December 16, 1835 when a massive fire destroyed 648 buildings in the New York City business district. The aggregate loss was $18 million (equivalent to $248 million today), and 23 of the 26 insurance companies in New York went insolvent.[4] Over the next 15 years, a series of fire and marine disasters struck the insurance industry, driving a large number of multiline insurers into insolvency and rendering worthless the life insurance policies they had issued. In consequence, in 1849, New York passed a statute precluding any insurer writing fire and/or marine insurance from writing life insurance. In 1853, another statute was enacted splitting fire and marine insurers.[5]

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[1] Bogardus, John, "Spreading the Risks – Insuring the American Experience," Chevy Chase, Posterity Press, 2003, pp. 13-18
[2] Pugh, William, "Multiple Line Regulation," Chapter 22 in Kimball, S. and Denenberg, H, eds., "Insurance, Government, and Social Policy," Homewood, Irwin, 1969, pg. 244
[3] Harbison, Hugh, "Legal Environment for All Lines Insurance," Chapter II in "All Lines Insurance," Homewood, Irwin, 1960, pp.14-15
[4] Ibid., pg. 15
[5] Bogardus, op. cit., pg. 43

As liability insurance and other casualty lines developed over the next half century, the monoline approach was extended to separate casualty companies as well.[6] In fact, the general need for monoline restrictions was adopted by the National Convention of Insurance Commissioners (later the National Association of Insurance Commissioners or NAIC) in 1891 as their fifth recommendation:

> "The principle embodied in the laws of many of the States, that an insurance company organized under the laws should confine its transactions to one kind of business, your committee believe to be a safe and wise one, and that there is an abundance of business of any of the kinds, that now employ the attentions of the various companies, to occupy the energy and vigilance of any one set of officers. And especially should no two kinds of business be allowed in any one company, except such as are now akin, and in which the maturity of the policy depends upon the happening of similar events."[7]

This monoline principle was no sooner enunciated than pressures began to build to break it down. The NAIC, then as now, could recommend but it could not legislate. Insurance legislation in most states generally preserved the tripartite division of life & health, fire and marine, and casualty. Some other states did not require such a separation. However, the variation in state practice was vitiated in large part because New York, which was firmly in the monoline camp, required that companies doing business in New York abide by New York's monoline rules for their entire nationwide business. This requirement was known as the Appleton Rule in honor of Deputy Superintendent Henry D. Appleton during whose tenure it was promulgated, and is now incorporated in Section 1106 of the New York Insurance Code.[8] Operating on a monoline basis

[6] Pugh, op. cit., p. 244
[7] "Proceedings of the 22nd National Convention of Insurance Commissioners of the United States," St. Louis, Daly, 1891, p. 53
[8] Harbison, op. cit., p. 18. Section 1106 Subsection 3(c) reads:" No foreign insurer shall be licensed to do in this state any kind of insurance business, or combination of kinds of insurance business, which are not permitted to be done by domestic insurers hereafter to be licensed under the provisions of this chapter. No foreign insurer shall be authorized to do business in this state if it does in this state ***or elsewhere*** any kind of business, other than an

became known as the "American system," in contrast to the multiline approach that was universal in England and continental Europe.[9]

Over the ensuing thirty years, the American system continued in effect. As new lines of insurance developed, they were incorporated into one of the three general categories on a more or less arbitrary basis. Public inconvenience attendant on having to buy several policies to cover what seemed a single risk (e.g., separate fire and windstorm policies for a home, or separate property damage and liability policies for an automobile) were somewhat ameliorated by the development of special policies incorporating multiple coverages, or by the simultaneous issuance of two policies by separate monoline companies under common ownership (known as members of an insurance "fleet.") [10]

By 1943, the fact that the monoline requirement was being overwhelmed by commercial realities led to the formation of a special NAIC study committee which recommended that the regulatory barrier between fire insurers and casualty insurers be dissolved. This recommendation was adopted by the NAIC in 1947, and incorporated into New York law in 1949.[11] Thus, 1949 marks the beginning of multiline insurance in the modern era, which continues to today.

Keep in mind, however, that multiline authority has not become universal. The separation between life insurance and property-casualty insurance has been maintained. In addition, the monoline restriction was maintained for title insurance. Further, when private mortgage

insurance business and such business as is necessarily or properly incidental to the kind or kinds of insurance business which it is licensed to do in this state." (emphasis added) Subsection 3(d) imposes the same restriction on alien insurers.

[9] Interestingly, the term "American system" was something of a misnomer, since the Appleton rule contained a grandfather clause exception that permitted several of the largest U.S. insurers to ignore it.

[10] Harbison, op. cit. p. 24

[11] Ibid., p. 25.

insurance, which had vanished during the 1930s, was reintroduced in 1956, it, too, was subjected to a monoline requirement in most states.[12]

III. ARGUMENTS FOR AND AGAINST MONOLINE REQUIREMENTS

The primary justifications for monoline insurance are derived from considerations of solvency and equity:

- A monoline requirement for a high-risk line of insurance protects policyholders of other, inherently safer lines. This point was made particularly eloquently in 1860 by the Insurance Department of the State of New York:

  > "Life insurance in particular is a specialty; and the accumulated funds which are held by a company for a lifetime as a savings bank, in sacred trust for the widow and orphan, should never be liable to be swept away by a storm at sea or a conflagration on land."[13]

- A monoline requirement for a very safe line of insurance protects its policyholders from the risks presented by other, higher-risk lines.[14]

These overall solvency considerations give rise to a variety of other technical arguments.

- Unusual insurance lines require special expertise distinct from that needed to conduct most property-liability lines, and these skills are best maintained and developed in a monoline organization.[15]
- Only a monoline firm can isolate its surplus for the protection of policyholders.[16]

[12] Jaffe, Dwight, "Monoline Restrictions, with Applications to Mortgage Insurance and Title Insurance," University of California at Berkeley preprint, January 27, 2004
[13] First Annual Report of the Insurance Department of the State of New York, March 1, 1860
[14] Jaffe, loc. cit.
[15] National Conference of Insurance Commissioners, Proceedings of the 22nd National Convention, Report of the Committee on the President's Address, Recommendation 5, p. 53
[16] Ibid., p. 54

- Unusual insurance lines need a special asset structure to match their special liability structure.[17]

There are two primary arguments against monoline restrictions:

- The diversification of a multiline insurer decreases its overall risk, which leads both to greater policyholder protection and to lower premiums.[18]
- A multiline insurer can develop broad coverage products that simplify the purchasing of insurance, and guarantee that there are no gaps in coverage as might occur if consumers had to purchase several different policies to cover different but related risks. The best illustrations are homeowner's and automobile insurance.[19]

In order to see how these arguments play out in practice for title insurance, it is illuminating to examine the solvency history of the title industry.

IV. INSOLVENCY RISK IN THE TITLE INSURANCE INDUSTRY

Insolvency in the insurance industry overall is rare. A recent study by A.M. Best covering the period 1969 to 2002 indicates that in prosperous times, about 1 in 200 insurance companies fail each year. In times of stress, 1 in 50 companies fail each year.[20] This performance is similar to the experience of monoline title insurers. In 1969 there were 81 title insurers operating in the United States,[21]and in 2002 there were 84.[22] Over this period, there were three title insurer insolvencies.[23]

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[17] For example, mortgage guaranty insurers invest their contingency reserves in special tax and loss bonds that permit the tax-free accumulation of large reserves. See Internal Revenue Code Section 343.3 Subpart B.
[18] This effect is incorporated in the covariance adjustment in the NAIC property-casualty risk based capital formula.
[19] Mowbray, A., Blanchard, R., and Williams, C., "Insurance," New York, McGraw-Hill, 1969, p. 273
[20] A.M. Best, "Best's Insolvency Study -Property/Casualty U.S. Insurers 1969-2002," May 2004, p. 12
[21] American Land Title Association, "1969 NAIC Form 9 Data"
[22] Corporate Development Services, "CDS Performance of Title Insurance Companies – 2003 Edition"
[23] Peninsular Title Insurance Company and Owners Title Insurance Company in Florida, and USLife Title Insurance Company of Dallas in Texas.

It is particularly important to maintain solvency for title insurers, even more than for other property-casualty lines. Most property-casualty lines write insurance for a short period of time, during which all claims occur. In contrast, the term covered by the single premium collected for a title insurance policy is the duration of property ownership or the term of a real estate loan. In consequence, the failure of a title insurance company affects not just insureds who have recently paid a premium, but all title insurance customers for decades past. This long-term obligation is reflected in the fact that most state statutes require the restoration of title insurance unearned premium reserves to income over a period of 20 years.[24] In this respect, the title insurer is much more like a life insurer than a property-casualty insurer, and it is universally accepted that separating life insurance from property-casualty insurance is sound regulatory policy.

A. Title Insurance in the Multiline Environment

Title insurers had a very different experience when they were parts of multiline companies. In the early 1930's, there were about 84 companies in the title insurance and mortgage guaranty business.[25] Of these companies, 32 were domiciled in New York. The New York domiciliary companies dominated the industry, and had a surplus as regards policyholders which constituted 67% of the industry total (see Table 1).

[24] A.M. Best, "Title Insurance Industry Statistics," November 2000, p. 17. of the 39 states on which Best's reports, 32 have a 20 year requirement; 3 have a 15 year requirement; 2 have a 10 year requirement; and 2 have a 25 year requirement.
[25] A. M. Best & Co., "Best's Insurance Reports," 1931 – 1934 editions. The Best's Reports do not appear to report all existing title and mortgage guaranty companies in any given year. We have included all companies listed in the four additions cited. In addition, we have also included the other companies listed in Van Schieck, George S., "The Administration of the Delinquent Title and Mortgage Guaranty Companies by the New York Insurance Department," May 10, 1935, p. 18 ff.

Table 1

Title and Mortgage Guaranty Companies 1931-1933

Domiciliary State	Number of Companies	As % of Total	Surplus as Regards Policyholders	As % of Total
California	9	10.7%	39,943,530	11.7%
Illinois	1	1.2%	29,630,227	8.7%
Kentucky	3	3.6%	5,076,259	1.5%
Louisiana	1	1.2%	682,152	0.2%
Maryland	1	1.2%	1,644,174	0.5%
Massachusetts	1	1.2%	2,365,281	0.7%
Michigan	2	2.4%	2,009,294	0.6%
Minnesota	1	1.2%	1,800,000	0.5%
Missouri	1	1.2%	1,097,925	0.3%
New Jersey	21	25.0%	20,277,962	5.9%
New York	32	38.1%	228,162,812	66.8%
Oregon	2	2.4%	1,484,583	0.4%
Texas	1	1.2%	1,901,936	0.6%
Utah	1	1.2%	320,979	0.1%
Virginia	1	1.2%	957,008	0.3%
Washington	5	6.0%	3,367,961	1.0%
Wisconsin	1	1.2%	644,122	0.2%
	84	100.0%	341,366,205	100.0%

SOURCES:
Best's Insurance Reports - Casualty and Miscellaneous, 1931-1933
Additional New York companies not listed in Best's identified from Van Schiek, George S., "The Administration of the Delinquent Title and Mortgage Guaranty Companies by the New York Insurance Department," May 10th, 1935

The title and mortgage guaranty companies subject to New York law had actually started out as monoline title insurers.[26] While the 1885 legislation authorizing title insurers had somewhat ambiguous language, the 1892 New York Insurance Law clarified the monoline nature of the coverage:

> "To examine titles to real property and chattels real, to procure and furnish information in relation thereto, make and guarantee the correctness of searches for all instruments, liens or charges affecting the same; and guarantee or insure bonds and mortgages and the owners of real property and chattels real and others interested therein against loss by reason of defective titles thereto and other encumbrances thereon, which shall be known as a title guaranty corporation;"[27]

[26] Alger, George W., "Alger Report," Moreland Commissioner's Report, October 5, 1934, p. 7
[27] New York Statutes, Insurance Law of 1892, c. 690

However, in 1904, the law was revised to add the power to insure the ***payment*** of bonds and mortgages.[28] This turned out to be a catastrophic legislative error.

The legislature exacerbated its error in 1911 when it changed the requirements for investment activities of title and mortgage guaranty insurers to include trading in mortgages.[29] The title and mortgage guaranty companies immediately expanded their activities to include the mortgage banking business, and were the issuers and guarantors of mortgage participation certificates that worked exactly like the mortgage-backed securities (MBS's) which play such an important role in mortgage finance today.

The onset of the Great Depression in 1929 had little impact on the title and mortgage guaranty insurers. However, by 1931 spiraling unemployment produced a blizzard of mortgage defaults, and real estate prices began to plummet. The unemployment rate rose from 3.2% in 1929 to 16.3% in 1931, to 24% in 1932 and 25% in 1933.[30] The number of foreclosures more than tripled, from 68,100 in 1926 to 252,400 in 1933. [31] The value of the foreclosed properties dropped by 20%.[32] Understandably, the holders of mortgage participation certificates attempted to cash them in. But, as the New York Insurance Commissioner noted later:

> "And yet, as it is seen in retrospect, the danger was ever present that if a great number of investors at the same time refused to renew their mortgages or certificates when they became due and demanded payment, there must develop the same crisis that occurs when there is a run on a bank."[33]

Develop it did.

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[28] Alger, op.cit., p 7
[29] New York Statutes, Insurance Law of 1911 c. 525, Section 170
[30] U.S. Bureau of the Census, "Historical Statistics of the United States – Colonial Times to 1970," p. 126, Series D 1-10
[31] Ibid., p. 651, Series N 310.
[32] Ibid., p. 647, Series N 259-261
[33] Van Schieck, op. cit., p.3

Pursuant to emergency legislation passed during 1933, the New York Commissioner seized 21 companies out of the 32 title insurance and mortgage guaranty companies doing business in New York, companies which represented 74% of the total surplus as regards policyholders of the New York industry (see Table 2).[34] Most of the companies were ultimately liquidated for the benefit of the investors in mortgage participation certificates. However, in six cases, the title insurance pieces of the businesses were split off as monoline title insurers that continued in business.[35]

Table 2

Status of New York Domiciliary Title and Mortgage Guaranty Insurers 1935

	Number of Companies	As % of Total	Surplus as Regards Policyholders	As % of Total
All Companies	32	100%	228,162,812	100%
In rehabilitation or liquidation	23	72%	169,562,537	74%
Solvent	9	28%	58,600,275	26%

SOURCE: Van Schiek, George S., "The Administration of the Delinquent Title and Mortgage Guaranty Companies by the New York Insurance Department," May 10th, 1935

It would be easy to dismiss this experience as an anomaly of the Great Depression, inconceivable today. Unfortunately, that is not the case. In the absence of monoline regulation of title insurers, we would have come perilously close to similar disasters during the S&L crisis of the 1980's and even as recently as two years ago.

[34] Ibid., p. 18 ff.
[35] Ibid., table following p. 18

B. Financial Crises of the 1980's

The basic economic process that led to the collapse of the multiline title insurance-mortgage guaranty companies in the 1930's was an explosion of mortgage foreclosures driven by surging unemployment followed by a precipitous decline in the value of the seized collateral as home prices plummeted and bank credit became unavailable. A similar scenario played out in the U.S. in the 1980's, particularly in the Southwest.

From 1986 to 1988, the unemployment rate rose from 6% to 9% in Texas, to 13% in Louisiana, to 8.5% in Oklahoma, to 7.5% in Arkansas, and to 9% in New Mexico.[36] Housing prices in the West South Central region dropped by 14% between the second quarter of 1986 and the fourth quarter of 1988.[37] This drop in value was sufficient to extinguish the equity of many homeowners with high loan-to-value mortgages who defaulted on these mortgages and simply walked away from their properties, leaving lenders and the mortgage insurers holding the bag. This situation is identical to what happened during the Great Depression. In describing the collapse of the title and mortgage guaranty insurers in the early 1930's, the Alger Report noted:

> "The practice of not setting up proper reserves is objectionable at all times, but ***it becomes one of real danger in the case of these companies in times of depression of real estate values, when some mortgagors prefer to discontinue interest and tax payments and lose their sometimes non-existent equity in the property***, in order to benefit from the income from it."(emphasis added) [38]

As the S&L collapse proceeded, the loss ratio of mortgage guaranty insurers rose to 180%, and 72% of the industry's contingency reserve was exhausted.[39]

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[36] Bureau of Labor Statistics, Seasonally Adjusted Unemployment Rates
[37] Office of Federal Housing Enterprise Oversight housing price index
[38] Alger, op.cit., p. 41
[39] Mortgage Insurance Companies of America, "Fact Book," 1980-2003. The industry's contingency reserve dropped from $1.158 billion in 1984 to $321 million in 1987.

The mortgage guaranty industry survived the crisis, but it was a difficult period. Had title insurance been combined with mortgage guaranty insurance, the situation would have been even worse. During the 1980's, the title insurance industry suffered two outright insolvencies, those of Owner's Title Insurance Company and USLife Title Insurance Company of Dallas. In addition, the then largest title insurer, Ticor, suffered such severe surplus depletion that it had to be rescued by acquisition.[40]

C. Dodging the Bullet – The Reliance Insurance Debacle

From 1975 until 1998, Commonwealth Land Title Insurance Company was a subsidiary of the Reliance Insurance Company.[41] Commonwealth is one of the oldest and largest title insurers. When Reliance sold off Commonwealth and Comonwealth's wholly owned subsidiary, Transnation Title Insurance Company, Commonwealth had a consolidated annual volume of about $1 billion in premium out of an industry total of $8 billion. Its overall market share of about 12% understates the company's importance, since its share of market was much higher in individual states (e.g., 45% in Delaware, 40% in Rhode Island, 20% in Maryland, and 19% in Pennsylvania).[42] At the same time, Reliance also divested itself of Commonwealth Mortgage Assurance Company, a monoline mortgage guaranty insurer.

Within two years of the divestiture of Commonwealth, Reliance was in desperate trouble. In response to a downgrade from A.M. Best, Reliance merged all its subsidiaries into the parent in a fruitless attempt to buttress its surplus. The Pennsylvania Insurance Department seized the company on May 29, 2001; and on October 3, 2001 the company was placed in liquidation.[43]

[40] Ticor was acquired by Chicago Title Insurance Company in 1991.
[41] National Title –Duluth website, "Title Insurance – An American Tradition"
[42] Corporate Development Services, "CDS Performance of Title Insurance Companies – 1999 Edition"
[43] Philadelphia Inquirer, October 4, 2001

The list of companies Reliance Insurance absorbed in desperation is illuminating. In addition to several diversified property-liability insurers, Reliance also absorbed its surety company and its indemnity company.[44] The Order of Liquidation did not unroll the subsidiary mergers, but applied to all the merged subsidiaries. Once the subsidiaries were in the pool, they were all doomed.

What would the consequences for title insurance have been if Reliance had held onto Commonwealth for two more years? In the actual monoline environment, Reliance would have been prohibited from merging a title insurer into the parent, and nothing would have happened to the title insurance market. But if no monoline statute were in place, Reliance would have merged its title insurer in as well, would have dragged 12% of the national title insurance business into confusion, and would have devastated the markets in states in which Commonwealth had a high market share.

The risk to the real estate markets from a single title insurer failure is not confined to the case of Commonwealth. There are 2,850 property-casualty insurance companies,[45] but only about 84 title insurers. Further, industry consolidation over the past two decades has placed the companies covering about 90% of all title insurance risks into only five ownership groups.[46] Even the small companies outside the three major groups can play a very large role in particular

[44] Pennsylvania Insurance Department, Order of Liquidation, October 3, 2001. The merged companies included Reliance National Indemnity Company, Reliance National Insurance Company, United Pacific Insurance Company, Reliance Direct Company, Reliance Surety Company, Reliance Universal Insurance Company, United Pacific Insurance Company of New York, and Reliance Insurance Company of Illinois.
[45] A. M. Best & Co., "Best's Insolvency Study," May 2004, p. i
[46] Demotech, "Performance of Title Insurance Companies – 2004 Edition," p. 12. The five company groups are Fidelity National Financial, First American Financial; LandAmerica, Old Republic; and Stewart Information Systems.

states. For example, Investor's Title Insurance Company has a 25% share of the North Carolina market; and the Attorney's Title Insurance Fund has a 22% market share in Florida.[47]

V. EXPECTED IMPACTS OF REMOVING THE MONOLINE RESTRICTION FOR TITLE INSURANCE

The cyclical history of monoline vs. multiline insurance practice demonstrates that these different modes of regulation are popular at different times. Monoline restrictions gain popularity as a "flight to safety" in the wake of some disaster. Multiline permissions gain popularity as a "flight to convenience" as the memory of disaster fades, and remain in effect until the next disaster strikes. Accordingly, in considering the advisability of continuing monoline regulation for title insurance at the present moment, it is important to consider the current economic situation (including both macroeconomic factors and institutional factors) to determine whether present conditions would present a high or low risk of difficulties for multiline title insurers.

A. Solvency Risk Prospects in the Current Economy of Multiline Combinations of Title Insurance with Mortgage Insurance and Financial Guaranty Insurance

Title insurance products have been offered in recent years by at least eight non-title insurers.[48] The most widely known product is the so-called "lien protection policy" offered by Radian Guaranty, Inc., which is primarily a mortgage insurance and financial guaranty insurance company. Regulators in a large number of jurisdictions have disapproved the product, based on the existing monoline restriction on title insurance. Accordingly, it is worth re-examining whether the legal monoline restriction also makes economic sense today when applied to a title insurance-mortgage guaranty insurance combination.

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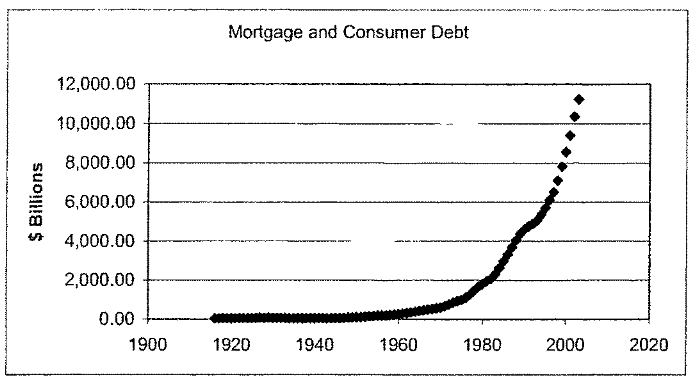
[47] Ibid., Section Four

[48] See American Land Title Association website. The companies include Norwest Mortgage, Radian Guaranty, Chubb Custom Insurance, Great American, BancInsure, St. Paul Medical Liability, Fidelity and Deposit of Maryland, and United States Liability Insurance.

The cause of economic downturns is a subject of continuing debate. But no matter which theory of business cycles one adopts, the heart of the financial consequences of such downturns is the inability of borrowers to service their debt.

The debt load in the U.S. economy has reached truly astounding proportions. Figure 1 presents total mortgage debt and consumer credit over the period 1961 to 2003.[49] Since 1961, this debt has grown by a factor of 42.

FIGURE 1



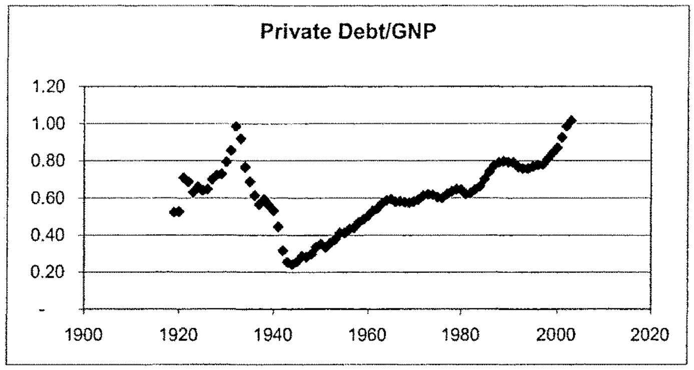
Of course, the economy has also grown enormously over the same period.[50] A better measure of the relative private debt load being born by real property purchasers is the ratio of mortgage and consumer debt to the gross national product. In terms of this metric, the current debt level is not unprecedented. Unfortunately, this is not a cause for rejoicing. Figure 2 presents the ratio of total

[49] Bureau of the Census, "Historical Statistics of the United States Colonial Times to 1970," U.S. GPO, Series X 393-409 p. 989 and Council of Economic Advisors, "Economic Report of The President 2004," U.S. GPO, Tables B-75 and B-77

[50] Bureau of the Census, "Historical Statistics of the United States Colonial Times to 1970," U.S. GPO, Series F 1-5 p. 224 and Council of Economic Advisors, "Economic Report of The President 2004," U.S. GPO, Table 1

mortgage debt and consumer credit to gross national product over the period 1916-2003. ***It is sobering to note that the last time that debt was as large compared to GNP was 1929.***

FIGURE 2



Signs of strain have already emerged. Currently, personal bankruptcies constitute over 95% of all bankruptcy filings.[51] Since 1950, the annual number of bankruptcies has increased by a factor of 50 (see Figure 3). Since 1980, the number of bankruptcies per capita has been growing at an average rate of 6.4% per year (see Figure 4).

[51] Hansen, Bradley A. and Hansen, Mary Eschelbach, "The Transformation of Bankruptcy in the United States," American University preprint, 2004

FIGURE 3

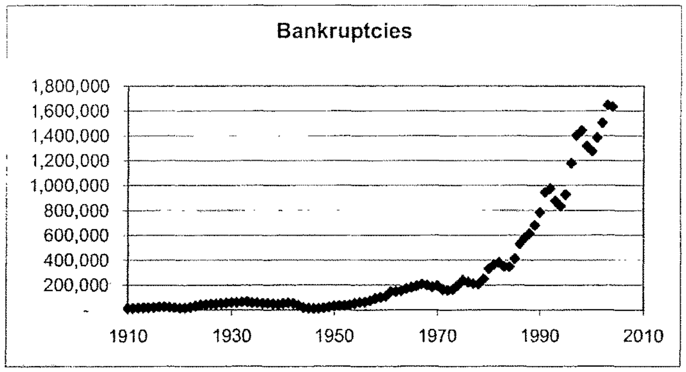
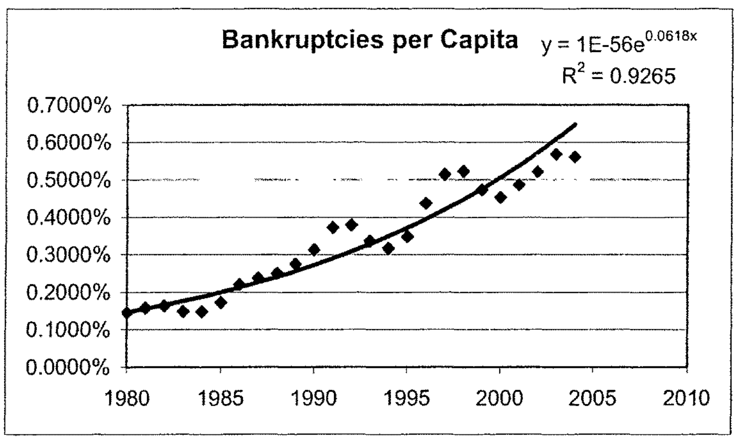


FIGURE 4

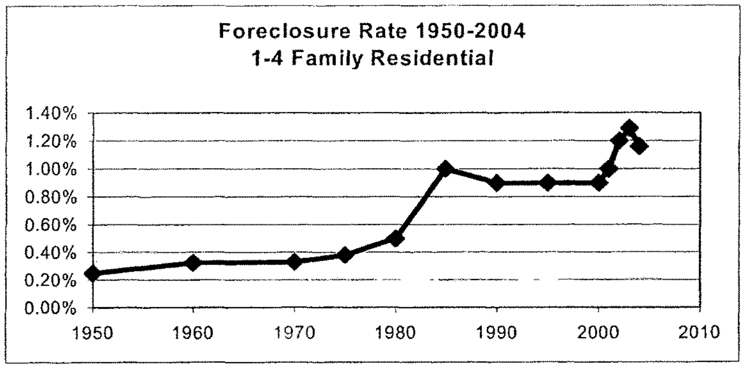


At the same time, mortgage foreclosures have also been rising.[52] In the post-Depression period, annual foreclosure rates averaged around 0.25% until the 1980's. Since 1980, foreclosure

[52] Elmer, Peter. J. and Seelig, Steven A., "The Rising Long-Term Trend of Single Family Mortgage Foreclosure Rates," FDIC Working Paper 98-2, Federal Deposit Insurance Corporation, 1998

rates have increased by a factor of 5, rising to 1.3% in 2003 (see Figure 5).[53] The last period in which foreclosure rates were this high was the 1930's.

FIGURE 5



The current rate of foreclosures on residential mortgages is about 1.16%,[54] which corresponds to 500,000 foreclosures.[55] The foreclosure rate in 1933 was about 5%.[56] ***If we were to experience the 1933 rate of foreclosures today, it would correspond to two million foreclosures per year.***

No responsible observer anticipates a recurrence of the Great Depression. Techniques of public financial management and regulatory supervision have improved immeasurably since that time. But there is little question that the current level of debt is placing an enormous strain on the economy's power to generate enough income to service the rising debt level. It is in precisely

[53]Historical Statistics of the United States, Series N 301 divided by Series N 302-307, p. 651 for 1930-1970; Mortgage Bankers Association, "National Delinquency Survey," various years, quoted in Statistical Abstract of the United States, various years.
[54] Mortgage Bankers Association, National Delinquency Survey, 2nd Quarter 2004
[55] Bureau of the Census, "American Factfinder," Table QT-H15 indicates that there were 39 million home mortgages outstanding in 2000.
[56] I.e., the 253,000 foreclosures in 1933 divided by 5 million mortgages outstanding. See "Historical Statistics of the United States Colonial Times to 1970," p. 651, Series 302-307

these circumstances that defaults on debt rise most quickly, and the greatest strain is placed on guarantors of financial payments. ***Under current circumstances, allowing a multiline combination of title insurance and mortgage guaranty or other financial guaranty insurance would be the height of imprudence.***

B. Solvency Risk Prospects of Multiline Combinations of Title Insurance with Other Insurance Lines

The other companies that have attempted to offer title insurance products in a multiline environment are catchall subsidiaries of multiline insurance groups, writing a variety of specialty coverages.[57] Table 3 lists the companies. The companies have policyholders' surplus ranging from $14 million to $340 million, which makes them much smaller than the primary title insurers. ***In aggregate, these companies have about one-fifth of the surplus of the monoline title insurance industry.***

TABLE 3

NON-MORTGAGE GUARANTY COMPANIES OFFERING ALTERNATIVE LIEN PROTECTION PRODUCTS

COMPANY	2003 Statutory SURPLUS
Chubb Custom Insurance Company	56,618,000
Great American	14,112,000
BancInsure/Matterhorn	30,237,000
St. Paul Medical Liability Company	47,622,000
Fidelity and Deposit of Maryland	165,944,000
United States Liability Insurance Co.	336,605,000
TOTAL	651,138,000
Title Industry	3,252,036,665

SOURCES:
Best's Insurance Reports - Property-Liability Edition, 2004 for property liability companies.
Demotech, Performance of Title Insurance Companies - 2004 Edition for title industry.

[57] The American Land Title Association website lists the companies and includes sample policy descriptions.

On the other hand, these companies are members of company groups that are much larger than most title insurers. An immediate question that arises, therefore, is whether the large size of the parent fully compensates for the small size of the subsidiary. The answer, of course, is partially but not completely. The recent A.M. Best study of insurer insolvencies indicates that 8% of all insurer insolvencies over the period 1991-2002 were due to the insolvency of an affiliate.[58] Being a member of a larger group is not a guarantee of safety.

It is unclear why these particular companies were selected by their company groups. In several cases, it appears to have been a mere subterfuge, designed to conceal the fact that the coverage is, in fact, title insurance.[59] But it is also noteworthy that these policies were placed in companies carrying primarily errors and omissions, surety, and other specialty commercial lines, which have historically been the lines most subject to major fluctuations in rates and loss experience. Based on data compiled in Best's Aggregates and Averages, over the period 1976-2002 the operating ratio of property casualty insurance as a whole had a standard deviation of 8.8%. In contrast, medical malpractice had a standard deviation of 20.4%, allied lines had a standard deviation of 34%, surety had a standard deviation of 19.4%, and fidelity had a standard deviation of 15.4%.[60]

C. Impact of Multiline Writing of Title Insurance on the Quality of the Title Insurance Product

Another important issue is the quality of the title work that a multi-product casualty company would tend to produce. Underwriting a title policy is much more complicated than

[58] A.M. Best, op. cit, p. 34, Exhibit 28
[59] For example, the Great American policy and United States Liability policy are described as errors and omissions policies, and the BancInsure/Matterhorn policy is described as a performance bond.
[60] Schwartz, Alan I., Pre-Filed Rebuttal Testimony in Docket 2538, Texas Department of Insurance, December 5, 2003, Exhibit AIS-31.

underwriting a casualty risk.[61] It takes only a small underwriting lapse to produce an enormous title loss, and ***25% of all titles require active underwriting intervention to cure an existing defect and prevent a loss.***[62] In recognition of this fact, title agents and escrow agents in most states are licensed separately from property-casualty insurance agents and, in the states with the largest title insurance markets, are required to pass specialized examinations and complete title-insurance-specific continuing education.[63] In some states, the specialized examination and licensure requirements also extend to the employees of the title insurer itself who are actively engaged in closing transactions.[64]

Whether the title underwriter is monoline or multiline would have relatively little impact on the work product of independent title insurance agents. However, about 41% of all title insurance is written by title insurer branch offices and agency subsidiaries.[65] There is certainly no theoretical barrier to a multiline insurer requiring specialized title insurance training for some of its employees. However, the practical consequence of treating title insurance as just another casualty line will inevitably be to produce mounting pressure to change licensure requirements to subsume title insurance into general casualty insurance practice. The concomitant diminution of title insurance underwriting expertise will inevitably lead to higher title losses and a progressively degrading public record.[66]

The next issue that requires some consideration is the security of the assets backing the title insurer's reserves. There are two primary classes of title insurance reserves: case-basis loss

[61] Lipshutz, Nelson R., "The Regulatory Economics of Title Insurance, Westport, Praeger, 1994, pp. 6-7
[62] American Land Title Association Research Committee, *Abstractor and Title Agent Operations Survey 2000*, American Land Title Association, 2000, Washington, DC
[63] Palomar, Joyce, "Title Insurance Law," Thomson-West, 2004, Chapter 18
[64] Cf., e.g., Texas Insurance Code, Chapter 9, Articles 9.41, 9.58 and Texas Department of Insurance Procedural Rule P-28.
[65] Demotech, Inc., "Performance of Title Insurance Companies – 2004 Edition," p. 47
[66] Lipshutz, Nelson R., "The Role of Title Insurance in Mortgage Finance," Washington, D.C., ALTA, 2004

reserves and unearned premium reserves. Case-basis loss reserves need no further comment. However, it is important to keep in mind that the so-called "unearned premium reserve" for title insurers is something of a misnomer, since it actually serves the economic function of an IBNR reserve. In contrast to all other property-casualty lines other than mortgage guaranty and financial guaranty, most state statutes require that the assets supporting the unearned premium reserve be sequestered and used solely for the purchase of reinsurance in the event of disaster.[67] No such special title policyholder protection would be available if title insurance were treated as simply another casualty line; the title policyholder would simply become part of the general group of casualty insureds, and would sink or swim depending on the adequacy of the overall reserves the insuring company established for all its lines. This change would represent a significant increase in the risk faced by title insurance policyholders. The A.M. Best insolvency study indicates that over the period 1991 to 2002, 49% of all insurance insolvencies were attributable to inadequate loss reserves.[68]

D. The Impact of Multiline Writing of Title Insurance on the Price of Title Insurance

Finally, we must address the real source of the developing pressure for multiline title insurers: the claim that it will reduce the cost of title insurance. The Title Insurance Working Group of the NAIC is currently studying issues including:

> "...whether monoline laws and regulations needlessly diminish competition; whether greater price competition among title insurers can be encouraged;..."[69]

[67] Cf., e.g., California Insurance Code, Sections 12380-12388
[68] A.M. Best, op. cit., p. 34, Exhibit 28
[69] National Association of Insurance Commissioners Title Insurance Working Group 2005 Charges, charge d.

In a previous study, we demonstrated that the particular title insurance product marketed by Radian Guaranty, Inc. produces no true consumer savings.[70] Here, we must address the broader question of the price impact, if any, of writing title insurance by any type of multiline company.

Title insurance is a loss prevention line, so that rates are driven primarily by production expenses, not by loss payments.[71] Title insurance riskiness is caused primarily by the interaction of its very volatile premium stream with its high fixed costs. Therefore, any anti-covariance of title insurance losses with losses in other lines (see note 18) would produce negligible reduction in the riskiness of title insurance, and would have no impact on title insurance prices.

More importantly, the search, examination, and closing activities of the title insurance process would be the same no matter what the business mix of the insurer. While economies of scale may exist in some administrative functions, administrative expenses make up only 15% to 30% of the title insurer's cost mix.[72] Accordingly, any scale economies in overhead functions that might be produced by multiline operations would not lead to significant title insurance price declines.

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[70] Lipshutz, Nelson R., "Consumer Impacts Of Substituting Radian Lien Protection Coverage For Refinance Lender's Title Insurance," ALTA, 2003

[71] Lipshutz, Nelson R., "The Regulatory Economics of Title Insurance," Westport, Oraeger, 1994, Chapter 1

[72] Title Insurance Rating Bureau of Pennsylvania, 2003 Statistical Report Results, p. 17 shows a ratio of 14%; Title Insurance Rate Service Association (New York), 2003 Statistical Report Composite, Schedules U-3, U-4, and U-5 show a ratio of 28%.

VI. IMPLICATIONS FOR PUBLIC POLICY

The monoline restriction for title insurance continues to make economic and regulatory sense. Our analysis of recent insurance industry history proves that the hazards of multiline operation that caused the demise of multiline title insurers in the 1930's and the institution of monoline requirements for title insurance still exist today. Our analysis of economic history demonstrates that the combination of rapid growth and excessive debt levels that exacerbated the Great Depression is being reconstructed in the contemporary economy. If title insurers are to be immune to the problems that any substantial economic downturn will produce in this environment, it is important that the monoline requirement be maintained.

INCORRECT CONCLUSIONS ABOUT COMPETITION IN THE CALIFORNIA TITLE AND ESCROW MARKETS ASSERTED IN THE DECEMBER 2005 CONTRACTOR REPORT TO THE CALIFORNIA INSURANCE COMMISSIONER

Preliminary Study prepared for the

American Land Title Association

by

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January 5, 2006

EXECUTIVE SUMMARY

The California Department of Insurance (DOI) recently commissioned an outside contractor to prepare a report entitled "An Analysis of Competition in the California Title Insurance and Escrow Industry" (henceforth the contractor report). The American Land Title Association asked Regulatory Research Corporation to review the report. Our most significant findings are that:

- The contractor report asserts that the California title insurance and escrow market is characterized by significant barriers to entry. This assertion is incorrect. The data show that 253 new escrow companies have entered the California market since 2003, and have opened 389 new offices. In fact, market entry is remarkably easy.

- The contractor report asserts that title insurers and underwritten title companies are earning excessive profits. This assertion is incorrect. The data show that title insurers earned a return on equity in 2004 which was less than the average for the Dow Jones Industrials or for the Standard and Poor's 500. The data also show that underwritten title companies earned a rate of return on equity in 2003 and 2004 which was less than that earned by accounting firms or legal services firms.

- The contractor report omits any analysis of the cyclicality of the industry. The profitability figures presented cover only the recent boom market. The title insurance industry is characterized by high fixed costs, and periods of high profitability alternate with periods of low profitability. The data show that during the real estate downturn of the 1980's, title insurers earned extremely low profits, i.e., a return on equity 30% below the interest rate on risk-free T-bills.

- The contractor report asserts that title insurers charge prices that are very close. This conclusion is produced by the contractor's exclusion of many California title insurers from the analysis. The DOI data on all California title insurers show that prices vary from 8% below to 21% above the average, and that escrow prices vary from 37% below to 68% above the average.

- The contractor report characterizes the monoline requirement as a barrier to entry. The monoline restriction is not a barrier to entry, but is a well-considered consumer safeguard, established by almost every state legislature because of the catastrophic failures of multiline companies that wrote both title insurance and mortgage insurance.

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1. INTRODUCTION

California has long been recognized as the pioneer and the strongest state advocate for competitive insurance rate setting. The California Legislature has enacted a statute that allows the Commissioner of Insurance to intervene in the rate-setting process of the marketplace only if "(1) the rate is unreasonably high for the insurance or other services provided, and (2) a reasonable degree of competition does not exist in the particular phase of the business of title insurance to which the rate is applicable." (California Code 12401.3)

The California Department of Insurance (DOI) has recently commissioned an outside contractor to prepare a report entitled "An Analysis of Competition in the California Title Insurance and Escrow Industry" (henceforth the contractor report). The report concludes that workable competition does not exist in these industries. Based upon this conclusion, DOI has announced that it intends to initiate rate regulation in accordance with California statutes.

As a prelude to such regulatory action, DOI has invited participation in a workshop to discuss the findings in the contractor report. In response to DOI's invitation, the American Land Title Association asked Regulatory Research Corporation to review the report and to provide our findings to DOI. Because the time between the release of the report and the date of the workshop was so short, the present document is preliminary and may be substantially expanded at a later date.

2. THE CONTRACTOR REPORT INCORRECTLY ASSERTS THAT "REVERSE COMPETITION" IS A UNIQUE FEATURE OF TITLE INSURANCE RATHER THAN A STANDARD TYPE OF MARKETING TO DISTRIBUTORS USED BY MANY INDUSTRIES.

"Reverse competition" is not a term of art in economic theory, and owes its origin to an almost 30 year old report by the Department of Justice.[1] The contractor report describes reverse competition as: "This competition is called reverse competition because market forces cause title insurers and escrow companies to spend money to obtain business – costs that are passed on to consumers."

Every business spends money to obtain business. The specific type of marketing which the report calls "reverse competition" occurs in every industry with a distributor layer. Drug companies market primarily to physicians who prescribe drugs, not to patients who take them. Auto manufacturers compete for representation by accomplished multi-brand dealers. Food product vendors bid for shelf space in supermarkets. Manufacturer's reps in a multiplicity of product lines compete to have retailers carry their products. There is nothing special or unusual about title insurance and escrow companies competing for distributors.

The alternative to marketing to distributors is direct marketing to the final consumer. The report does not analyze whether the marketing costs produced by marketing to realtors, lenders, et. al. are any higher than the marketing costs that would be incurred if title insurers, underwritten title companies, and escrow companies attempted to market directly to consumers. Further, if marketing directly to consumers were effective, profit-maximizing companies would do such marketing in addition to marketing to distributors. For example, drug companies now advertise prescription drugs extensively because such activity is now permitted. Title and escrow

[1] The Pricing and Marketing of Insurance, Department of Justice, January 1977

companies have always been permitted to advertise directly to ultimate consumers. Since the Internet has exploded, title companies do indeed market extensively to consumers through their websites, many of which include a detailed explanation of the product in consumer-friendly language. But title and escrow companies have also found over the years that direct advertising to the public is of limited efficacy.

This is not the case when title and escrow fees are advertised by lenders. Even cursory perusal of the real estate section of any California newspaper reveals a wide variety of print advertisements by lenders that explicitly promote low closing charges a reason to elect that lender for financing.

Further, it is becoming progressively less frequent for lender's title insurance costs to be passed through to borrowers. A substantial fraction of new and refinance mortgage loans are now originated on a "no closing costs" basis, with the insured lender paying the premium and escrow fees. For example, a recent article quotes Countrywide, a major mortgage lender, as indicating that 40% of its refinance loans are issued on this basis.[2] In these cases, the lender is strongly motivated to shop for the best price, because it can only recover its costs through the interest rate, which itself is subject to enormous competitive pressure. Since refinance transactions have constituted up to 66% of all mortgage originations in recent years,[3] competition for "no-cost" loan business has acted as a brake on rates.

This is not to say that "no-cost"loa ns are an unmixed blessing. While they do provide some downward pressure on title and escrow rates, they place upward pressure on interest rates. Professor Guttentag, cited in the contractor report, points out that the consumer's increased

[2] http://loan.yahoo.com/m/refi1.html
[3] "1-4 Family Mortgage originations 1990-2003" and "Mortgage Finance Forecast," Mortgage Bankers Association

interest cost more than offsets any possible decrease in the consumer's title insurance and escrow costs for loans held for more than a very few years.[4]

3. THE CONTRACTOR REPORT MISINTERPRETS THE BEHAVIOR OF CALIFORNIA TITLE INSURANCE PRICES AS EVIDENCE FOR THE ABSENCE OF PRICE COMPETITION

The contractor report concludes that the California title insurance and escrow markets are not price competitive. In particular, the contractor's report adduces a lack of price competition from the fact that "the rates of the major insurers are very similar. The absence of diversity among filed rates also indicates a lack of price competition."[5]

At the threshold, the claim that rates are "very similar" is incorrect. The high and low owner's title insurance rates reported range from 3.4% above the average to 5.9% below the average.[6] This substantially understates the actual range in the market. The DOI website presents title insurance rates which span a much greater range. When all the companies are included, the range runs from 16% above the average to 8% below the average.[7] For lender's polices, the range runs from 13% above the average to 21% below the average. The analysis is set forth in Table 1.

[4] http://www.mtgprofessor.com/A%20-%20Refinance/does_no-cost_refinance_make_sense.htm
[5] Contractor report p. 88
[6] Ibid., p. 89
[7] We excluded the rates reported for United Capital and North American because they vary so much from the norm that they appear to be in error. If these companies were included, the variation would be even greater.

TABLE 1

CALIFORNIA TITLE AND ESCROW FEES FOR FRESNO REPORTED ON DEPARTMENT OF INSURANCE WEBSITE (2003 Rates)

Company Name	Title Homeowner Fee	Title Lender Fee	Escrow Sale Fee	Escrow Loan Fee
CHICAGO TITLE INSURANCE COMPANY	1695	609	875	700
COMMERCE TITLE INSURANCE COMPANY	1954	475	1500	N/A
COMMONWEALTH LAND TITLE INSURANCE COMPANY	1652	611	700	N/A
FIDELITY NATIONAL TITLE INSURANCE COMPANY	1695	603	700	560
FIRST AMERICAN TITLE INSURANCE COMPANY	1572	597	1025	820
LAWYERS TITLE INSURANCE CORPORATION	1551	676	842	N/A
NATIONAL TITLE INSURANCE OF NEW YORK, INC.	1695	608	1500	1500
OLD REPUBLIC NATIONAL TITLE INSURANCE COMPANY	1799	607	N/A	N/A
SECURITY UNION TITLE INSURANCE COMPANY	1572	597	N/A	N/A
TICOR TITLE INSURANCE COMPANY OF FLORIDA	1695	609	N/A	N/A
TICOR TITLE INSURANCE COMPANY	1572	597	N/A	N/A
TRANSNATION TITLE INSURANCE COMPANY	1603	545	700	N/A
UNITED GENERAL TITLE INSURANCE COMPANY	1677	605	N/A	N/A
WESTCOR LAND TITLE INSURANCE COMPANY	1726	680	N/A	N/A
N.B. Excludes North American and United Capital				
AVERAGE	1,690	602	980	895
MAXIMUM	1,954	680	1,500	1,500
MINIMUM	1,551	475	700	560
Deviation from Average				
CHICAGO TITLE INSURANCE COMPANY	0%	1%	-11%	-22%
COMMERCE TITLE INSURANCE COMPANY	16%	-21%	53%	NA
COMMONWEALTH LAND TITLE INSURANCE COMPANY	-2%	2%	-29%	NA
FIDELITY NATIONAL TITLE INSURANCE COMPANY	0%	1%	-29%	-37%
FIRST AMERICAN TITLE INSURANCE COMPANY	-7%	-1%	5%	-8%
LAWYERS TITLE INSURANCE CORPORATION	-8%	12%	-14%	NA
NATIONAL TITLE INSURANCE OF NEW YORK, INC.	0%	1%	53%	68%
OLD REPUBLIC NATIONAL TITLE INSURANCE COMPANY	6%	1%	NA	NA
SECURITY UNION TITLE INSURANCE COMPANY	-7%	-1%	NA	NA
TICOR TITLE INSURANCE COMPANY OF FLORIDA	0%	1%	NA	NA
TICOR TITLE INSURANCE COMPANY	-7%	-1%	NA	NA
TRANSNATION TITLE INSURANCE COMPANY	-5%	-9%	-29%	NA
UNITED GENERAL TITLE INSURANCE COMPANY	11%	1%	NA	NA
WESTCOR LAND TITLE INSURANCE COMPANY	2%	13%	NA	NA
MAXIMUM	16%	13%	53%	68%
MINIMUM	-8%	-21%	-29%	-37%

The escrow rates reported within a county vary substantially, as indicated in the contractor report.[8] However, the contractor report also substantially understates the actual range. For example, the contractor's report shows escrow charges in Fresno for a $500,000 transaction ranging from $700 to $1,025 or from 13% below to 27% above the average. If all companies are included, the Fresno escrow rates for a $500,000 purchase transaction actually range from $700

[8] Contractor report., p. 22

to $1,500 or from 29% below to 53% above the average; and loan escrow rates vary from $560 to $1,500 or from 37% below to 68% above the average. Table 1 also sets forth this analysis.

The contractor's exclusion of the rates charged by companies other than the very large ones he selects biases his analysis. California title insurance and escrow companies are clearly jockeying for market share within each single geographic home purchase market by varying their prices substantially.

Even if one were to accept the contractor's incorrect assertion that rates are "very similar," his conclusion that this demonstrates a lack of price competition is seriously in error. In a highly competitive market, the prices charged for a given product by different vendors will be close. (In a perfectly competitive market, there would be no variation at all. Perfect competition, however, is not an ideal model. Economic research has demonstrated that some deviation from perfect competition is essential to product innovation.)

Another serious problem with the contractor's report is that it confines itself to the basic rates and a single refinance rate. The level of basic rates is an imperfect measure of title insurance prices. Much price competition in the industry occurs through the development of special rates discounted from the basic rate. A more accurate indicator of price competition would have been the competitive response by other market participants to the introduction of a new discounted rate product.

4. THE CONTRACTOR REPORT INCORRECTLY CHARACTERIZES BARRIERS TO ENTRY IN THE CALIFORNIA TITLE INSURANCE AND ESCROW MARKET

The contractor report concludes that "We found the biggest barrier to entry to be established relationships between the entities that can steer the consumer's title and escrow business to the entities who sell title insurance and escrow services."[9] This is an incorrect characterization.

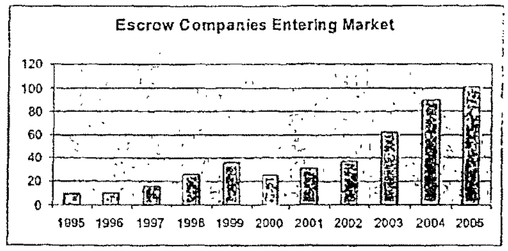
Established business relationships are generally not a barrier to entry. All businesses have business relationships. The very essence of competition is to act so as to change these relationships – with suppliers, with distributors, and with customers. Therefore, the best way to determine if unreasonable barriers to entry exist is to examine whether market entry and exit has occurred.

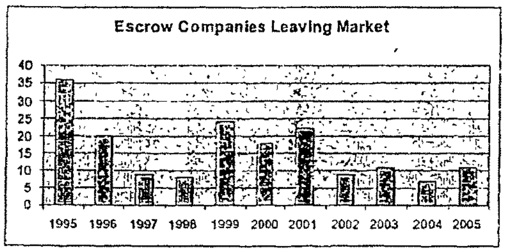
Entry and exit from the title and escrow industry has been extensive, particularly at the escrow company level. Figures 1 and 2 show the numbers of companies and offices entering and exiting from the escrow business over the period 1995-2005, based on license statistics from the California Department of Corporations, Financial Services Division.[10] Figure 1 shows that 90 companies entered the market in 2004, and 101 companies entered the market in 2005. This ease of entry is accompanied by ease of exit. Figure 1 also illustrates that companies leave the industry rapidly in less buoyant times. For example, in 1995 when title insurance revenues dropped about 17%, 36 companies left the business.

[9] Contractor report, p. 93
[10] www.corp.ca.gov/fsd/lic/index.pl

FIGURE 1

COMPANIES ENTERING AND EXITING THE CALIFORNIA ESCROW MARKET

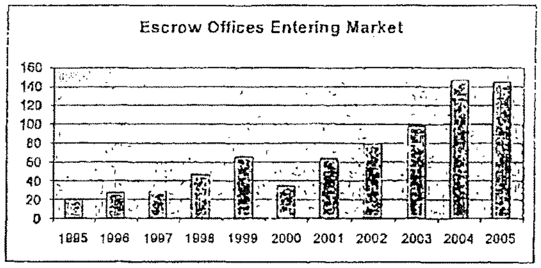


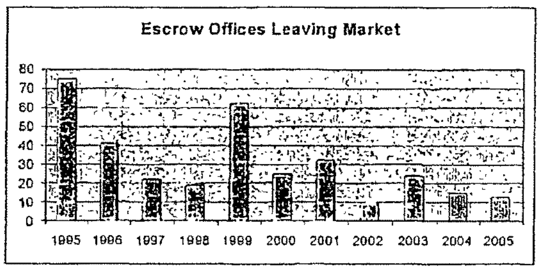


The rates of entry and exit are even greater when measured at the office level. Not only did hundreds of companies enter the market in recent years, but existing companies expanded to new portions of the market by opening additional branch offices. Figure 2 shows that over 147 offices were opened in 2004 and 144 offices were opened in 2005. Similarly, in 1995 some 75 offices closed. Barriers to entry into and out of the industry are clearly quite low.

FIGURE 2

OFFICES ENTERING AND EXITING THE CALIFORNIA ESCROW MARKET





The contractor report also indicates, in its discussion of the Fidelity v. Mercury lawsuit, that a lack of competition can be deduced from the fact that "recruiting title and escrow employees from competitors was commonplace in California."[11] The existence of competition for skilled personnel characterizes every business. Attorneys migrate from firm to firm, taking their clients with them, yet no one would dispute that the market for legal services is highly competitive. The critical point is that title insurance and escrow services are not a simple, homogeneous commodity. The non-price aspects of the real estate closing process dominate consumers' choices. This is quite rational behavior. Rapid and correct closing of real property

[11] Contractor report., p.39

transactions results in considerable cost savings, for example, from shorter rate lock periods (which allow lower interest rates),[12] and shorter periods during which sellers continue to pay interest on the loans on the property they are selling.[13]

5. THE CONTRACTOR REPORT PLACES UNDUE EMPHASIS ON THE DEGREE OF CONCENTRATION IN THE MARKET

The contractor report points out that the California title insurance and escrow markets are concentrated at the insurer level, whether measured statewide or at the county level.[14] High concentration (as measured by the market share of the top few firms or the HHI) is not, in itself, an indicator of lack of competition. The 1997 DOJ-FTC Horizontal merger guidelines emphasize that a market in which entry is easy will be competitive even if a few firms have large market shares, because the threat of new entrants holds prices down to the competitive level.[15] The analysis in Section 4 above demonstrates that entry into the marketplace has been extensive.

Much of the distribution of title insurance and escrow products is carried out by underwritten title companies and independent escrow companies. The concentration of the marketplace, whether statewide or at the county level, is better measured by the HHI for these distribution outlets, particularly with respect to escrow services in southern California. The contractor report fails to consider this issue at all.

---

[12] Economic Benefits of Permitting Title Insurance Sales in Iowa, Regulatory Research Corporation, 2004, pp. 10 and 34 Table 14, available on Iowa Land Title Association website.
[13] The Role of Title Insurance in Mortgage Finance and Home Ownership, Regulatory Research Corporation, 2003, pp. 18 and 22 footnote 19, available on American Land Title Association website.
[14] Contractor report, pp. 61 ff.
[15] Horizontal Merger Guidelines, Department of Justice and Federal Trade Commission, Revised April 8, 1997, pp. 27 ff.

6. THE REPORT INCORRECTLY ASSERTS THAT THE TITLE INSURANCE INDUSTRY IS EARNING EXCESSIVE PROFITS WITHOUT ANY CONSIDERATION OF THE LEVEL OF PROFIT THAT IS APPROPRIATE FOR THE INDUSTRY

The report makes no attempt to assess the profitability of the title insurance industry compared to other industries, but simply asserts that its profits are excessive. High profitability is not unusual during economic booms. Yahoo finance data for public companies indicate that the 2005 return on equity for the companies in the Dow Jones Industrial Average was 21%, and the average for the Standard & Poor's 500 companies was 22%, well above the profitability of 12% to 18% for title insurers nationwide in 2004 reported in Table 6 of the contractor report. Further, the return on equity of many companies even in extremely competitive sectors of the economy reached much higher levels than those achieved by the insurers or underwritten title companies. For example, in the pharmaceutical industry, the 2005 return on equity of Glaxo-Smith Kline was 49%, and Kinetic Concepts had a return on equity of 193%. In the computer industry, Dell had a return on equity of 60%. In the extremely competitive consumer goods industry, Proctor and Gamble had a return on equity of 45%, Colgate-Palmolive had a return on equity of 100%, and Avon had a return on equity of 119%.

Returns on equity are even higher for service industries similar to underwritten title companies and escrow companies, which include many small, closely held companies with moderate levels of capital investment. For example, Bizstats reports 2005 returns on equity of 67% for accountants and auditors, and 101% for legal services. The return on equity data are summarized in Table 2.

TABLE 2

RATES OF RETURN ON EQUITY 2005

Dow Jones Industrial Average	21%
S&P 500	22%
Glaxo-Smith-Kline	49%
Kinetic Concepts	193%
Dell Computer	60%
Proctor & Gamble	45%
Colgate-Palmolive	100%
Avon Products	119%
Title Insurers 2004	12.5% - 17.3%
Accountants and auditors	87%
Legal Services	101%
Underwritten Title Companies 2004	32.3%

7. THE CONTRACTOR REPORT INCORRECTLY ASSERTS THAT THE LACK OF IMMEDIATE RATE RESPONSE TO CHANGES IN COSTS IS INDICATIVE OF LACK OF COMPETITION

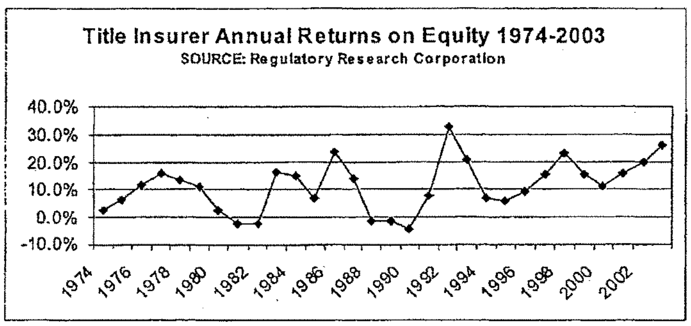
The contractor's report asserts that lack of an immediate price response to any change in cost is indicative of a lack of price competition.[16] This assertion is incorrect.

The title insurance market is highly cyclical, because it is linked to the volatile and unpredictable real estate and refinancing markets. The title insurance industry is characterized by high fixed costs, because of the need to keep title plants current and to retain highly skilled employees who require years of training. Accordingly, title insurers adjust their rates to compensate for secular trends in long-run marginal cost, not random year-to-year fluctuations, so

[16] Contractor's Report p. 91

as to generate an adequate profit ***on average over the real estate cycle,*** as periods of high profitability alternate with periods of low profitability. The contractor's report examines profitability only in the period 1995-2004, an extremely good time for the industry. During the decade 1980-1990, the title industry had a return on equity which averaged 6%, which was a third less than the return on riskless Treasury bills. Figure 3 presents the title insurance industry's nationwide return on equity over the period 1974-2003 based on figures compiled by the Texas Department of Insurance, adjusted to a GAAP basis.[17]

FIGURE 3



8. THE CONTRACTOR REPORT PRESENTS NO ANALYSIS OF COST TRENDS IN THE TITLE INSURANCE AND ESCROW INDUSTRIES

The contractor's report repeatedly asserts that the costs of title insurers, underwritten title companies, and escrow companies have declined markedly due to increasing automation.[18]

[17] For a description of the adjustment process, see Pre-filed Direct Testimony of Dr. Nelson R. Lipshutz, Texas Department of Insurance Docket 2538
[18] Contractor report pp. 3, 88, 91, 94

However, the contractor has made no analysis of any actual cost data, but has relied solely on a popular article published by A.M. Best.

Automation lets one do a job better and faster, but not necessarily cheaper. Automation is not free. While it is certainly true that the cost of computer hardware has declined, the cost of software continues to climb. For example, a study by the Texas Comptroller of Public Accounts showed that the software costs (including license fees and support fees) of Texas state government increased by 49% from 1994 to 1997, and were projected to increase another 160% from 1997 to 2004.[19]

9. THE CONTRACTOR REPORT DOES NOT ACKNOWLEDGE THE POLICY REASONS FOR THE MONOLINE REQUIREMENT NOR RECOGNIZE THE BENEFITS OF MONOLINE PROTECTION FOR CONSUMERS

The contractor report lists the monoline requirement as a barrier to entry.[20] However, the monoline restriction is not a barrier to entry, but is a well-considered consumer safeguard, established by almost every state legislature because of the catastrophic failures of multiline companies that wrote both title insurance and mortgage insurance. Cavalier disregard of the need for business restrictions in industries with a large fiduciary component can lead to untoward results. The financial collapse of the S&L industry in the 1980s was caused in large part by the relaxation of restrictions on the businesses in which S&L's could engage. The monoline restriction constitutes sound legislative and regulatory policy.[21]

[19] Texas Performance Review, March 1999, Chapter 3, Exhibits 1 and 3
[20] Contractor report, p. 66
[21] The Role of the Monoline Requirement in Assuring Title Insurance Effectiveness, Regulatory Research Corporation, 2005, passim. Available on American Land Title Association website. See also proceedings of the NAIC Title Insurance Working Group, Chicago, December 4, 2005.

WORKSHOP REGARDING TITLE INSURANCE COMPETITION REPORT AND IMPLICATIONS FOR RATE REGULATION

Statement of Michael J. Miller, FCAS, MAAA

on behalf of the

California Land Title Association

January 5, 2006

Introduction

My name is Michael J. Miller. My business address is 138 Lakeshore Drive, Minocqua, Wisconsin 54548.

I obtained a Bachelor of Science degree in 1968 from Illinois State University, with a major in mathematics and a minor in accounting. In 1967, prior to graduation, I began working for State Farm Insurance as an actuary trainee. I continued working for State Farm until 1984, serving in various management roles where I had insurance rate-setting responsibilities. Thereafter, I was a Principal and Vice President at Tillinghast, an international property/casualty consulting firm. I remained with Tillinghast through 1993 at which time I became a Principal in Miller, Herbers, Lehmann, & Associates. In 2003 I helped establish a new actuarial consulting firm EPIC Consulting, LLC which we merged into the Tillinghast practice in October 2004.

I am a Fellow of the CAS and have been a member of the American Academy of Actuaries since 1975. I have satisfied all of the qualification and continuing education requirements of my profession to render a public actuarial opinion on ratemaking issues and have testified as an expert actuary in several state and federal courts and at governmental insurance ratemaking administrative hearings in many U.S. states and Canadian provinces. A copy of my *curriculum vitae*, which accurately sets forth my experience, qualifications, and publications, is attached hereto as Exhibit A.

Through my work in the insurance industry since 1967, I have been directly involved in the development of professional standards that guide actuaries in areas of property/casualty actuarial practices. I have served the Actuarial Standards Board as chair of the Property/ Casualty Committee. I have served the Casualty Actuarial Society (CAS) as Vice President for Research/Development and Chair of the committees on Risk Classification and Principles of Ratemaking. As chair of the Ratemaking Committee, I was the principal drafter of the

Statement of Ratemaking Principles and was the sole author of the first draft. I have served two terms on the CAS Board of Directors.

Scope of Work

In preparation for this affidavit, I reviewed a report authored by Mr. Birny Birnbaum entitled "An Analysis of Competition in the California Title Insurance and Escrow Industry". I found no analysis in the report of the type necessary in order for Mr. Birnbaum to support his conclusion that title insurers are charging excessive rates.

Actuarially Sound Rates

Actuaries specialize in the calculation of insurance rates based on generally accepted actuarial principles and standards of practice. Actuarially sound rates are reasonable, adequate, not excessive, and not unfairly discriminatory if the rates reflect all the costs associated with the risk transfer process. The four broad categories of costs included in ratemaking are claim costs, expenses associated with settling claims, general/administrative expenses, and the cost of capital.

Prospective Ratemaking

Ratemaking is necessarily prospective in nature because the rate is set before the issuance of a policy and before any losses and expenses are incurred. Insurance rates are based on prospective loss costs, prospective expenses and a prospective estimate of the cost of capital. Determinations concerning the adequacy or excessiveness of insurance rates cannot be made unless there is an actuarial analysis of the reasonableness of the prospective costs which were included in the rate. This prospective analysis of costs would be necessary in order for Mr. Birnbaum to support his conclusion that title insurance rates are excessive. His report contains no actuarial analysis of rate adequacy or excessiveness.

Insurer Specific Rates

Ratemaking is insurer specific. Broad, sweeping statements about the excessiveness of rates on an industrywide basis have no significance. Each insurer has its own expectations concerning future losses and expenses. Each insurer has a unique capital structure and unique cost of capital. Mr. Birnbaum has not conducted the actuarial analysis of the prospective costs for any specific insurer which would be necessary to support an opinion that any insurer's rates were excessive.

Title Insurance Risk

Title insurers conduct extensive loss prevention activities intended to reduce claim losses covered by the insurance policy. Reduced loss payments does not mean that title insurance is necessarily a low-risk line of insurance. Title claims may develop 25 to 30 years after the policy issuance. Title insurers are required by law to maintain statutory premium reserves for as much as 20 years so as to provide sufficient protection for this very long period of claim occurrence. The financial results of a title insurer are highly sensitive to economic cycles, especially cycles in the real estate market. Birnbaum has cited financial results from a five-year period (Birnbaum Report at page 109) without any analysis to determine whether these results are being distorted by an up-cycle or down-cycle in the financial results.

Rates of Return

At page 109 of his report, Mr. Birnbaum cites "ROE" returns in the range of 10.16% to 38.40%. These returns are mislabeled and are not returns on the insurers' equity capital. Rather, the "ROE" returns are expressed as a percentage of statutory surplus. Statutory surplus does not equal equity capital. Mr. Birnbaum made no effort to determine the equity capital of any title insurer, or the industry as a whole.

Also unexplained by Mr. Birnbaum is why his "ROE returns" (actually returns on surplus) on page 109 are significantly different than the yearly change in statutory surplus.

For instance, Mr. Birnbaum alleges a 24.69% ROE in 2004, but in 2004 statutory surplus increased only 1.9%.

Cost of Capital

Rates are not excessive unless the rates are likely to produce a return that is unreasonably higher than a specific insurer's cost of capital. A determination of rate excessiveness requires a determination of both the insurer's cost of capital and a range of reasonable returns above the cost of capital benchmark. Mr. Birnbaum has conducted no analysis of either the cost of capital for any title insurer or the range of reasonable returns above the cost of capital. Without a cost of capital benchmark for each insurer, and a range of reasonable returns above the cost of capital, there can be no basis for Mr. Birnbaum's conclusions concerning title insurance rate excessiveness.

Exhibit A

CURRICULUM VITAE

NAME:	Michael J. Miller	
BUSINESS ADDRESS:	138 Lakeshore Drive Minocqua, WI 54548 E-Mail: mike.miller@towersperrin.com	
EDUCATION:	ILLINOIS STATE UNIVERSITY Bachelor of Science – 1968 Major – Mathematics Minor – Accounting	
CONTINUING EDUCATION:	Estimated study time exceeding 3,000 hours necessary for completion of 10 qualifying exams for membership in Casualty Actuarial Society (CAS). Participation as an attendee and on the faculty of the CAS Loss Reserve Seminar, the CAS Ratemaking Seminar, and other CAS educational seminars on special topics, such as rate of return and underwriting practices. Meet all continuing education requirements of the American Academy of Actuaries necessary to sign a public actuarial opinion.	
MEMBERSHIP IN PROFESSIONAL ORGANIZATIONS:	Casualty Actuarial Society (CAS)	
	Associate Member	1971
	Fellow	1981
	American Academy of Actuaries (AAA)	1975
	Conference of Consulting Actuaries	2002-2004
	Fellow	
	International Actuarial Association	
	Midwestern Actuarial Forum	
	Chartered Life Underwriter (CLU)	

PROFESSIONAL ACTIVITIES:	CAS Committee on Risk Classification,	
	Member	1982-1984
	Chairman	1983-1984
	CAS Committee on Principles of Ratemaking	
	Member	1985-1987
	Chairman	1991-1992
	CAS Examination Consultant	1987-1990
	CAS Long-Range Planning Committee	1993-1994 1997-2000
	CAS Board of Directors	1992-1993 2001-2003
	CAS Officer,	
	Vice President – Research and Development	1993-1996
	CAS Task Force on Non-Traditional Practice Areas	
	Chairman	1998-2000
	CAS/SOA Joint Task Force on Financial Engineers	1998-2001
	AAA, Liaison Committee to the National Association of Insurance Commissioners	1985-1988
	Actuarial Education and Research Fund Board of Directors	1994-1996
	AAA, Casualty Practice Council	1990-1993
	Property Casualty Committee of Actuarial Standards Board, Member	1987-1993
	Chairman of Ratemaking Subcommittee	1987-1988
	Chairman of Property/Casualty Committee	1989-1993
	Midwestern Actuarial Forum	
	Education Officer	1986-1987
	President	1988
EMPLOYMENT HISTORY:	State Farm Insurance	1967-1984
	M. J. Miller and Company	1984
	Tillinghast	1984-1993
	Miller, Herbers, Lehmann, & Associates, Inc.	1994-2002
	EPIC Consulting, LLC	2003-2004
	Tillinghast/Towers Perrin	2004

PROFESSIONAL PUBLICATIONS:	"Private Passenger Automobile Insurance Ratemaking", Proceedings of CAS, Volume LXVI.
	"Review – Risk Classification Standards by Walters", Proceedings of CAS, Volume LXVIII.
	"A History of the Rating and Regulation of Personal Car Insurance in the United States", The Institute of Actuaries of Australia, February, 1990.
	"An Evaluation of Surplus Allocation Methods Underlying Risk Based Capital Applications", CAS Discussion Paper Program, Volume I, 1992.
	"How to Successfully Manage the Pricing Decision Process", CAS Discussion Paper Program, 1993.
	"Building a Public Access PC-Based DFA Model", CAS Forum, Summer 1997, Volume 2.
	"Auto Choice: Whose Fault Is It Anyway", Contingencies, January/February 1998
	"Actuarial Implications of Texas Tort Reform", CAS Forum, Spring 1998.
	"The Relationship of Credit-Based Insurance Scores to Private Passenger Automobile Insurance Loss Propensity", June 2003.
PRESENTATIONS:	Faculty member on National Association of Insurance Commissioners' orientation program for new insurance commissioners, 1987-1994.
	Faculty member on National Association of Independent Insurers' seminars on ratemaking and loss reserving.
	"Key Provision in Rate Filings", Society of State Filers.
	Numerous presentations at educational seminars and meetings conducted by the Casualty Actuarial Society on topics including ratemaking, loss reserving, underwriting, risk classification and rate of return.
EXPERT TESTIMONY:	Rate Regulatory Hearings in Alberta, California, Florida, Georgia, Louisiana, Maryland, Massachusetts, Michigan, Mississippi, New Brunswick, New Jersey, New York, North Carolina, Ohio, Oklahoma, Ontario, Pennsylvania, Texas, Vermont, West Virginia, and Wyoming.

Courts in Alabama, California, Florida, Minnesota, Mississippi, New Hampshire, Pennsylvania.

An Economic Analysis of the December 2005 Birney Birnbaum Report to the California Insurance Commissioner

Comments submitted to the California Department of Insurance's January 5, 2006
Workshop Regarding Title Insurance Competition Report and Implications for Rate Regulation

Gregory S. Vistnes, Ph.D.
Vice President
CRA International
Washington, DC

January 5, 2006

INTERNATIONAL

I. OVERVIEW & SUMMARY

I have been retained by the California Land Title Association to review the December 2005 report by Birney Birnbaum ("the BB report") that was commissioned by the California Insurance Commissioner. I have been asked to assess whether the economic analyses in that report are correct and can be relied upon for making policy decisions.[1]

The BB report concludes that a "reasonable" degree of competition does not exist in California's title insurance market. This conclusion has no basis in fact, and flows from an inappropriate and error-ridden analytic methodology.

The BB report also fails to define its standard for distinguishing between markets that do, and do not, exhibit a "reasonable" degree of competition. As such, its conclusion about whether California's title insurance market is "reasonably competitive" is entirely subjective. It is clear, however, that the BB report did *not* use an economically-based standard to define "reasonable" competition. To use that economically-based standard would require analyzing the likely costs and benefits of rate regulation; that analysis, however, is entirely absent from the BB report.

Any one of these flaws and errors would call for rejecting the BB report's conclusion that there is not a "reasonable" degree of competition in the California title insurance market. Collectively, these flaws and errors make the BB report an entirely unsuitable study upon which to base public policy decisions. As such, that conclusion should be disregarded by public policymakers.

Significant errors in the BB report include the following:

- The BB report incorrectly asserts a lack of price competition among title insurers, ignoring evidence that title insurers have filed for rate reductions and price discounts.
- The BB report incorrectly focuses exclusively on price competition, ignoring the fact that non-price competition (e.g., service) is also a significant aspect of competition that benefits consumers.
- Recent investigations by the U.S. Federal Trade Commission suggest that, as long as title insurers have access to title plants, title insurance markets will likely be competitive. The BB report ignores this significant fact and fails to reconcile it with its own conclusion.
- The BB report inappropriately assesses competition by looking at simple market concentration measures (HHIs and market shares), an approach that economists have long recognized as potentially misleading.

[1] Although the BB report also opines on the market for escrow services, my review is limited to that report's opinions regarding the title insurance market.

- The BB report provides only a limited and superficial competitive analysis, and fails to conduct the fact-intensive analysis called for by the federal antitrust agencies' *Merger Guidelines*.
- The BB report incorrectly appears to treat "perfectly competitive" markets as the benchmark against which the title insurance industry should be judged when assessing whether there is a "reasonable" degree of competition. It is well known, however, that "perfectly competitive" markets do not exist, making this an unrealistic benchmark.
- Other than the unobtainable standard of "perfect competition," the BB report never addresses the question of what constitutes "reasonable" competition, nor does it make any attempt to compare the state of competition in California to that standard. This renders the BB report's conclusion entirely subjective.
- The BB report's conclusion that there is not a "reasonable" degree of competition is necessarily flawed inasmuch as the BB report never considered the costs and benefits of any alternative regulatory regime that his conclusion might suggest.

II. QUALIFICATIONS

I am an economist specializing in the fields of industrial organization and the economics of competition. I hold a Ph.D. in economics from Stanford University in California and a B.A. from the University of California at Berkeley. I have published, made professional presentations, testified, and consulted in the areas of industrial organization, competition, and antitrust economics for over 15 years. I am currently a Vice President in the Washington, DC office of CRA International ("CRA"), an economics and business consulting firm. A copy of my curriculum vitae is attached as Exhibit 1.

Prior to joining CRA, I have held several positions at both federal competition agencies: the U.S. Federal Trade Commission ("FTC") and the U.S. Department of Justice's Antitrust Division. In each of those positions, I was involved in formulating federal policy regarding competition and antitrust, as well as assessing expert studies and reports to determine whether they could be relied upon in the policy making process. Immediately before joining CRA, I was the Deputy Director for Antitrust at the FTC's Bureau of Economics. In that position, I was responsible for directing the economic analysis of all antitrust matters before the FTC and overseeing its staff of approximately 40 Ph.D. economists. I have also held several positions in the Economic Analysis Group of the U.S. Department of Justice's Antitrust Division, including Assistant Chief of the Economic Regulatory Section and Manager for Health Care Matters. In all of these positions, my antitrust analyses have focused on assessing competition among firms.

III. THE BB REPORT INCORRECTLY FAILS TO ACKNOWLEDGE PRICE COMPETITION

The BB report fails to acknowledge the presence of price competition among California title insurers. In this section, I point out that price competition does, in fact, occur.

A. Lenders Stimulate Price Competition Among Insurers

The BB report argues that title insurers do not compete on the basis of price in California.[2] Yet even the BB report's conclusion regarding this very limited aspect of competition – price competition – is wrong.

For both new/resale and refinance transactions, title insurance companies compete for the recommendations of mortgage lenders and other real estate professionals.[3] For example, a real estate professional will frequently recommend those title insurance companies that offer the most favorable price (and non-price) offerings. Thus, even if the individual consumer is not actively involved in selecting among competing title insurance companies, the real estate professional frequently will be.

In fact, real estate professionals are better positioned than individuals to stimulate aggressive price (and non-price) competition among title insurance companies. Mortgage lenders, for example, are likely to know more about a title insurance company's reputation and ability to fulfill its obligations by the settlement date, and be better positioned to understand precisely what services the competing title insurers are offering. Furthermore, because of the volume of business they represent, and the fact that they (unlike most individuals) are repeat customers, mortgage lenders are more able to stimulate significant competition among title insurance companies.

Title insurers also engage in price competition for the direct business of consumers: individuals can (and do) select their title insurance firm based on the price that firm offers. While less prevalent than price competition for a real estate professional's recommendation, such price competition takes place and should not be simply ignored.

B. The BB Report Ignores Recent Rate Reductions

BB report states that "there were no base rate reductions filed over the period from 1998 to present," suggesting that this shows a lack of price competition.[4] This statement, however, is at best irrelevant, and also misleading and wrong.

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[2] See, for example, the report's claim of "compelling evidence of the absence of price competition in California title insurance and escrow markets" (BB report at p. 91).
[3] Although mortgage lenders do not make the final selection of title insurers, those lenders typically make recommendations that carry significant weight.
[4] BB report at p. 88.

In fact, California title insurance companies have offered numerous rate reductions in recent years, frequently citing competition or the need to match rivals' rate reductions as the reason for their own rate reductions. Examples of these rate reductions include:[5]

- Commonwealth Land Title filed in May 2005 to offer a new title insurance policy "in response to our competitors, who have developed and launched similar products in the marketplace;[6]
- First American announced in 2005 that it planned to reduce significantly its rates for title insurance on refinances;[7]
- Rate reductions were approved for First American Title in late 2002 and more recently for Fidelity National Financial;[8]
- First American Title announced discounts of 50% on title insurance associated with post-disaster reconstruction loans following the 2003 fires in Southern California;[9]
- Many title insurance companies offer discounts on the order of approximately 10% for electronically filed policies;
- Title insurance companies regularly offer rate discounts on the order of 20% for refinances in cases where the previous policy was recently issued.

This evidence of actual price discounts contradicts the BB report's claim that there were no base rate reductions.

IV. THE BB REPORT'S SOLE FOCUS ON PRICE COMPETITION RENDERS ITS CONCLUSIONS UNRELIABLE

In this section, I discuss why the BB report is wrong to focus exclusively on price competition: non-price competition is important, and the BB report provides no evidence that the costs of such competition outweigh the resultant consumer benefits.

[5] Other examples of title insurance discounts can be found on the California Department of Insurance's website: http://160.88.209.44/pls/wu_survey_title/titw_get_rates$.startup.
[6] Commonwealth Land Title Insurance Co. filing with the California Department of Insurance, May 5, 2005.
[7] First American Title Insurance Company press release, March 17, 2005.
[8] Mortgage Servicing News, March 2003.
[9] First American Press Release, October 28, 2003.

A. Non-Price Competition Is Important

Economists and policymakers in the U.S., including competition enforcers at both the U.S. Department of Justice and the Federal Trade Commission, have long recognized that firms compete on many dimensions, including price, quality, service, reliability and innovation. Competition on each of these dimensions generally provides very real benefits to consumers, and no particular dimension is generally viewed as a "preferred" or "superior" form of competition.[10]

B. The BB Report is Wrong Not to Consider The Benefits of Non-Price Competition

The BB report focuses exclusively on *price* competition, noting that "[g]iven the placement of the competition requirement in a statute on rate regulation, generally, and as part of a definition of excessive rates, specifically, we conclude that the type of competition at issue is price competition."[11] This is a completely arbitrary decision that causes the BB report to ignore evidence that could have revealed significant market competition.

This failure to consider the benefits of non-price competition is surprising inasmuch as the BB report recognizes the existence of such non-price competition. For example, BB report notes the following statement by United Capital Group:

> "the level of service provided is therefore the key differentiating factor among title insurance competitors .... we are committed to providing an unparalleled quality of service to our customers [and] .... [o]ur advanced technology platform facilitates our prompt and efficient delivery of title and escrow services .... We believe that our focus on providing high levels of personal service to our customers ... has enabled us to compete effectively with the major title insurers."[12]

There is no economic justification, however, for limiting attention to just the benefits of price competition. By ignoring both the extent to which non-price competition currently exists, and the benefits of such non-price competition, there is no way that the BB report can reach any credible or reliable conclusions regarding the intensity of competition.

C. The BB Report Simply Assumes its Conclusion That Non-Price Competition Offers No Benefits

Non-price competition is hardly unique to title insurance. In fact, virtually *all* markets are characterized by such non-price competition: many firms choose to increase product quality, despite the resultant higher costs and higher prices, as a means of attracting more business. For example,

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[10] See, for example, the U.S. Department of Justice/Federal Trade Commission's *Antitrust Guidelines for Collaborations Among Competitors*, which indicates that competitive analyses of market power need to consider both price and non-price dimensions: "Sellers also may exercise market power with respect to significant competitive dimensions other than price, such as quality, service, or innovation" (footnote 30 at p. 11).

[11] BB report at p. 8, emphasis in original. See also BB report at p. 1: "the type of competition at issue is price competition" and "competition is understood as price competition."

[12] BB report at p. 39.

supermarkets that add a salad bar with fresh vegetables, movie theaters that offer stadium seating, and auto repair shops that offer its customers the use of a free loaner car are all engaged in non-price competition that most consumers value, even though this non-price competition may increase costs. Firms engage in this non-price competition for much the same reason that they engage in price competition: non-price competition helps firms attract new customers and retain existing customers. The point is that non-price competition is genuine competition on the merits, and results in direct benefits to consumers.

The BB report, however, seemingly dismisses the significance of non-price competition on the grounds that non-price competition can increase costs.[13] For example, the BB report states that, "Competition for business raises the costs of production and raises the price to consumers."[14] As just mentioned, however, this ignores economists' recognition that non-price competition provides important consumer benefits.

Further, the BB report provides no support for its claim that non-price competition is harmful to consumers.[15] The closest that the BB report comes to such an analysis concerns the relative costs and benefits of title insurers competing on terms of service by offering preliminary title reports, yet it is clear that the BB report has no evidence upon which to base its findings:

> "As a *ballpark estimate* of this cost, we will *assume* that 50% of underwritten title company personnel costs are associated with the production of preliminary reports. *For ease of illustration*, we will add only title plant rent and maintenance expenses to personnel costs for total cost of production for preliminary reports .... It *may be* that actual customers .... *might* desire and be willing to pay for multiple title commitments. On the other hand, consumers *might be* quite happy with a seven-day turnaround for a title commitment instead of a two-day turnaround and prefer to pay significantly less for the longer turnaround time." [16] (emphasis added)

By simply *asserting* that non-price competition leaves consumers worse off, the BB report effectively *assumes* its conclusion that non-price competition can be ignored when asking whether the market exhibits a "reasonable" degree of competition.

As indicated above, this arbitrary conclusion runs contrary to generally-accepted competition analysis, and the BB report provides no justification for arbitrarily excluding evidence of non-price competition. As such, the BB report's conclusion should be given no weight.

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[13] As an example of the costs that title insurance competition imposes on consumers, the BB report cites the fact that it is costly for title insurance companies to make competing bids when only one of those bidders will ultimately be chosen. Bidding competition of this type, however, is a common, and very important, form of competition among firms, e.g., individuals commonly seek (and benefit from) competing bids for mortgages. The fact that only one bidder wins the competition is a necessary aspect of that competition, not something that renders the competition undesirable.

[14] BB report at p. 27.

[15] For example, the BB report makes no attempt to measure benefits such as consumers' ability to schedule earlier settlement dates because title insurance is available on a more expedited basis, or the benefits of not having to reschedule a settlement date (including changing move-in dates, arranging for alternative lodging, etc.) because a title

V. THE BB REPORT FAILS TO CONSIDER IMPORTANT ASPECTS OF MARKET COMPETITION

In addition to inappropriately limiting its attention to price competition, the BB report fails to conduct a complete and correct competitive analysis. In this section, I discuss the commonly accepted approach that economists use to analyze competition, how the BB report deviates from that accepted approach, and the errors that result because of this deviation.

A. Economists Typically Analyze Competition Using the Framework Set Forth in the Horizontal Merger Guidelines

Economists and policymakers typically analyze competition using the framework set forth in the Department of Justice/Federal Trade Commission's *Horizontal Merger Guidelines* ("*Merger Guidelines*")[17] The *Merger Guidelines* is used by the Antitrust Division of the U.S. Department of Justice and the U.S. Federal Trade Commission to evaluate competition. The *Merger Guidelines'* analytical framework for analyzing competition is also similar to the framework adopted by the National Association of Attorneys General and many state insurance commissions to analyze competition.[18]

As discussed further below, however, the BB report fails both to acknowledge and to follow the methodology outlined by the *Merger Guidelines*. In failing to consider, or only superficially considering, important determinants of competition, the BB report falls short of professional standards among economists for analyzing competition.

B. The BB Report Incorrectly Places Too Much Weight on the HHI

As the BB report notes, economists analyzing competition frequently look at the Hirschman-Herfindahl Index ("HHI") statistic.[19] Beginning more than 20 years ago, however, economists and policymakers have concluded that, except in cases where HHIs are at the upper or lower bounds, HHIs (and market shares) are too simplistic to provide a useful or reliable measure of competition.[20] This point was recently made by recent FTC Commissioner Thomas Leary:[21]

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insurer did not meet the promised settlement date. Similarly, the BB report has no real estimate of the costs that title insurers incur in order to provide higher-quality services.

[16] BB report at p. 60.

[17] Although the competitive analysis in the *Merger Guidelines* is cast in terms of analyzing how a merger would affect competition, many of the concepts relevant to merger analysis are equally relevant in assessing competition in a non-merger context.

[18] The BB report also cites to the *Merger Guidelines* (BB report at p. 61).

[19] The HHI ranges from 0 to 10,000, with smaller HHIs corresponding to markets with more firms (each with smaller market shares) and larger HHIs corresponding to more "concentrated" markets with fewer firms (with higher market shares). The HHI is calculated by summing the square of each firm's market share. For example, in a market with four firms with market shares of 40%, 30%, 20% and 10%, the HHI = $40^2 + 30^2 + 20^2 + 10^2 = 3{,}000$.

[20] Concentration measures may be slightly more useful in the context of a merger where the focus is less on the absolute level of the HHI than on how the merger *changes* the HHI.

"Statistical calculations of concentration have, if anything, become progressively less significant as we move from 1982, through 1984 and 1992, and into the present day .... The most likely explanation for this progressive shift of emphasis is ... the accumulation of experience .... The strong concentration presumptions in the 1982 Guidelines were soon seen to be impractical and began to be softened only two years later." [22]

Similarly, the recent FTC Chairman Tim Muris noted:

"The data we released highlights several important issues in merger analysis. One involves the longstanding debate about the significance of concentration or HHI numbers. I hope the data we released ... will finally put to rest the notion that HHI levels have any specific significance, except at very high levels .... Thus, the preeminence that some would continue to give to concentration or HHI numbers is misplaced. State-of-the-art merger analysis has moved well beyond a simplistic causality of high concentration leading to anticompetitive effects." [23]

And finally, Charles James, the recent Assistant Attorney General in charge of the U.S. Department's Antitrust Division, stated:

"Over time, economic research seriously undermined fears of low market share mergers and questioned the overly simplistic reliance on market structure as the [*sic*] both the beginning and end of competitive analysis. These new concepts were embraced by the Supreme Court in *United States v. General Dynamics*, where the Court held that high market shares alone were insufficient to block a merger and required a deeper inquiry into the actual, future competitive effects of a merger .... Today, no U.S. enforcement agency or court would think of rejecting a merger solely based on structural presumptions from small increases in concentration ...."[24]

This position regarding HHIs and market shares is reflected in the Merger Guidelines, which states that, "market share and concentration data provide only the *starting point* for analyzing the competitive impact of a merger ...." [25] Economists and policymakers now recognize that a much more detailed, fact-intensive analysis is necessary in order to fully understand the competitive performance of any particular market.

The limited significance that economists and policymakers now attach to HHIs and market shares stems from the fact that those statistics simply do not reflect factors that can significantly affect the intensity of competition in a particular market. For example, HHIs and market shares fail to capture information about the characteristics of buyers, how products are bought or sold, the extent to which rivals' products are similar, or the ease with which firms can expand sales at the expense of their rivals. All of these (and other) factors, however, can dramatically affect the

[21] While this, and the next two statements, were made in the context of analyzing competition with respect to mergers, they are equally applicable to non-merger analyses.
[22] "The Essential Stability of Merger Policy in the United States," Speech by FTC Commissioner Thomas Leary, January 17, 2002.
[23] Prepared remarks of Tim Muris, FTC Chairman, Workshop on Horizontal Merger Guidelines, Federal Trade Commission/Department of Justice, Washington, DC, February 17, 2004.
[24] "Antitrust in the Early 21[st] Century: Core Values and Convergence," Address by Charles James, Assistant Attorney Genera for Antitrust, U.S. Department of Justice, May 15, 2002.
[25] *Merger Guidelines* at Section 2.0, emphasis added.

nature and intensity of competition in a particular market. As a result, even markets in which firms have high market shares and HHIs are high can be quite competitive.

Economists also recognize that the threat of entry can critically affect the nature and intensity of competition. In fact, the economic literature on contestable markets notes that, if entry is easy, a market can be very competitive even with very few firms and a high HHI.[26] Once again, however, simple market shares and HHIs do not reflect this competitively significant issue.

For these reasons, a reliable competitive effects analysis must go beyond simple HHI calculations and consider all factors likely to affect competition. Accordingly, the BB report is wrong to rely on high HHIs to support its claim that the California title insurance market is not "reasonably" competitive.[27]

C. The BB Report Does Not Properly Analyze Competition

A credible and thorough competitive effects analysis is typically a very fact-intensive investigation covering many different areas. The following is a list of market considerations that would likely affect the degree of price, and non-price, competition among firms. The BB report, however, contains little or no discussion of these factors. This lack of a careful, factually-based analysis renders the conclusions in the BB report unsupported and unreliable.

1. The BB Report Fails to Properly Analyze Expansion Possibilities

A particularly important aspect of the competitive analysis of this market is the ease with which rivals can expand (i.e., increase their sales). A factual inquiry into rivals' ability to expand is necessary in order to assess the intensity of competition in this market.

The BB report claims that firms with individual market shares of less than 10% made up approximately 22% of California's 2005 title insurance market.[28] The BB report, however, fails to investigate or analyze those smaller firms' ability to increase market share, and thus provide additional competition. Such an investigation could have shown, for example, that the smaller firms

[26] See, for example, Baumol, W., Panzar, J., and Willig, R., 1982. *Contestable Markets and the Theory of Industry Structure*. New York: Harcourt Brace Jovanovich.

[27] It is of some interest to note that the HHI in many of California's other insurance sectors appears to be even higher than the 2005 HHI of 2,454 that the BB report cites (BB report at Table 3 on p. 62) for title insurance. For example, based on 2004 data from the California Department of Insurance (http://www.insurance.ca.gov/0400-news/0200-studies-reports/0100-market-share/upload/IndMktShr2004alpha.pdf), the HHI exceeds 2,600 for workers' compensation insurance, and exceeds 3,500 for commercial auto no-fault insurance. For various types of accident and health (disability) insurance, the HHI ranges from approximately 3,900 to 9,600, while for private passenger no-fault insurance, a single firm has a 98% market share and the HHI exceeds 9,600. The BB report does not address the question of whether those high HHIs mean those insurance sectors fail to exhibit a "reasonable" degree of competition.

[28] BB report at Figure 1, p. 63.

in this industry have the ability and incentive to increase price or non-price competition in order to increase their own sales, and thus their market shares.

Having failed to consider the ease with which existing rivals can expand sales, the BB report cannot claim to have analyzed the competitive dynamics of this market. Accordingly, the BB report cannot credibly claim to have analyzed whether or not there is a "reasonable" degree of competition in this market.

2. The BB Report Fails to Properly Analyze Entry Conditions

It is well known that entry is a critical aspect of the competitive effects analysis. In fact, the threat of entry can make even very concentrated markets perform quite competitively:

> "Low barriers to entry enable a potential competitor to deter anticompetitive behavior by firms within the market simply by its ability to enter the market .... Existing firms know that if they collude or exercise market power to charge supracompetitive prices, entry by firms currently not competing on the market becomes likely, thereby increasing the pressure on them to act competitively."[29]

> "Time after time, we have recognized . . . [a] basic fact of economic life: A high market share, though it may ordinarily raise an inference of monopoly power, will not do so in a market with low entry barriers or other evidence of a defendant's inability to control prices or exclude competitors."[30]

The BB report, however, fails to consider adequately these entry issues. For example, despite several successful title insurance companies with no significant presence in California (e.g., Attorneys Title Insurance Fund, Guaranty Title Insurance Co., and Title Resources Guaranty Co.). Presumably, these title insurers could readily enter the California market and begin competing if the California market became noncompetitive. The BB report, however, fails to consider this issue. This failure to analyze carefully entry considerations is particularly surprising inasmuch as entry appears to be a critical consideration in the FTC's previous investigations in the title insurance industry. In particular, the FTC's investigations appear to suggest that, as long as title information services are available, title insurance markets will be competitive.

Finally, although the BB report claims that there are large barriers to entry, the report acknowledges that entry has taken place in the California market.[31] The report, however, does not reconcile this evidence of entry with its claim that there exist significant barriers to entry. Nor does the report contain any analysis showing that more entry could not take place in the future. Finally, the report does not analyze why there has not been more entry if the title insurance is as profit-

[29] FTC v. H.J. Heinz Co., 246 F.3d 708, 717 (D.C. Cir. 2001).
[30] *Syufy Enters.*, 903 F.2d at 664 (quoting *Oahu Gas Serv., Inc. v. Pacific Resources Inc.*, 838 F.2d 360, 366 (9th Cir. 1988)).
[31] BB report at p. 3 and p. 73.

able as the BB report claims, or whether the limited historical entry is indicative of an already competitive market.[32]

By failing to carefully consider these issues, the BB report fails to assess entry considerations and its effect on competition, thus rendering the report's analysis incomplete and unreliable.

3. The BB Report Fails to Properly Analyze Product Differentiation

Economists generally believe that the more similar (homogeneous) are firms' products, the easier it is for customers to compare rival firms' offerings. This, in turn, can stimulate competition. Product homogeneity can also facilitate entry and expansion, further increasing competition. On the other hand, in some markets, homogeneity might facilitate coordination (i.e., collusion), thus lead to reduced competition.

Despite some contrary evidence, the BB report asserts that title insurance is a homogeneous product.[33] The BB report does not support that assertion with evidence, however, nor does it discuss how this homogeneity affects competition in this particular market – is it likely to increase, or decrease, competition? Thus, the BB report fails to conduct a key aspect of the competitive analysis in this market.

4. The BB Report Fails to Properly Analyze Competitive Responses

An important technique for economists to analyze competition in a particular market is to study how firms respond to changes in that market. For example, how does a firm's price, quality or service change after a merger? How does a firm's conduct change following entry? How do firms respond when a rival drops price? Economists may also study other similar geographic markets (e.g., another state) to understand why competition may differ between states. For example, if prices are lower in other states, economists can learn about the determinants of prices and competition by exploring why those prices are different. Similarly, if service or quality between states differ, economists can learn about non-price competition by exploring the causes of those differences. These studies could show, for example, that rapid entry by out-of-state rivals is easy, that prices and other forms of competition are largely unrelated to the HHI in a particular state, or that price reductions by one firm tend to be quickly matched by another firm, thus suggesting significant price competition.

The BB report contains none of these analyses. For example, although the BB report notes the recent Fidelity National Financial/Chicago Title and First American/United General Title mergers, and the impact that these mergers had on market shares and HHIs, the BB report fails to ask whether title insurance prices or other measures of competition changed. Similarly, the BB report fails to analyze how firms and customers responded to historical price changes, or investigate the

[32] BB report at p. 73.
[33] BB report at p. 61.

motivation behind those price changes. Finally, the BB report fails to consider the extent and cause of title insurance rate differences across states.

By failing to conduct analyses of this type, the BB report again fails to fully analyze the determinants of competition in this market.

5. The BB Report Fails to Properly Analyze Cost Considerations

Although firms' costs and cost structures generally affect the nature of competition in most markets, the BB report contains very little analysis of how those costs affect competition. For example, while the BB report asserts that title insurance companies' costs have been falling as a result of technology changes, the report does not attempt to quantify those cost reductions.[34] Indeed, the report does not even contain evidence documenting its claim that costs have, in fact, been falling. Similarly, the BB report fails to provide any analysis of how technology changes may have affected competition, and fails to analyze how changes in California real estate activity may have affected the costs of providing title insurance, and thus the competitiveness of different firms.

D. The BB Report Fails to Reconcile its Conclusion with That of the FTC

As the BB report notes, there have been two recent mergers of large title insurers in California: the 1999 merger of Fidelity National Financial and Chicago Title Corporation, and the 2005 merger of First American and United General Title Company.

Despite the increase in market concentration caused by these two mergers, once access to local title plants was ensured, the FTC did not object to either merger. This suggests that, after its lengthy, fact-intensive investigation, the FTC concluded that entry and expansion in the title insurance market is reasonably easy as long as insurers had access to local title plants.

The BB report's conclusion that the California title market is not "reasonably" competitive clearly contradicts the FTC's findings. The BB report, however, makes no effort to resolve this contradiction, or to explain why its analyses should be accepted in lieu of the FTC's analyses.

VI. THE ANALYSES IN THE BB REPORT CARRY NO WEIGHT

Rather than rely on the *Merger Guidelines*' methodology for analyzing competition – a methodology accepted and employed by virtually all economists who study competition – the BB report adopts its own approach and measures of competition. In this section, I point out why the BB report's approach is inappropriate and how it yields incorrect conclusions.

[34] BB report at p. 88.

A. The BB Report Fails to Recognize Significant Data Problems

The California title insurance market consists of three significant types of title insurance: title insurance for new and resale homes; refinances; and commercial properties. Each type of title insurance involves different parties, different costs and different markets. For example, commercial title insurance is generally regarded as the most costly to provide, while refinances are generally regarded as the least costly. The BB report, however, does not distinguish between these types of insurance in the data that relies upon in its analyses.

This failure to recognize different types of title insurance results in clear errors. Most importantly, in arguing that there is no price competition among title insurers, the BB report fails to recognize that for commercial properties, the consumer can be very knowledgeable about title insurance and will shop for the best rate. Thus, price competition (as well as non-price competition) is likely to be significant. Similarly, in assessing price changes over time, the BB report fails to distinguish between the different products and how changes in the mix of those products over time can affect overall prices and costs.

B. The BB Report Incorrectly Relies on HHIs

As previously discussed, professional economists recognize that HHIs can provide very misleading information about the competitiveness of a particular market. As a result, economists do not rely on HHIs to conclude that markets are not "reasonably" competitive.

Instead, economists require a more intensive, fact-specific analysis that considers a variety of factors – factors that experience has shown is critical to evaluate properly the intensity of competition in any particular market. The BB report, however, places excessive reliance on the HHI in reaching its conclusion about the intensity of competition among California title insurers.

C. The BB Report Incorrectly Assesses Barriers to Entry

As the BB report states, "... access to title plant information is not a barrier to entry for underwritten title companies or title insurers in California – at least in the larger counties." [35] This access to title plants facilitates entry into the market by new title insurance companies. In fact, as previously mentioned, once access to title plants was assured, the FTC was apparently sufficiently confident that entry could take place that it did not object to the two recent title insurance company mergers in California.

The BB report's claim that barriers to entry are high is based in part on its assertion that "while creating a new title insurer and obtaining a license to do business is *not impossible*, it is *not a trivial* undertaking"[36] (emphasis added). Absent evidence about actual costs or time requirements

[35] BB report at p. 67.
[36] BB report at p. 66.

for entry, however, this vague claim provides no useful information or evidence in support of the BB report's conclusions. Thus, the BB report contains no credible or useful analysis of barriers to entry.

The BB report also bases its claim about barriers to entry on its observation that skilled underwriters with established relationships can command very high fees. The BB report fails to recognize, however, that while this may increase an entrant's cost of doing business, it also increases the costs of incumbents. More significantly, while underwriters may be costly to hire, the BB report does not claim that an entrant would be unable to obtain their services; in fact, the report states, "We do not believe the availability of skilled personnel for title examination and escrow services is a barrier to entry".[37] In other words, it appears that entrants could readily enter the market, and provide significant competition, by simply hiring away the skilled personnel that are currently working for incumbent firms.

Thus, with no evidence that entrants would be disadvantaged relative to market incumbents, there appears to be no real barrier to entry.

D. The BB Report Incorrectly Looks at Profits to Assess Competition

The BB report relies heavily on its finding that California title insurance companies enjoy "excessive" profits, and that these "excessive" profits demonstrate that the market is not "reasonably" competitive. Yet economists recognize that a firm's profits provides no real information about the intensity of market competition.

There are several reasons why economists no longer assess competition by looking at firms' profits. First, economically meaningful measures of profits are notoriously difficult to calculate; not only do they typically include overhead, joint, and fixed costs, but they may include revenues from products unrelated to the product at issue.[38] Profits are also difficult to interpret in industries such as title insurance where there is significant year-to-year variation in demand. This is particularly true with insurance where there is also significant year-to-year variation in costs, and when claims can be filed many years after policies are written and premiums collected.

The BB report clearly illustrates the errors that result from using profits as an indicator of competition. First, it appears that the BB report incorrectly calculates and reports profits.[39]

Second, the appropriate measure of profits here is unclear. For example, while the BB report claims that profits are "excessive by any reasonable measure," A.M. Best reports that margins in the title industry over the long-run are only on the order of 1.9%.[40]

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[37] BB report at p. 69.
[38] The BB report appears to recognize, but then go on to ignore, this fundamental problem: "Stated differently, title insurer profitability can be masked within the broader holding company profitability." (BB report at p. 76)
[39] Statement of Michael J. Miller, January 5, 2006.

Finally, profits – even if correctly measured – are by no means indicative of a non-competitive market. In fact, economists recognize that allowing firms to pursue, and then realize, profits is the lynchpin of competitive markets: to motivate competition to "build a better mousetrap," firms must be allowed to reap the profits from that better mousetrap. Thus, even very significant profits can be consistent with very competitive markets.

Thus, the BB report would have been well advised to heed the counsel of noted economist Professor Franklin Fisher:

> "Economists (and others) who believe that analysis of accounting rates of return will tell them much ... are deluding themselves. The literature which supposedly relates concentration and economic profit rates does no such thing, and examination of absolute or relative accounting rates of return to draw conclusions about monopoly profits is a totally misleading enterprise."[41] (p. 253)

E. The BB Report's Price/Cost Sensitivity Analysis is Flawed

The BB report claims that, although title insurance companies' costs have been falling over time, their rates have not been.[42] The BB report views this claimed lack of a price/cost relationship as indicative of a lack of competition.[43]

In fact, the BB report appears to have absolutely no evidence to support its claim that prices have not been falling. As previously discussed, there is evidence that title insurance companies have been filing rate reductions and offering discounts, and it appears that the BB report may have been inappropriately focusing on base rates when, in fact, many policies are instead sold using a different pricing methodology. In fact, the discounts that title insurance companies offer for electronically-filed policies or for refinancing soon after the previous title insurance policy was issued, seem to be discounts directly related to the insurer's lower costs. Thus, these two examples appear to directly contradict the BB report's claim.

Similarly, the BB report provides no support for its claim that title insurance company costs have been falling over time. Although the report claims that new technology should have lowered costs, the report provides no evidence in support of that claim. The BB report also fails to recognize that other significant costs may have been increasing over time: as discussed, there are different costs associated with the different types of title insurance (refinances, new/resale, and commercial), so that changes in the mix of these products over time will affect overall costs.

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[40] See BB report at p. 2 and p. 93, and Exhibit 6, *A.M. Best Special Report*, October 20, 2003.
[41] Fisher, F., McGowan, J., and Greenwood, J., 1983. *Folded, Spindled and Mutilated: Economic Analysis and U.S. vs. IBM.* Cambridge, MA: The MIT Press.
[42] BB report at p. 88.
[43] The BB report also claims that premiums fall in a narrow range, suggesting that this indicates a lack of "reasonable" competition. Here, the BB report suffers from two errors. First, it is perfectly consistent for competitive firms to offer very similar prices. Second, it is not clear that prices actually fall in a narrow range – the two examples in the BB report (pp. 89 – 90) exhibit price ranges of approximately 10 - 18%, ranges that are entirely consistent with a competitive market, but are inconsistent with the claim in the BB report.

Finally, the BB report fails to consider whether title insurance companies' labor costs – the largest component of overall costs – may have been increasing over time. Such cost increases might be expected given the increased real estate activity over the last several years that has led to increased title searches, thus increased demand for title insurance services. As economists know, increased demand for such services is likely to lead to a higher price for those services. That fundamental economic relationship, however, is not considered in the BB report.

VII. THE BB REPORT NEVER TESTS WHETHER THE MARKET IS "REASONABLY" COMPETITIVE

Although the BB report concludes that the California title insurance market is not "reasonably" competitive, the report never makes clear what it means by "reasonably" competitive. In this section, I point out that the report's criteria for a "reasonably" competitive market is subjective, and not based on basic economic principles.

A. The BB Report Criteria for a "Reasonably Competitive" Market is Entirely Subjective

The BB report notes that the title insurance market is not perfectly competitive. This comes as no surprise – the BB report correctly notes that, in practice, perfect competition *never* exists.[44] Yet the report fails to assess the extent to which the title insurance market deviates from this perfectly competitive ideal, or specify how far a market can deviate from that unachievable ideal before being judged no longer "reasonably competitive."

The only criteria that the BB report seemingly considers for distinguishing between a market that is "reasonably competitive," and one that is not, is the HHI. The BB report notes that the *Merger Guidelines* refer to markets with HHIs above 1800 as being "highly concentrated." Thus, the BB report may be equating "reasonably competitive" to "not highly concentrated."[45] As discussed above, however, HHIs are an imperfect and frequently misleading measure of market competition. Thus, if the BB report is assuming that a market is not "reasonably competitive" solely because the HHI exceeds 1800, then the report is reaching a conclusion that is without evidentiary support and is contrary to professional economic standards.

Alternatively, the BB report may be equating "reasonably" competitive to the concept of "workably" competitive. The BB report is not clear, however, on what it means by "workable" competition. If the report defines "workable" competition as an outcome that approximates perfect competition, then the BB report appears to be adopting a standard that it concedes to be vir-

[44] BB at p. 6.
[45] One would have thought, however, that if this were the sole basis for determining whether a market was "reasonably competitive," then the California Insurance Code presumably would have explicitly referred to the HHI in section 12401.3 as part of the definition for a "reasonable" degree of competition.

tually unobtainable. More generally, the subjectivity of any "workably competitive" standard has been clearly articulated by Nobel prize winning economist George Stigler:

> "To determine whether any industry is workably competitive, therefore, simply have a good graduate student write his dissertation on the industry and render a verdict. It is crucial to this test, of course, that no second graduate student be allowed to study the industry." [46]

Absent details on the criteria that the BB report considers when distinguishing between a "reasonably" competitive market and one that is not, the report's conclusion about the title insurance market appears to be entirely subjective and without basis.

B. The BB Report Fails To Use An Economically-Based Criteria For Defining "Reasonable" Competition

Although not discussed in the BB report, the question of what constitutes "reasonable" competition is very much an economic question. Inasmuch as a lack of "reasonable competition" is required under the California Insurance Code to determine whether additional rate regulation should be considered, a market should only be deemed "not reasonably competitive" if consumers are likely to be better off under that more regulated system.

This notion of "reasonably competitive" is, in fact, the generally accepted interpretation among economists of what constitutes "workable competition." This definition recognizes the commonsense observation that *no* system is perfect: both competitive markets and regulated markets have some imperfections. Given the fact that neither competitive markets nor markets with rate regulation are perfect, what responsible economists and policymakers must do is determine which system is "best" – even if not perfect. This requires a careful balancing of the likely costs and benefits of each system.[47] As economists recognized over 50 years ago:

> "[a]n industry may be judged to be workably competitive when, after the structural characteristics of its market and the dynamic forces that shaped them have been *thoroughly examined*, there is no clearly indicated change that can be effected through public policy measures that would result in greater social gains than social losses." [48] (emphasis added)

The BB report, however, does none of the balancing inherent in determining what constitutes "reasonable" or "workable" competition.

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[46] George Stigler, "Report on Antitrust Policy – Discussion," *American Economic Review* 46 (May 1956): 505.

[47] This balancing would have to include a consideration of non-price factors such as service, quality and innovation. The importance of these non-price considerations is one of the reasons why the BB report's exclusive focus on *price* competition in evaluating whether there exists a "reasonable" degree of competition is incorrect: those non-price considerations must be considered when asking whether consumers would be better off with more highly regulated rates, thus whether there exists a "reasonable" degree of competition.

[48] Jesse Markham, "An Alternative Approach to the Concept of Workable Competition," *American Economic Review* 40 (June 1950): 349 – 61.

The BB report also fails to even consider – much less assess – what problems might arise in an alternative more regulated; these problems might include setting the "wrong" regulated rate, difficulties in adjusting regulated rates in response to market changes, and issues with firms trying to "game" the regulated system to their own advantage. The significance of these potential problems has led noted economist Professor Paul Joskow to state:

> "Attempts by some states to go toward more price regulation rather than less should be vigorously discouraged.... Regulators attempting to apply public utility ratemaking procedures to individual insurance firms or for the industry as a whole will be applying these techniques to an industry which has every single characteristic of historical regulatory disasters. Since there is no apparent reason to go this route, this can of worms should remain closed."[49]

Thus, the BB report provides absolutely no analysis of whether consumers would be better off under the current (albeit imperfect) market system or the alternative of more highly regulated rates. As such, its conclusion that the California title insurance market fails to meet the criteria of "reasonably competitive" is entirely subjective and without merit.

VIII. SUMMARY

The conclusions in the BB report are based on incorrect economic analyses and an inappropriate analytical framework. Thus, the BB report's conclusion that there is not a "reasonable" degree of competition in California's title insurance market has no basis in fact and should be rejected.

In addition, because the BB report fails to define its standard for distinguishing between markets that do, and do not, exhibit a "reasonable" degree of competition, its conclusion about whether California's title insurance market is "reasonably competitive" is entirely subjective.

For these reasons, the BB report's conclusions regarding competition deserve no consideration by public policymakers.

[49] Paul Joskow "Cartels, competition and regulation in the property-liability insurance industry," *Bell Journal of Economics and Management Science* 4 (1973) at pp. 425 – 26.

Review and Comment on "An Analysis of Competition in the California Title Insurance and Escrow Industry" by Birny Birnbaum

by
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I. INTRODUCTON

A. Overview and Summary of Conclusions

I have been engaged by Gardere Wayne Sewell LLP (Gardere) to provide expert economic assistance to Gardere in connection with Gardere's work for its client, Land America Financial Group, Inc. As part of this engagement, I was asked to review the report, "An Analysis of Competition in the California Title Insurance and Escrow Industry," prepared by Birny Birnbaum under contract to the California Insurance Commissioner (hereafter referred to as the contractor report).[1]

Mr. Birnbaum states that he has made a comprehensive analysis of the state of competition in the market for title insurance and escrow and other related services in California. Based on this analysis, he concludes that a "reasonable degree" of competition does not exist in this market.[2]

My review is based solely on the information and analysis contained in the contractor's report. Unfortunately, justification for some of the more important conclusions reached in the report are based on his analysis of data which are not publicly available (including non-public information redacted for public versions of this report).[3] Since I have not had access to much of the data and information relied upon by Mr. Birnbaum in performing his analysis, of necessity my review must be preliminary. However, as explained below, the analysis itself raises many serious questions.

The report falls far short of meeting the professional standards of economists for conducting an analysis of competition in an industry. It relies on a fifty-year-old methodology for assessing competition that economists no longer accept as being adequate. Its application of the concept of reverse competition to the industry and the conclusions drawn from that application are unsupported both in theory and in fact. The data presented in the report fail to support its conclusions. The report's descriptions of such important industry factors as demand, supply, costs, prices, entry and exit conditions, competitive behavior,

[1] Birny Birnbaum, "An Economic Analysis of Competition in the California Title Insurance and Escrow Industry," December 2005, Report to the California Insurance Commissioner.
[2] Contractor report, p. 1.
[3] See contractor report footnotes 26, 27, 40, 45, 47, 55, 115, 116, 118, 121, 132, 155, 156, 157, 158, 159, 160, 161,173, 174, 175, 176, and Appendix 4 and Appendix 5.

and profitability are superficial at best, and at places misleading. In several instances, the report makes logical errors in its interpretation of economic factors. In summary, the report's conclusions regarding competition in this market are unsupported by the available evidence and based on a faulty analysis of the industry. They provide no basis for making regulatory decisions about the state of competition in the California title insurance and escrow services industry.

After completing the first draft of my review, I had an opportunity to read Dr. Gregory S. Vistnes' and Dr. Nelson R. Lipshutz's analyses of the contractor report.[4] I agree with their findings which provide additional support for the conclusions reached in my review.

B Personal Qualifications[5]

I received my BBA degree in Accounting from the University of Oklahoma and my Ph.D. in economics from Rice University. I have been a tenured full professor in economics, finance, and public policy at the University of Texas, the University of Washington, Texas A&M University, and the University of North Texas. I served as Associate Dean of the LBJ School of Public Affairs at UT-Austin, Dean of the Graduate School of Public Affairs at the University of Washington, founder and Director of the Center for Business and Economic Analysis at Texas A&M University, and Dean of the College of Business Administration at the University of North Texas.

Outside of academics, I have served as an Officer in the U.S. Navy, an officer of the Federal Reserve Bank of Boston, president of the Texas Research League (a 501c organization doing research on issues of public policy at the state and local level), and vice president for economics for Mesa Limited Partnership (at the time the largest independent oil and gas firm in the nation). I am the author of three books, four monographs, and over 40 professional publications, and have been a principal investigator on more than $2 million of research projects sponsored by the National Science Foundation. I have been an expert witness on economic issues in both federal and state courts.

C. The Market Structure-Conduct-Performance Methodology

The contractor report relies on the market structure-conduct-performance methodology pioneered by Joe Bain in 1956: "The theory is that market structure influences market conduct of industry participants, which, in turn, influences market performance."[6] Having published an industry study based on

[4] Gregory S. Vistnes, An Economic Analysis of the December 2005 Birney Birnbaum Report to the California Insurance Commissioner, January 5, 2005; and Nelson R. Lipshutz, Incorrect Conclusions About Competition in the California Title and Escrow Markets Asserted in the December 2005 Contractor Report to the California Insurance Commissioner, January 5, 2005.
[5] See Appendix A for complete curriculum vitae.
[6] Contractor report, p. 61. See Joe Bain, Barriers to New Competition, (Cambridge, MA: Harvard University Press, 1956).

this methodology in 1970, I recognize the value of such an approach.[7] But there are also major limitations.

Criticisms of the structure-conduct-performance methodology focus on three defects. First, such an approach is inherently static, neglecting the dynamics inherent in any industry. Second, it fails to consider the strategic implications of the interdependency found in most real-world markets in which firms must consider the reactions of their competitors in adopting their own competitive strategies. Third, in the absence of a theoretic ideal or norm, conclusions regarding the workability of competition are not based on science but on value judgments. As one recent study observed, "The structure-conduct-performance (SCP) paradigm of the 1950s and 1960s *was implemented with little theoretical guidance*" [emphasis added].[8]

While the contractor report makes a passing reference to the substantial body of literature developed in the past three decades which focuses on the limitations of the structure-conduct-performance approach and provides newer methodologies for analyzing competition in industries that do not meet the stringent requirements of the perfect competition model, the report fails to make use of the insights gained from this research.[9] This is demonstrated by its preoccupation with concentration ratios and Herfindahl-Hirschman indices, its failure to recognize the implications of product differentiation, its incomplete analysis of barriers to entry, and its reliance on returns on equity based on accounting conventions to judge the competitiveness of the industry.

Despite its theoretical limitations, however, the market structure-conduct-performance paradigm provides a useful framework for studying an industry and I have used it to organize my review of the contractor report.

II. MARKET STRUCTURE

A. Market Definition

The contractor report defines the relevant product market as encompassing title insurance, escrow services, and other services.[10] The title insurance component involves title search, examination, and commitment, as well as the issuance and service of a title insurance policy. In defining the escrow services component, the contractor report cites industry sources that identify eleven separate elements or activities. In defining the "other services"

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[7] Jared E. Hazleton, An Economic Analysis of the Frasch Sulphur Industry (Baltimore,MD: The Johns Hopkins Press for Resources for the Future, 1970).
[8] Xavier Vives, Oligopoly Pricing: Old Ideas and New Tools (Cambridge, MA: The MIT Press, 1999) p. 357.
[9] Footnote 120 on page 61, contractor report.
[10] Contractor report, p. 24.

component, the contractor report again cites industry sources that enumerate no less than 21 instruments and five additional activities.

In this study, the relevant geographic market is defined as including a county or regional group of counties. The contractor report fails to make clear that the basis for differentiating one local market from another is not only geographical distance, but also jurisdictional independence. Title search and examination are tied to the records of local jurisdictions and their record systems which make each local market unique.

The contractor report also fails to make clear that the products being provided are *financial services*, not commodities. While insurance is an important part of the product, helping sustain the stability of the real estate marketplace, services constitute over 90% of the product. Finally, the contractor report also fails to clearly indicate that some firms in the industry provide *all* of these services, directly or through their agents, while others provide only a subset of these services. While title search, examination, and issuance, as well as escrow and related services are highly localized businesses, title insurance is underwritten by large national companies that usually operate in many states. These are important distinctions in analyzing the geographic structure of the industry and the nature of the competitive environment in each market segment.

B. Characterization of the Product

After providing an expansive definition of the relevant product market for title insurance and escrow services, the contractor report describes the product as being homogeneous.[11] With homogeneous products, the customer is assumed to be indifferent as to which product he purchases, since the products provided by industry suppliers are perceived to be in all aspects identical. In other words, the contractor report is alleging that the sizeable array of specialized financial and legal services that are characterized as the title insurance and escrow services market could be provided much like the standardized $10,000 accidental life insurance policy that used to be sold through airport kiosks. Nothing could be further from the truth. Title insurance and escrow services are not homogeneous products. They are differentiated in many ways.

As I drive to work each day, I never cease to be amused by a small billboard advertising the services of a local CPA that says, "Income Tax Preparation: Cheap, Accurate, and Fast – Pick Any Two." The sign reminds us of **the multidimensionality of any service industry**. By definition, services are not and cannot be homogeneous.

Consumption of services, as distinct from commodities, **involves an experiential component that makes each transaction unique**. This is

[11] Contractor report, p. 61.

certainly true of title transactions. Title and escrow transactions are not identical. Each is a unique event, usually involving several parties with distinctly different interests and a specific piece of property. As the contractor report shows, in addition to title insurance, a title transaction may involve provision of a number of escrow services, preparation and execution of one or more ancillary instruments, and carrying out several related activities. The **mix of services provided** varies widely, making the service differentiated, rather than homogeneous.

Title insurance and escrow and other related services have an important **time dimension**. Anyone who has needed to close on a house in time to meet a residency requirement for local schools or to take advantage of a favorable loan commitment before it expires can attest to the value of timely performance. Response time is a significant aspect of the value consumers place on the product. Speed is also important to the other parties usually involved in closing. Real estate agents do not get paid and lenders do not begin receiving interest until the sale closes. The importance of timely performance contributes to making these services differentiated, rather than homogeneous.

Accuracy is another dimension of title insurance and escrow services. The purchase of real property is made much more complex by the need to comply with a large number of federal and state laws and regulations, relating to real property usage, development and financing, that require extensive disclosure. In addition, the existence of a national (if not world-wide) secondary market in mortgages, itself a product of public policy, has resulted in the need for lenders to carefully standardize and document their loans so that they may be marketable directly or as collateral for other securities. Thus, both lenders and buyers of property place great emphasis on reduction in errors and last minute changes. This need for accuracy also makes title insurance and escrow services differentiable, not homogeneous.

The title insurance and escrow services market is also characterized by a number of **intangibles** that add value for consumers. For example, consumers appreciate having a convenient location for the office. As suburbanization continues, title companies must incur costs to establish new offices to serve emerging markets. Anyone who has ever sat through a real estate closing recognizes the value of efficient, well-organized, thorough, pleasant, and convenient service. These intangibles contribute to a consumer's perception of the quality of the services being provided, making the product differentiable.

As noted above, a final factor making each title transaction unique is **geography**. Each jurisdiction poses different challenges in the title insurance industry. Counties and other jurisdictions vary widely in the availability and extent of records necessary to research and clear titles. Title search and examination require a thorough understanding of these complex nuances, as well as a professional workforce trained and experienced in dealing with them. The geographical dimension of title insurance contributes to the differentiation of the product.

In summary, the title insurance and escrow services industry produces financial services that are differentiated in a number of ways: by the mix of services being provided, by the timeliness of the delivery, by the accuracy of the products, by intangible factors such as convenience and efficiency that add to the value of the overall experience, and by jurisdictional differences in the availability and extent of the records required for title research and clearing. It is inaccurate to label them homogeneous products.

The contractor report's assertion that the title insurance, escrow services, and other related services markets produce a homogeneous product is critical to its decision to define competition solely on the basis of price and ignore nonprice competition. If the product is homogeneous, an analysis of competition should focus solely on prices. If suppliers produce a product that is identical in every respect to the product being produced by their competitors, then the only dimension of competition permitted is price. However, if the industry produces differentiated products, economists would analyze and evaluate competition in much broader terms encompassing the various aspects of nonprice competition.

C. Demand

The contractor report concludes that demand inelasticity at the industry level means that "...sellers, as a group or **individually**, could raise the price of title insurance and escrow services without seeing any decline in the quantity of title insurance policies or escrow services demanded" [emphasis added].[12] This conclusion is logically inconsistent with the contractor report's characterization of the product as being homogeneous. If title insurance and escrow services constitute a homogeneous product, then it would be impossible for any seller to raise its price above the market clearing level without losing *all* of its sales. The demand curve facing each firm is totally elastic (*i.e.*, the firm can sell all it can produce at the market price).

Even if the assumption of homogeneity is relaxed, the contractor report's conclusion remains incorrect. As Stanford University economist and former chairman of the President's Council of Economic Advisors, Joseph Stiglitz observes, in the situations where there are a limited number of firms, producing differentiated products,

"Firms compete, often vigorously, against one another. But each believes

[12] Contractor report, p. 71.

> that if it lowers the price it can capture some but not all sales from other firms; and if it raises its prices it will lose some but not all of its customers."[13]

In other words, while industry demand is inelastic, as indicated by a vertical demand curve showing that the firm can sell its output at any price, the demand curve facing individual firms in the industry is downward sloping.

With a downward-sloping demand curve, the amount of sales lost or gained when a firm changes its price depends on how its competitors react. Economist James W. Friedman explains the conjectural interdependency of firms in concentrated local markets with this analogy:

> "Imagine, for example, a town with four home mortgage lenders in a nation with no national mortgage market. Each lender must select a mortgage interest rate and will, let us say, lend to all qualified applicants. Applicants will not all automatically go to the lender offering the lowest rate, because other details of the contract may differ, not all applicants will undertake the cost of fully informing themselves on alternative lenders, and some will have lenders with which they prefer to deal (provided the cost of doing so is not too high). However, any change in terms offered by one lender will affect the rate of flow of applicants to each other lender. An interest rate change for one may be profitable or unprofitable, depending on the subsequent rate adjustments the others make as a result of the initial lender's change."[14]

While the number of sellers of title insurance and escrow services is greater than four in most local markets, the competitive situation facing these sellers is very similar to that described in this analogy.

D. Industry Supply

The title insurance and escrow services industry in California consists of title insurers, underwritten title companies that are affiliated with a title insurer, and underwritten title companies that are unaffiliated. Each type of entity sells title policies. Table 1 of the contractor report indicates that the premium share of direct sales by title companies fell precipitously between 1995 and 1998. No explanation is given for this shift. Since 1998, however, the market share of all three providers has remained relatively constant.

Table 3 of the contractor report shows that in 2004, the top three providers accounted for nearly 76% and the top five providers for nearly 91% of total title

[13] Joseph E. Stiglitz, Economics (New York, NY: W.W. Norton & Company, second edition, 1997), p. 346.
[14] W. Kip Viscusi, John M. Vernon, and Joseph E. Harrington, Jr., Economics of Regulation and Antitrust, (Cambridge, MA: The MIT Press, Third Edition, 2000), p. 153.

written premiums in California. The contractor report alleges that this level of industry concentration is "...inconsistent with competitive markets."[15] While this level of concentration does indicate that the structure of the segment of the industry that underwrites title insurance does not fit the ideal conditions of perfect competition, as noted in the contractor report, this is a statement that could be made about virtually all real world industries.[16] Economists recognize that in and of themselves, market shares say nothing about the extent of competition in an industry.

By combining affiliated underwritten title companies with their parent insurer into insurer groups, the contractor report understates the degree of competition present in the markets for title insurance and escrow services. Affiliated title companies compete for business not only with unaffiliated title companies, but also with other members of their corporate family. And both affiliated and unaffiliated title companies compete with direct sales by insurers. Since agent compensation is based on the amount of premium generated, there is an incentive for each affiliated company to outperform its peers. As the contractor report notes, "These entities are fighting for a share of a fixed demand from home buyers and borrowers."[17] This can be seen by the fact that members of one insurer group often file separate rates. Even where all members of an insurer group operate under one set of rate filings, they compete for business on the basis of the quality of the services offered. The contractor report emphasizes the aggressive efforts by title insurers and underwritten title companies to recruit staff who can generate high premium volume.[18]

The contractor report ignores the competitive forces in play in title insurance and escrow services markets and focuses instead on the degree of concentration as measured by the Herfindahl-Hirschman Index (HHI). Economists and judges have long recognized that the HHI is simply a starting point for analyzing the degree of competition in a market, not a direct measure of competition. Since the HHI measures only the share of firms in a market, it ignores the competitive impact of potential competition from firms that might enter the industry or from existing firms that might expand their market share.

Although the contractor report defines the relevant market to include not only title insurance but escrow, closing, and other related services, nowhere in the report is there evidence as to the number of suppliers of escrow and other services and their relative market shares.

[15] Contractor report, p. 63.
[16] Contractor report, p. 6 notes, "In practice, perfect competition never exists."
[17] Contractor report, p. 68.
[18] Contractor report, p. 69.

E. Conditions of Entry and Exit

One of the most important factors used by economists to assess competition in an industry is the ease of entry and exit. An analysis of entry begins by examining the record. Has there been entry over time? Have firms exited the industry? If entry and exit have occurred, there is a presumption that the industry is competitive. The second step of the analysis would be to examine whether or not there are barriers to entry. There is an extensive literature reporting the results of research by economists on the subject of barriers to entry. Where barriers to entry are nonexistent, or low, economists consider that the market is "contestable."[19] In such a situation, high concentration and other market imperfections need not result in noncompetitive results.

The contractor report indicates that in the title insurer segment of the industry rather than entry there has been extensive consolidation via mergers and acquisitions. It notes that the number of title insurers operating in California rose from 19 in 1995 to 21 in 2004, but the number of insurer groups (*i.e.* related insurers combined under a holding company arrangement) fell over this period from 12 to 11.[20] The contractor report observes that this absence of entry is "...surprising because of dramatic increases in title premiums (due to major increases in the number of transactions and the average sales price of homes) and because of high profitability."[21]

Having raised the question, one might expect the contractor report to provide an analysis of the reasons why new title insurers have not entered the market. Instead, the contractor report observes: "There has been considerable consolidation and growth in concentration in the title insurance industry on a countrywide basis...."[22] This would indicate that whatever is causing consolidation among title insurers, it is not related to competitive conditions in California.

The contractor report also asserts that the number of established underwritten title companies in California has declined gradually over time.[23] The reason given for this trend is that national title insurers have acquired local underwritten companies and independent escrow companies and incorporated them into existing underwritten title company structure. In other words, the acquired companies remain in the market, they have not disappeared. And as explained previously, these companies compete vigorously for business. They remain competitive forces in the industry.

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[19] See J. Bain, Barriers to New Competition, Cambridge, MA: Harvard University Press, 1956; and W. Baumol, J. Panzar, and R. Willig, Contestable Markets and the Theory of Market Structure, (New York: Harcourt, Brace, Jovanovich, 1982).
[20] Contractor report, p. 73.
[21] Contractor report, p. 72.
[22] Contractor report, p. 72.
[23] Contractor report, p. 74.

The contractor report also asserts that "some new underwritten title companies have been created," but observes "...the number is small and the ones created have been controlled business arrangements."[24] Rather than present actual data, the contractor report states that evidence of this trend can be found in examples, but notes that they are contained in "non-public information redacted for public version [sic] of this report."[25] The failure of the contractor report to provide explicit data on entry and exit from this segment of the industry is difficult to understand. Since underwritten title companies are required to obtain a license from the California Department of Insurance (DOI), it would seem a simple matter to determine their number. The failure to do so represents a major omission in the contractor report.

If, as alleged in the contractor report, there has been limited entry into the underwritten title company segments of the industry, an analysis of entry conditions is needed. Performing such an analysis is not an easy task. As one study by prominent economists notes:

> "Defining the relevant set of entry conditions has proven to be a difficult and controversial subject in industrial organization. Nevertheless, here are some questions one needs to ask in order to assess entry conditions: How many prospective firms have the ability to enter in a reasonable length of time? How long does it take to enter the industry? How costly is entry? Will a new firm be at a disadvantage vis-à-vis established firms? Does a new firm have access to the same technology, the same products, the same information? Is it costly to exit the industry?"[26]

The contractor report concludes that the only barrier to entry into the title insurance and escrow services industry in California is established business relationships between underwritten title insurance companies and real estate brokers, lenders, homebuilders, and mortgage brokers.[27] But it provides no evidence to support this assertion other than the observation that there is "intense competition" among title companies for the services of individuals who have established relationships with these entities (based on plaintiffs' briefs in pending lawsuits). In other words, the established business relationship which the report claims restricts entry into the market can be obtained simply by hiring individuals who have such relationships. Given the large number of individuals employed in the real estate, banking, homebuilding, and mortgage banking industries in California, there would appear to be an ample supply of this critical resource, especially since it is their relationship with individuals in these industries that is essential, not their specialized skills.

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[24] Contractor report, p. 75.
[25] Contractor report, p. 75.
[26] Viscusi, *et.al.* op. cit, p. 153.
[27] Contractor report, p. 3. The body of the report also indicates that the monoline requirement may deter entry because it requires "millions of dollars in capital and a detailed application (p. 66). These requirements, however, should pose no difficulty for an established title company determined to enter the California industry.

This is not to diminish the expertise and knowledge required to assemble, analyze, and distribute the information necessary to complete a real estate transaction. Underwriting expertise is also required to identify the appropriate endorsements to add to the policy in order to respond to title issues. The industry professionals who carry out these tasks are essential. Their efforts add security to what is often the consumer's single most valuable asset and make possible a smoothly functioning real estate market. Nonetheless, as the contractor report notes, "We do not believe the availability of skilled personnel for title examination and escrow services is a barrier to entry."[28]

A potential barrier to entry that is not mentioned in the contractor report is the licensing requirement. To the extent that regulatory licensing is not timely or efficient, it may pose a barrier to new entrants or to the expansion of existing participants. Thus, one step that might result in improvements in competition in California title insurance and escrow services markets would be examine the potential role of licensing in limiting entry.

The failure of the contractor report to provide persuasive evidence of the existence of significant barriers to entry into the California title insurance, escrow services, and other related services market not only casts doubt on its allegation that the industry earns excessive profits but also indicates that concentration in the industry does not preclude "reasonable" competition. As noted previously, where barriers to entry are nonexistent, or low, *i.e.*, contestable, high concentration need not result in noncompetitive results. The evidence indicates that the California title insurance, escrow and other related services market is contestable.

III. MARKET BEHAVIOR

A. The Existence of "Reverse" Competition

The analysis of market behavior presented in the contractor report proceeds from the allegation that the market for title insurance, escrow services, and other services related to the transfer of real property in California can be explained primarily in terms of the concept of "reverse" competition. [29]

Reverse competition is not a recognized term in the economics profession. It cannot be found in generally accepted dictionaries of economics.[30] Nor is it mentioned in widely used economics texts, either at the undergraduate

[28] Contractor report, p. 69.
[29] Contractor report, p. 2.
[30] For example, the term does not appear in the 7th edition of the New Palgrave Dictionary of Money and Finance or 4th edition of The New Palgrave, A Dictionary of Economics, (London, England: MacMillan Press, Ltd, 1996, 1998), Peter Newman, Murray Milgate, and John Eatwell, eds.

or graduate level or in the extensive literature dealing with industrial organization. In short, it is not a term of art in economics.

The term appears to have originated in a 1977 U.S. Department of Justice study.[31] The DOJ study focused on analyzing the effects of state regulation on the pricing and distribution of insurance after the passage of the 1945 McCarran-Ferguson Act. That act ratified the states' power to regulate insurance and provided an antitrust exemption for private concerted price-fixing activities which were subject to state regulation. The study concluded that "...an alternative scheme of regulation, without McCarran Act antitrust protection would be in the public interest."[32]

The DOJ study devoted 36 of its 372 pages to what it termed "special problem lines," including title insurance, credit life and credit health insurance, and life insurance, noting:

> "The primary focus of this Report has been on the P-L lines of insurance. Our less extensive consideration of some other lines, however, has revealed some special problems, which may call for different conclusions on whether these lines may be written on a fully competitive basis without any regulatory oversight. We discuss below some particular problems presented, including the phenomenon of 'reverse competition.'" [33]

In passages that have been frequently cited in subsequent regulatory proceedings and featured prominently in the contractor report, the DOJ report describes what it labels reverse competition in title insurance markets:

> "Due to the lack of time, lack of knowledge, and lack of interest the purchaser of a title insurance policy *frequently* exerts little, if any, influence on the selection of sellers. Although the person who pays for the title insurance policy could determine the seller, he *usually* does not, relying, instead, on his real estate broker, mortgage banker, or attorney to direct the business to the most suitable insurer."

> "In other words, competition in the title insurance business is directed at the producer of business rather than the consumer. A title company wishing to increase its share of the market *would not necessarily* try to reduce prices or improve coverage in order to attract retail purchasers of title insurance. Rather, the company would seek to influence those

[31] The Pricing and Marketing of Insurance: A Report of the U.S. Department of Justice to the Task Group on Antitrust Immunities, (Washington, D.C.: U.S. Government Printing Office, January 1977), hereinafter cited as DOJ Study.
[32] DOJ study, p. viii.
[33] DOJ study, p. 250.

brokers, bankers, and attorneys who are in position to direct title insurance business to it. The most direct manner of influencing this business is to grant the producer of business a fee, commission, rebate, or kickback -- to the detriment of the title insurance purchaser. This is the phenomenon of reverse competition."[34]

Marketing to intermediaries is a common phenomenon in our economy. Textbook publishers primarily market their products to the professors who select the textbooks, rather than to students who purchase them. The pharmaceutical industry, until very recently, directed almost all of its marketing efforts to doctors who prescribe the medicines, rather than to their patients who purchased them. In virtually all manufacturing industries, a portion of marketing budgets is directed toward purchasing agents rather than to ultimate consumers. However, the DOJ report alleges that reverse competition in the title insurance industry is harmful to consumers because it "...drives up title costs as insurers strive to pay higher commissions and kickbacks to real estate settlement producers."[35]

Although the contractor report devotes more than 30 pages to reverse competition, it breaks no new ground. It cites "numerous studies and reports [that] have described the reverse-competitive structure of title insurance markets."[36] In addition to the 1977 DOJ study, these include lengthy excepts from testimony in various title rate hearings in Texas as well as several long citations from plaintiffs' briefs in lawsuits (hardly an objective source of information). Given the importance placed by the contractor report on the DOJ study, it is worthwhile to examine that study more closely.

For its description of the title insurance industry, the DOJ study apparently relied on a 1964 dissertation by a student at the University of Southern California.[37] The DOJ study presents no independently developed economic analysis of the industry. It contains neither a description of the relevant product nor a definition of the relevant market. It provides no information on the number of suppliers. It fails to consider conditions of entry and exit. It contains no analysis of pricing or profits in the industry.

While the contractor report contains lengthy quotes from the 1977 DOJ study, it fails to note the conclusions reached by that study.

"However, the problem [reverse competition] may not exist for all life insurers. Likewise, the problem may not be universal for all title insurers or all credit life and health insurance companies. ***Consequently, we***

[34] DOJ study, p. 256 [emphasis added].
[35] DOJ study, p. 256.
[36] Contractor report, p. 27.
[37] J. Brown Jr., An Analysis of Competition in the Title Insurance Industry, Ph.D. dissertation, University of Southern California, 1964, University Microfilm No. 64-13, 488.

believe that further study of the reverse competition problem is required..."[emphasis added].[38]

Unfortunately, in the nearly 40 years since the DOJ report was released, observer after observer, including the contractor, simply assert its existence without adding the qualification that the DOJ characterization of the industry in terms of reverse competition is tentative and requires further study. None provide more than a cursory description of the competitive forces in title and escrow services markets. Given the importance placed on the existence of reverse competition, it is useful to examine in some detail the applicability of this decades-old description of the industry to the title insurance and escrow and other related services industry in California today.

The existence and significance of reverse competition is based on the assumption that decisions regarding which provider of title and escrow and other related services to use is made by intermediaries, rather than by the consumers who pay for these services. Although it is recognized that consumers are free to select their own supplier, the existence of reverse competition depends on the assumption that they do not. But how valid is this assumption?

It is true that title insurance, as well as escrow and other related services, are bought by many consumers who have neither the experience, knowledge nor interest to evaluate alternative suppliers. But it is also true that these services are often purchased by real estate professionals – entrepreneurs, lenders, developers, and builders – who know the market and have a vested interest in achieving the lowest possible price. For example, some national mortgage lenders put out requests for proposals inviting title insurers to submit bids. In refinance transactions, where the magnitude of closing costs becomes a significant competitive factor, many lending institutions are offering to absorb part or all of these costs in order to make an attractive loan. It is important to recognize that for competition to occur, it is not necessary that every consumer or even that most consumers be price-sensitive and knowledgeable. It is sufficient that those who are price-sensitive and knowledgeable are able to exert influence.

Reverse competition also assumes that the marketing efforts of firms providing title insurance and escrow and related services produce little or no benefit for consumers. Under the theoretical conditions of perfect competition, there would be no incentive for producers to advertise or expend money in marketing their products, since they are assumed to be able to sell all that they can produce at the existing market price. Moreover, perfect competition assumes that consumers already have all relevant information. But under real world market conditions, firms selling differentiated products under conditions of intense rivalry where there are a few sellers have incentives to advertise and engage in other marketing efforts. Title insurers have an incentive to offer a

[38] DOJ study, p. 371.

higher quality product in order to attract more business. All of the parties in a real estate transaction are interested in timely, accurate, efficient, and convenient service. The fact that quality improvements benefit all parties to the transaction, and not just the party paying for the service, should not obscure the fact that the payer is benefiting.

To the extent that advertising presents information of use to consumers, it promotes a more competitive market. To the extent that it persuades consumers to purchase more of a product than they otherwise would, advertising can expand the market, enabling producers (and indirectly consumers) to reap the benefits of economies of scale. Admittedly, some advertising is aimed simply at preserving or increasing a firm's market share. But it is very difficult *a priori* to differentiate between beneficial advertising and non-beneficial advertising, and economists as a rule make no attempt to do so.

Economists also recognize that marketing involves not only advertising but the positioning of the product within the market and differentiating it from the products being offered by competitors. This differentiation is viewed as an important dimension of competition, especially in industries where a few sellers are producing a non-homogeneous (differentiable) product. To put the matter somewhat differently, consumers are concerned with the perceived quality of the product as well as its price.

The notion of reverse competition adds little to the above discussion. Some marketing efforts of title insurance firms inform consumers (directly or indirectly through their agents). Given the inelastic nature of demand, advertising in the title insurance and escrow and other services industry is unlikely to expand the market by persuading consumers to consume more of the product. But efforts by firms providing title insurance, escrow and other related services to differentiate their product from those of competitors frequently provide value to consumers, enhancing the perceived quality of the service.

Explications of reverse competition assume that title insurers are unconstrained in their ability to pass forward cost increases to consumers. The implication is that all market power exists in the hands of suppliers. *A priori* there is little to suggest that suppliers of title insurance and escrow and related services are monopolists who can be assumed to have total market power and to be able to independently determine market prices. The intense rivalry noted by the contractor report on page 8, for example, would not exist if these firms were monopolists. Moreover, knowledgeable and experienced intermediaries, representing the interests of purchasers of title insurance and escrow and related services, are in a position to restrain the actions of suppliers and promote the delivery of efficient, convenient, and cost-effective services.

As we have seen, barriers to entry into the title business are low. Any success title companies might have in raising prices above competitive levels and earning above normal profits is likely to induce entry. There are a number of large title insurers who are not represented in the California market that represent potential entrants. Firms in one local market (county) can and often do expand operations into nearby counties. However, it is not necessary that firms actually enter the market for their influence to be felt. The potential for entry acts as a check against existing firms raising their prices. This means that title companies are unable to pass forward higher costs to consumers without incurring the risk of entry.

Reverse competition assumes that intermediaries representing the interest of consumers (real estate brokers, lenders, mortgage bankers, attorneys, etc.) can extort favors from the suppliers of title insurance and escrow and related services. For example, the contractor report cites a State of California Department of Insurance Bulletin 80-12 (December 24, 1980) which states:

> "While the representative has a fiduciary relationship to the purchaser or seller, cost or service features of the transaction of potential benefit to the purchaser or seller may be subordinated to other considerations found to be personally desirable or beneficial to the representative. As a result the opportunity for enrichment of the representative may be placed in a higher order of priority than the opportunity of securing for the person required to pay for the policy of title insurance the best product in terms of cost or service."[39]

In other words, in title insurance and escrow and related services, as in other areas where intermediaries represent the interest of their customers, the potential exists for abuse.

As the contractor report emphasizes, it is certainly possible to find numerous instances of rebating. However, the instances cited represent an extremely small number compared to the large number and dollar volume of title transactions conducted each year (*e.g.*, three million transactions and $3.5 billion in premiums in California alone).

Thus, while offering inducements for referrals may not be practical or profitable as a competitive strategy, it may work to the advantage of individual sales agents seeking to increase their income. (In many instances, their compensation is tied to volume.)

The public policy issue presented by rebating is not whether it exists. The public policy issue is what weight to give it. Does it characterize the competitive behavior of every firm in the entire industry? What is the magnitude of its impact on prices? What is the most effective remedy to limit its impact?

[39] Contractor report, p. 34

Economic theory indicates that reverse competition is not an effective competitive strategy. Empirical evidence supports the conclusion that its presence is both limited in extent and sporadic. Neither the contractor report nor any other analysis of reverse competition provides evidence that it has raised prices. Offering inducements or rebates for title insurance is a violation of both federal and state law. The most effective public policy for combating the isolated instances where inducements for referrals are discovered is to enforce the law.

But the advocates of the existence of reverse competition do not limit their condemnation of the practice to instances in which title companies pay rebates, commissions, kickbacks, etc., to those who refer business to them. The contractor report cites with apparent approval the startling conclusion reached by a staff report to the State Board of Insurance in Texas that "The market failures which allow these problems [of reverse competition] to occur *call into question almost every type of expenditure by the title industry*."[40] Thus, the contractor report alleges that when title companies incur costs to improve services they harm consumers. In other words, normal competitive behavior is condemned.

Implicitly, reverse competition assumes that prices paid by consumers are higher than they would otherwise be. But none of the allegations of reverse competition discuss what pricing would result if title companies and providers of escrow and other services didn't market their products to the agents of consumers. Clearly, if all consumers of title insurance and escrow and related services had to determine on their own the best source of supply, they would have to incur significant costs. The very fact that many do not choose to incur such costs provides evidence that reliance on intermediaries is deemed by these consumers to be cost effective.

Common sense would also support the view that where expertise is required to determine the quality of service, it is much more efficient and, in the long run, less costly to consumers for firms to market their products to knowledgeable intermediaries rather than to consumers themselves. For example, until recently, pharmaceutical companies marketed their drugs to doctors, rather than to patients. Now one can hardly turn on the television or pick-up a magazine without being bombarded by advertisements for prescription drugs. Does anyone doubt that the decision to market to the general public has increased the costs of pharmaceutical companies and that consumers now pay a higher cost for these drugs?

In the absence of any workable definition of which expenditures produce benefits to consumers and which do not, nor any measure of their magnitude, some regulators have resorted to simply disallowing a proportion of expenses in calculating title insurance base rates. This action is both arbitrary and capricious. Most observers would agree that some taxpayers cheat on their taxes. But it is difficult to know the impact of this cheating on tax revenues. Should the Internal

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[40] Contractor report, p. 36.

Revenue Service add an arbitrary surcharge (say 2%) to the taxes of every taxpayer to offset the illegal actions of a small minority of taxpayers?

Reducing the rates for title insurance to penalize the industry for the illegal actions of a few of its members raises a serious regulatory issue. When carried out over successive rating periods, arbitrary reductions in rates could result in a steady diminution of industry profits endangering the ability of providers to attract capital and remain in business.

B. The Problem Posed by Controlled Business Arrangements

Given the emphasis on reverse competition as set forth in the 1977 DOJ study, controlled business arrangements pose a major difficulty for the contractor. Controlled business arrangements "...refer to business organizations with joint ownership by a title insurance company, underwritten title company, real estate agent, developer, mortgage broker, lender or other entity in a position to refer business to a title insurer or underwritten title company."[41] In its discussion of reverse competition, the contractor report had quoted the conclusions of the 1977 DOJ study regarding controlled business arrangements:

> "To sum up the major evils of controlled title companies, where a real estate settlement producer is able to direct the purchaser of a title insurance policy to a particular title company and at the same time that producer owns the title insurance company, the purchaser is likely to end up 1) paying unreasonably high premiums, 2) accepting unusually poor service, or 3) accepting faulty title examination and policies from the controlled title company."[42]

The contractor report notes, however, that the California Insurance Code 12397 "...requires any applicant for a title insurance company or underwritten title company license to indicate its intent to actively compete in each county where it conducts business and to indicate in its license application a plan of operations that 'will not involve reliance for more than 50% of its closed title orders from controlled business sources.'"[43] The Code also states:

> "Competitive behavior shall be measured by the source of closed title orders in each county in which the licensee engages in the title business and by the entity's progress toward meeting the 50% objective specified in Section 12397..."[44]

Thus, the California Insurance Code permits a controlled business arrangement as long as no more than half of the title company orders result from controlled

[41] Contractor report, p. 53.
[42] 1977 DOJ Study, page 273 as cited in the contractor report p. 30
[43] Contractor report, p. 53.
[44] Contractor report, p. 54.

business sources. But under the assumptions of reverse competition, which the contactor report alleges characterizes the California title insurance and escrow services industry and which its says results in a noncompetitive market, such arrangements would of necessity have to be seen as raising prices to consumers without any commensurate benefit.

To escape this dilemma, the contractor report asserts: "The determination of whether a reasonable degree of competition exists in the business of title insurance in California requires a far broader analysis than the narrow test for one type of entity as set out in the controlled business sections of California law."[45] It then provides two examples of where a broader analysis is required: 1) where illegal rebating is found; and 2) where there is only one title company in a county. "Both of these situations would indicate the absence of a reasonable degree of competition, even with no controlled business arrangements present."[46]

Taken at face value, this statement suggests that in markets in which there is more than one title company present and where illegal rebating is not found, even in the absence of a controlled business arrangement there must be a presumption that a reasonable degree of competition exists. It should also be noted that the contractor report's equating of illegal rebating and the absence of a reasonable degree of competition raises an important issue. Does a single instance of illegal rebating provide a justification for concluding that the entire market fails to exhibit a reasonable degree of competition? If not, how widespread would the rebating practice have to be to reach such a conclusion? What is reasonable? The contractor report fails to provide any answers to these important questions.

Even where a controlled business arrangement passes the 50% test, the contractor report indicates that its presence in the market can be seen as indicating that a reasonable degree of competition does not exist: "Consequently, the presence of controlled business arrangements is one factor in evaluating whether a reasonable degree of competition exists in a California title insurance and escrow market."[47]

In 1983, the U.S. Department of Justice weighed in on the competitive implications of controlled business arrangements:

> "The Department of Justice recognizes that controlled business arrangements have resulted largely from RESPA's prohibition against kickbacks and referral fees. However, we do not view such arrangements as necessarily anticompetitive. Rather, arrangements among providers of different goods or services who do not compete with one another –

[45] Contractor report, p. 54.
[46] Contractor report, p. 54.
[47] Contractor report, p. 54.

> including diversification by a single firm into the provision of additional complementary services – may benefit consumers in a variety of ways. Regulatory efforts to interfere with such arrangements should not be undertaken in the absence of a strong showing that they are economically harmful to consumers. We are not aware that any such showing has been made. Further, to the extent that there is competition among the providers of these services, any referral fees or other similar payments that a provider receives (**perhaps because of the controlled business arrangements**) are likely to be passed on (because of the forces of competition) partly or wholly to consumers through lower prices for the services. Accordingly, we do not believe such arrangements should be prohibited by federal law [emphasis added]."[48]

After noting that their view of controlled business arrangements is based upon study and economic analysis undertaken subsequent to the issuance of the Department's 1977 Insurance Report, the letter states, "...to the extent that the views stated in this letter are inconsistent with the findings and conclusions of that Report concerning controlled business arrangements, those findings and conclusions do not represent the current views of the Department of Justice on this subject."[49]

The 1983 DOJ conclusions regarding the economic beneficial impacts of controlled business arrangements cast doubt on the validity of applying the reverse competition paradigm to title insurance and escrow services markets. The economic logic underlying the DOJ's conclusions relating to controlled business arrangements suggests that it does not accept the assumptions of reverse competition as applying to the market for title insurance and escrow services.

C. Behavior of Prices for Title Insurance and Escrow Services

The contractor report concludes that the California title insurance and escrow services markets are not price competitive. It bases its conclusion on the allegation that "...the rates of the major insurers are very similar. The absence of diversity among filed rates also indicates a lack of competition."[50] The report's analysis of prices is plagued by errors of omission and internal contradictions in logic. It displays a fundamental lack of understanding of the economics of pricing.

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[48] Department of Justice (DOJ) Position on Affiliated Businesses, Letter, from Robert A. McConnell, Assistant Attorney General, to Honorable Henry B. Gonzalez, Chairman, Subcommittee on Housing & Community Development, Committee on Banking, Finance & Urban Affairs, U.S. House of Representatives, April 16, 1983.
[49] Ibid.
[50] Contractor report, p. 88.

As noted above, the contractor report states that the product being sold in the California title insurance and escrow services industry is homogeneous. This means that consumers would perceive the product sold by any one competitor as being completely identical to the products being sold by all other competitors. **Under such conditions, there could be no price differences among competitors.** Any firm that raised its price above the market price would lose all of its customers. Given the expressed view that the product is homogeneous, the contactor report is being **internally inconsistent** in assessing the degree of competition in terms of price differences among suppliers. If the product is homogeneous, then it is inappropriate for the contractor report to assess the state of competition on the basis of the extent of price differences. On the other hand, if there are price differences, then the product is not homogeneous and any assessment of competition should include both price and non-price factors.

As we have seen, the product being sold in the California title insurance and escrow services industry is not homogeneous, but differentiated. Thus, one might expect some differences in prices among competitors. However, the magnitude of differences in prices would be expected to be small given the number of competitors in the market. While alleging that the rates of the major issuers are very similar, the contractor report nonetheless shows that the base rate premiums filed by seven major insurers for a $500,000 owner's policy over the period 1998-2005 ranged from 3.4% above to 5.9% below the simple average.[51] (Charts 6 and 7 on pages 89-90 of the contractor report are perfect examples of how to mislead with statistics. By charting premium charges on a scale from $0 to $2,000 in one chart and $0 to $1,600 in the other, the report exaggerates the flatness of rates. Had the report used a scale of 0 to $1 million, the rates would have appeared to be identical!)

By only including the base rates filed by the major insurers, and omitting the base rates filed by all other insurers, **the report significantly understates the actual extent of price differences**. This understatement is magnified by the fact that the report focuses only on base rates, ignoring the fact that much of the price competition in the title insurance and escrow market occurs through the filing of special rates that offer discounts from the base rate. This is especially true with respect to refinancing transactions which have accounted for most of the growth in transactions and dollar volumes in California in the period 2000-2004. While information on these discounts is readily available from the publicly filed rates, the contractor elected to ignore them.

The contractor report also alleges that prices for title insurance have not changed over time. In evaluating this statement, again it should be noted that the data in the report pertain only to filed base rates. On its web site, the California DOI cautions consumers that the posted rates presented in the DOI survey may not be the price they pay. "These surveys provide basic fee

[51] Contractor report, p. 89.

information and do not factor in discounts or surcharges which may be applicable to your unique situation."[52]

The contractor report presents data showing that the volume of title insurance premiums varies widely year-to-year. It then concludes that it would be expected, given the high fixed costs in the industry, that prices would vary over time in response to these changing economic conditions, falling in good years and rising in bad years.[53]

Assuming for the moment that the filed rates do reflect actual prices, how valid is the argument that these rates should fall in good years and rise in bad years? Economic theory would suggest just the opposite. When demand for a product falls, one would expect prices to fall, not rise as the contractor report asserts. And in periods of slow real estate activity and declining home values, we would expect insurers to lower, not raise, rates.

How is this conclusion that rates should fall in good times and rise in bad times, which defies both common sense and the maxims of economic theory, reached? The contractor report argues that since real estate activity and home values have risen significantly in California, we would expect title insurers to have lowered rates several times to reflect **lower costs of production per unit sold**.[54] This statement appears to reflect a misconception, common among introductory economics students, confusing average and marginal costs.

Economic theory holds that the profit-maximizing price under any form of market structure is determined by equating marginal cost and marginal revenue. Fixed costs by definition are fixed, they don't impact marginal costs. Therefore, they don't impact the profit-maximizing price. While it is true that given high fixed costs, average costs are likely to fall when output rises, that fact is irrelevant in determining the profit-maximizing price.

Economic theory also holds that when demand expands price rises. The extent of the rise depends on the magnitude of the increase in demand and the shape of the industry supply curve (both short-run and long-run). Only if the industry long-run supply curve is perfectly elastic would it be expected that the price would remain the same. The only way in which an expansion in demand could result in a lower price would be if the long-run industry supply curve slopes down – a condition of natural monopoly which is not applicable here.

The contractor report also argues that costs of production have fallen, based on A.M. Best reports commenting on the benefits of improved technology.[55] These reports are suggestive, but certainly not proof that industry

[52] California Department of Insurance website, http://www.insurance.ca.gov/0100-consumers/
[53] Contractor report, p. 84.
[54] Contractor report, p. 91.
[55] Contractor report, p. 45.

costs have, in fact, fallen. No information is given on personnel costs and how they have changed over time. No data are provided on the costs of automation. Even though presumably the contractor had access to the reports filed by title companies with the California Department of Insurance, he has apparently drawn conclusions regarding industry costs without analyzing this data.

The contractor report alleges that stable prices in the face of declining costs are proof that the title and escrow and related services industry is noncompetitive.[56] While, as noted above, no data is presented on costs and the price data cited in the contractor report is quite limited and selective, stable prices would be consistent with what one would predict in a competitive industry with an elastic supply curve and expanding demand. An elastic supply curve means that when demand rises, either new firms enter or existing firms expand their capacity without incurring higher average costs. This implies an absence of barriers to entry.

Finally, the contractor report presents some limited data on escrow fees for different transactions amounts filed for selected counties in California that show significant variation, both between firms and between counties.[57] Once again, these data are not actual prices but filed rates and are limited to a few selected firms. Nonetheless, they do reflect sensitivity and responsiveness to local market conditions in setting prices. Yet the contractor report concludes that a reasonable degree of competition does not exist in the escrow and other related services market. That conclusion is contradicted by the data on escrow services prices contained in the contractor report.

IV. MARKET PERFORMANCE

A. Profit Levels

After stating unequivocally that "There is insufficient information available to determine the profitability of the title insurance business in California,"[58] the contractor report nonetheless alleges that firms in the industry earn "excessive" profits.[59]

With regard to title insurers, the data indicate that the return on equity (ROE) of the big four national title insurers in 2004 ranged from 12.5% to 17.3%.[60] It is asserted that "These profit levels are significantly higher than we would expect in a competitive market..."[61] However, the contractor report provides no basis for this assertion. When one considers that the average ROE

[56] Contractor report, p. 88.
[57] Contractor report, p. 22.
[58] Contractor report, p. 46.
[59] Contractor report, p. 2, pp. 80-82, p. 93
[60] Contractor report, p. 78.
[61] Contractor report, p. 78.

of the entire banking industry in the United States was 15.31 in 2003 and 13.74 for 2004 the ROEs of title insurers do not appear to be excessive.[62]

The contractor report also concludes that underwritten title companies in California earned after-tax net income in 2004 equal to 32.3% of shareholder equity. [63] The data on which this conclusion is based have not been made public. It is important to understand, however, that return on equity is not always a valid measure of profitability. In small firms producing financial services, the amount of equity may be very small. For such firms, net income often is more of a return on the owners' human capital than on their financial capital.

It is also important to note that title insurance and escrow services industry revenues vary considerably over time, due to the cyclical nature of real estate markets. The contractor report opted to present profitability data for underwritten title companies for 2003 and 2004, a period of unusually high industry activity. The contractor report presents data only on average profits. Yet a central issue in analyzing profitability is risk. To analyze risk it is necessary to have data on profits over the entire cycle, including both good and bad years, and to have data on profits by firm. Rather than relying on average returns for one or two years, a thorough analysis of profitability would be based on a study of variability across years and among firms in each segment of the industry. The contractor report not only does not address the variability of returns for the title insurance segment of the market, but it also fails to provide any profitability information for the escrow services and other related services segments of the industry. (The absence of information on the profitability of these market segments, however, does not prevent the contractor report from including these segments in its conclusions relating to the workability of competition.)

V. CONCLUDING COMMENTS

A. Conclusions Regarding the Workability of Competition

Economists are in general agreement that the theoretical model of perfect competition constitutes neither a normative ideal nor a satisfactory basis for appraising actual market conditions. As the contractor report notes:

> "In practice, perfect competition never exists. When perfect competition does not exist, but the characteristics of perfect competition exist to such a degree that market outcomes approximate those that would occur in a perfectly competitive market or that produce price competition, a situation called workable competition exists."[64]

[62] Federal Deposit Insurance Corporation, Quarterly Banking Profile, September 2005.
[63] Contractor report, pp. 81-82.
[64] Contractor report, p. 6.

This definition of workable competition is taken from a Peat Marwick Study. It appears to require results consistent with the theoretical model of perfect competition in real world markets lacking the structural prerequisites required to produce such results. What are the market outcomes referred to in this definition? How far can they depart from the theoretical norms of perfect competition for the market to be judged workably competitive?

Unfortunately, it is easier to recognize the need for alternative normative standards than to provide broadly applicable criteria. At best, the appraisal of the workability of competition in an industry remains a "subjective judgment by a given economist concerning the extent to which he thinks that the absence of one or another of the conditions of perfect competition will not prove *unduly* harmful to economic welfare."[65] In short, whether workable competition exists in a given industry is a judgment call rather than a measurable outcome justified by a theoretical norm. But that judgment can be informed by an extensive professional analysis of industry structure, behavior, and performance based economic theory and the best available data. The contractor report has not provided such an analysis.

Economists do not judge the workability of competition by application of a fixed standard of performance. It is not sufficient to say a market falls short of producing the results of perfect competition. Virtually all actual markets do. The goal of regulation is not to convert an imperfectly competitive industry into a perfectly competitive industry. From the outset, workable competition has been viewed in instrumental terms. Pragmatically, are there public policies available for application to the industry that can improve social welfare? Economists also recognize that regulation imposes costs as well as benefits. So any determination of the workability of competition in an industry must also balance the benefits that might be achieved through regulation against the costs that it imposes. The contractor report fails to consider these issues.

B. Summary

The contractor report's conclusions regarding the reasonableness of competition in the California title insurance and escrow services market are unsupported by the available evidence and based on a faulty analysis of the industry.

The contractor report relies extensively on the assertion that the markets for title insurance and escrow services are characterized by reverse competition. Reverse competition is a description, not an economic theory. In theory, reverse competition would be a limited phenomenon unlikely to significantly impact the prices charged by an individual firm, let alone an entire industry. In practice, its

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[65] H.H. Liebhafsky, The Nature of Price Theory (Homewood, Illinois: The Dorsey Press, Inc., 1963), p. 22.

assumptions are not supported by actual conditions in most title insurance and escrow services markets.

The contractor report contains both errors of fact and omission. Its descriptions of such important industry factors as the nature of the product, conditions of demand and supply, costs, prices, entry and exit conditions, competitive behavior, and profitability are superficial at best, and at places misleading. In several instances, the report makes logical errors in its interpretation of economic factors.

The contractor report provides no operational definition of workable competition and fails to address the issue of how public policy toward the industry could be altered to improve social welfare. This is not a matter of enforcing a standard of performance, but rather a need to balance costs and benefits of regulatory actions.

Given its significant limitations, the contractor report provides no basis for making regulatory decisions about the state of competition in the California title insurance and escrow services industry.

APPENDIX A

CURRICULUM VITAE OF DR. JARED E. HAZLETON

JARED E. HAZLETON

PERSONAL INFORMATION

Title:	Professor of Finance, Insurance, Real Estate, and Business Law (FIREL)
Business Address:	College of Business Administration University of North Texas P.O. Box 305460 Denton, Texas 76203-5460 E-Mail Address: Hazleton@unt.edu
Business Phone:	(940) 565-3620 (940) 369-8839 (FAX)
Home Address:	1726 Timber Ridge Circle Corinth, Texas 76205
Home Phone:	(940) 321-8000
Birth Date:	September 12, 1937
Birthplace:	Oklahoma City, Oklahoma

EDUCATION

B.B.A.	University of Oklahoma (Accounting), 1959
Ph.D.	Rice University (Economics), 1965

AWARDS AND HONORS

1986 – 1988	Elected President, National Taxpayers Conference
1979 – 1983	Elected Treasurer, Association for Public Policy Analysis and Management
1971 – 1972	Elected President, Southwestern Economics Association
1965	Recipient, John W. Gardner Award in the Humanities and Social Sciences, (presented yearly by the graduate faculty of Rice University for outstanding research)
1963 – 1964	Resources for the Future, Inc., Doctoral Dissertation Fellowship

1961 – 1963	Rice University, Graduate Fellowship

PROFESSIONAL EXPERIENCE

2004 – present

Professor of Finance, Insurance, Real Estate, and Business Law (FIREL), College of Business Administration, University of North Texas, Denton, Texas

Teach courses in Money and Capital Markets and Investments.

Areas of research include banking, natural resources, and public policy.

1999 – 2004

Dean and Professor of Finance, Insurance, Real Estate, and Business Law (FIREL), College of Business Administration, University of North Texas, Denton, Texas

Chief executive officer of a college which has 5,700 students, 103 faculty, 32 staff and an annual budget in excess of $I0 million.

Teach economics in the Executive MBA program.

1989 – 1999

Director, Center for Business and Economic Analysis and

Professor of Finance, Lowry Mays College and Graduate School of Business, Texas A&M University, College Station, Texas

Established and directed a center providing research on economic and business conditions and public policies impacting business.

Conducted research studies for the Texas Apartment Association, the Texas Healthcare & Biosciences Institute, Bell Helicopter Corporation, and the Texas Educational Economic Policy Center.

For four years served as an advisor to Lt. Governor Bob Bullock and The Select Committee on Taxation of the Texas House on state tax policy. Also served as a Research Fellow of the Texas Real Estate Center and as a consultant on a $700,000 National Science Foundation study of Water and Sustainable Development in the Binational Lower Rio

Grande/Bravo Basin. Wrote and distributed a monthly newsletter – Texas Economic Outlook. Wrote weekly columns for the Bryan Eagle and monthly columns for the Texas Banker. Developed forecasting models for the U.S. and Texas economies and made 40-50 formal presentations each year to various trade and professional groups. Views widely cited in business media, e.g., Wall Street Journal, Business Week, Newsweek, London Economist, CBS Evening News. Taught graduate and undergraduate courses in corporate finance, money and capital markets, global business, and the European Monetary Union.

1988 – 1989 Vice President - Economics, Mesa Limited Partnership, Amarillo, Texas

Established a department within Mesa to forecast oil and gas markets and analyze new investment opportunities. Served as a member of the Executive Committee helping to analyze merger and acquisition opportunities for the firm. At the time Mesa was the largest independent oil and gas company in the United States with a capitalization of $3 billion. Worked directly with the Chairman and CEO, T. Boone Pickens, Jr., on numerous special projects, including the formation of the United Shareholders Association.

1982 – 1987 President, Texas Research League, Austin, Texas.

Served as CEO of the Texas Research League, a nonprofit, privately supported organization with an annual budget in excess of $1.5 million created to conduct research related to public policies for state and local government in Texas. The League Board included 200 chief executive officers (for Texas-based firms) or top corporate officers in Texas (for firms headquartered in other states). Doubled the size of the staff and budget; advised the Speaker of the Texas House on interstate banking legislation for Texas; served as chief of staff for a commission appointed by the Governor to address the solvency of the Workman's Compensation Insurance Fund and other public policy issues related to economic development. Testified before legislative committees on economic and tax issues.

1980 – 1982 Dean, Graduate School of Public Affairs, the University of Washington, Seattle, Washington

Served as CEO of a graduate school of public policy having 15 faculty, 5 staff, and a budget of $1 million.

1972 – 1980	Associate Dean and Professor, Lyndon B. Johnson School of Public Affairs, The University of Texas at Austin, Austin, Texas As a founding member of the faculty of the school, assisted in the creation of its curriculum and course of study. Taught graduate courses on the economics of public policy and public finance. Supervised policy research projects receiving $590,000 in funding from the Ford Foundation and the Lyndon B. Johnson Foundation. Served as Co-Principal Investigator on coastal zone management research projects supported by $974,000 in funding from the National Science Foundation (RANN). Also served for three years as Associate Dean of the school, overseeing budget and academic administration.
1973 – 1975	Project Specialist - Economic Research, The Ford Foundation, New York City, New York While on leave from the University of Texas at Austin, lived in Amman, Jordan helping to establish an economic research unit within the Royal Scientific Society. Also served as an economic advisor and consultant on numerous Ford Foundation projects in Lebanon, Egypt, Syria, Bahrain, Kuwait, and Saudi Arabia.
1968 – 1972	Vice Chairman and Associate Professor, Economics Department, The University of Texas at Austin, Austin, Texas Taught undergraduate courses in principles of economics, money and banking, regional economics, and environmental economics.
1964 – 1968	Officer, Federal Reserve Bank of Boston, Boston, Massachusetts Joined the regional Fed in Boston as a resource economist. Promoted after one year to Manager of the Research Department.

Two years later named Banking Services Officer with responsibility for overseeing relations with 250 member banks in New England. Also served as secretary of the Federal Reserve System Presidents' Conference Committee on Computerized Communications Systems, a member of the Federal Reserve System Research Committee on Bank Credit Cards, chairman of the Federal Reserve System Committee on Computer Education, a member of the Federal Reserve System Committee on the Use of Computers in Research, and a member of the Federal Reserve System Committee on Current Research Statistical Series.

MILITARY SERVICE

NROTC Program, University of Oklahoma, 1955-1959. Entered active duty in July 1959 as Ensign, SC, USNR. Ranked 2nd in a class of 250 officers at the Navy Supply Corps School in Athens Georgia. Served 18 months as Supply Officer, USS HOWARD D. CROW (DE 252), with responsibility for maintaining spare parts and stores inventory, ship's payroll, ship's laundry and store, and the enlisted mess and wardroom meal service. Discharged from active duty in July 1961 as LTJG, SC, USNR. Attained rank of LT, SC, USNR before resigning commission in 1966.

OTHER PROFESSIONAL EXPERIENCE

1993 – 1994	Consultant, Southwestern Bell Telephone Company, re. strategic issues in local telephone regulation
1991 – 1992	Consultant, Texas Independents for Natural Gas, ARCO, Hoescht-Celanese/ Occidental Chemical Corporation re. proposed regulations relating to natural gas prorationing
1991 – 1992	Consultant, Texas Mid Continent Oil and Gas Association, re. study of gasoline marketing in Texas
1989 – 1990	Member, Economic Advisory Committee, State Comptroller of Texas
1989 – 1990	Interim Director, Project Bluebonnet, a consortium of universities, nonprofit organizations, and private firms seeking to form a not-for-profit public education and research corporation to support telecommunications and network research. Supervised the formation of the Bluebonnet Network Education and Research Corporation, and served as a member of its Board of Directors.

1988	Invited paper, "The Texas Economy - Current Situation and Future Prospects," presented to the 15th Annual Texas-Japan Conference, Austin, Texas, October 5, 1988.
1986 – 1987	Member, Economic Development Advisory Committee to the Speaker of the Texas House of Representatives
1986	"Texas at the Turning Point," Annual Distinguished Lecture, Angelo State University, San Angelo, Texas, November 1986.
1983 – 1985	Member, Board of Trustees, Government Research Association
1979 – 1982	Member, Panel on Economics and Public Policy, Intercollegiate Case Clearing House, Harvard Business School
1979 – 1980	Consultant, Occupational Safety and Health Administration, U.S. Department of Labor, Washington, D.C., re. determination of costs and benefits of proposed regulations requiring identification and labeling of toxic substances in the workplace
1977 – 1980	Consultant, U.S. Agency for International Development, Washington, D.C., re. development of the Jordan Valley
1977 – 1979	Consultant, Program Analysis Division, U.S. General Accounting Office, Washington, D.C., re. research on a national urban policy
1978	Consultant, Occupational Safety and Health Administration, U.S. Department of Labor, Washington, D.C., re. economic impact of generic regulation of carcinogenic substances
1972 – 1973	Consultant, Texas State Finance Commission, Austin, Texas, re. feasibility of state-authorized deposit insurance for state banks and savings and loan associations
1972 – 1973	Consultant, Division of Planning Coordination, Officer of the Governor, State of Texas, Austin, Texas, re. land use management programs and policies

1971 – 1973	Consultant, Texas State Parks and Wildlife Department, Austin, Texas, re. preparation of the State Outdoor Recreation Plan
1968	Instructor, Massachusetts School of Banking, Williams College, Williams, Massachusetts
1965 – 1968	Lecturer in Economics, Clark University, Worcester, Massachusetts
1966 – 1967	Lecturer in Economics, Northeastern University, Boston, Massachusetts
1964 – 1965	Consultant, Continental Oil Company, Houston, Texas re. acquisition of mineral properties

COMMUNITY ACTIVITIES

2000 – present	Director, United Way of Denton County
2004 – present	Member, First United Methodist Church of Keller
1993 – 1998	Chairman, United Way of Texas (board member, 1993-2000)
1996 – 1999	Director, Bryan Rotary Club
1990 – 1992	Member, State Steering Committee, Texas Business and Education Coalition (member, executive committee, 1991-1992)
1989 – 2004	Member, First United Methodist Church, Bryan
1983 – 1999	Director, Texas Council on Economic Education
1988 – 1995	Director, Texas Research League
1988 – 1989	Polk Street United Methodist Church, Amarillo, Texas (member of the Finance Committee and adult Sunday school teacher)
1988 – 1989	Director, United Way of Amarillo
1988 – 1989	Member, Amarillo Business and Professional Men's Club
1987 – 1988	Director, Austin Chamber of Commerce

1983 – 1987	President, Capital Area Branch, Arthritis Foundation, 1986-1987; (board member, 1983-1985)
1986 – 1987	Secretary, South Texas Chapter, Arthritis Foundation
1982 – 1987	St. John's United Methodist Church, Austin, Texas (member of the Administrative Board and adult Sunday school teacher)

PUBLICATIONS

Author or co-author of three books, four monographs, 43 academic and professional articles (including chapters in books), and 39 professional reports.

EXPERT TESTIMONY

Served as an expert economic witness in eight cases before state and federal courts.

WORKSHOP REGARDING TITLE INSURANCE COMPETITION REPORT AND IMPLICATIONS FOR RATE REGULATION

Statement of Michael J. Miller, FCAS, MAAA

on behalf of the

California Land Title Association

January 5, 2006

Introduction

My name is Michael J. Miller. My business address is 138 Lakeshore Drive, Minocqua, Wisconsin 54548.

I obtained a Bachelor of Science degree in 1968 from Illinois State University, with a major in mathematics and a minor in accounting. In 1967, prior to graduation, I began working for State Farm Insurance as an actuary trainee. I continued working for State Farm until 1984, serving in various management roles where I had insurance rate-setting responsibilities. Thereafter, I was a Principal and Vice President at Tillinghast, an international property/casualty consulting firm. I remained with Tillinghast through 1993 at which time I became a Principal in Miller, Herbers, Lehmann, & Associates. In 2003 I helped establish a new actuarial consulting firm EPIC Consulting, LLC which we merged into the Tillinghast practice in October 2004.

I am a Fellow of the CAS and have been a member of the American Academy of Actuaries since 1975. I have satisfied all of the qualification and continuing education requirements of my profession to render a public actuarial opinion on ratemaking issues and have testified as an expert actuary in several state and federal courts and at governmental insurance ratemaking administrative hearings in many U.S. states and Canadian provinces. A copy of my *curriculum vitae*, which accurately sets forth my experience, qualifications, and publications, is attached hereto as Exhibit A.

Through my work in the insurance industry since 1967, I have been directly involved in the development of professional standards that guide actuaries in areas of property/casualty actuarial practices. I have served the Actuarial Standards Board as chair of the Property/ Casualty Committee. I have served the Casualty Actuarial Society (CAS) as Vice President for Research/Development and Chair of the committees on Risk Classification and Principles of Ratemaking. As chair of the Ratemaking Committee, I was the principal drafter of the

Statement of Ratemaking Principles and was the sole author of the first draft. I have served two terms on the CAS Board of Directors.

Scope of Work

In preparation for this affidavit, I reviewed a report authored by Mr. Birny Birnbaum entitled "An Analysis of Competition in the California Title Insurance and Escrow Industry". I found no analysis in the report of the type necessary in order for Mr. Birnbaum to support his conclusion that title insurers are charging excessive rates.

Actuarially Sound Rates

Actuaries specialize in the calculation of insurance rates based on generally accepted actuarial principles and standards of practice. Actuarially sound rates are reasonable, adequate, not excessive, and not unfairly discriminatory if the rates reflect all the costs associated with the risk transfer process. The four broad categories of costs included in ratemaking are claim costs, expenses associated with settling claims, general/administrative expenses, and the cost of capital.

Prospective Ratemaking

Ratemaking is necessarily prospective in nature because the rate is set before the issuance of a policy and before any losses and expenses are incurred. Insurance rates are based on prospective loss costs, prospective expenses and a prospective estimate of the cost of capital. Determinations concerning the adequacy or excessiveness of insurance rates cannot be made unless there is an actuarial analysis of the reasonableness of the prospective costs which were included in the rate. This prospective analysis of costs would be necessary in order for Mr. Birnbaum to support his conclusion that title insurance rates are excessive. His report contains no actuarial analysis of rate adequacy or excessiveness.

Insurer Specific Rates

Ratemaking is insurer specific. Broad, sweeping statements about the excessiveness of rates on an industrywide basis have no significance. Each insurer has its own expectations concerning future losses and expenses. Each insurer has a unique capital structure and unique cost of capital. Mr. Birnbaum has not conducted the actuarial analysis of the prospective costs for any specific insurer which would be necessary to support an opinion that any insurer's rates were excessive.

Title Insurance Risk

Title insurers conduct extensive loss prevention activities intended to reduce claim losses covered by the insurance policy. Reduced loss payments does not mean that title insurance is necessarily a low-risk line of insurance. Title claims may develop 25 to 30 years after the policy issuance. Title insurers are required by law to maintain statutory premium reserves for as much as 20 years so as to provide sufficient protection for this very long period of claim occurrence. The financial results of a title insurer are highly sensitive to economic cycles, especially cycles in the real estate market. Birnbaum has cited financial results from a five-year period (Birnbaum Report at page 109) without any analysis to determine whether these results are being distorted by an up-cycle or down-cycle in the financial results.

Rates of Return

At page 109 of his report, Mr. Birnbaum cites "ROE" returns in the range of 10.16% to 38.40%. These returns are mislabeled and are not returns on the insurers' equity capital. Rather, the "ROE" returns are expressed as a percentage of statutory surplus. Statutory surplus does not equal equity capital. Mr. Birnbaum made no effort to determine the equity capital of any title insurer, or the industry as a whole.

Also unexplained by Mr. Birnbaum is why his "ROE returns" (actually returns on surplus) on page 109 are significantly different than the yearly change in statutory surplus.

For instance, Mr. Birnbaum alleges a 24.69% ROE in 2004, but in 2004 statutory surplus increased only 1.9%.

Cost of Capital

Rates are not excessive unless the rates are likely to produce a return that is unreasonably higher than a specific insurer's cost of capital. A determination of rate excessiveness requires a determination of both the insurer's cost of capital and a range of reasonable returns above the cost of capital benchmark. Mr. Birnbaum has conducted no analysis of either the cost of capital for any title insurer or the range of reasonable returns above the cost of capital. Without a cost of capital benchmark for each insurer, and a range of reasonable returns above the cost of capital, there can be no basis for Mr. Birnbaum's conclusions concerning title insurance rate excessiveness.

Exhibit A

CURRICULUM VITAE

NAME:	Michael J. Miller
BUSINESS ADDRESS:	138 Lakeshore Drive Minocqua, WI 54548 E-Mail: mike.miller@towersperrin.com
EDUCATION:	ILLINOIS STATE UNIVERSITY Bachelor of Science – 1968 Major – Mathematics Minor – Accounting
CONTINUING EDUCATION:	Estimated study time exceeding 3,000 hours necessary for completion of 10 qualifying exams for membership in Casualty Actuarial Society (CAS). Participation as an attendee and on the faculty of the CAS Loss Reserve Seminar, the CAS Ratemaking Seminar, and other CAS educational seminars on special topics, such as rate of return and underwriting practices. Meet all continuing education requirements of the American Academy of Actuaries necessary to sign a public actuarial opinion.

MEMBERSHIP IN PROFESSIONAL ORGANIZATIONS:	Casualty Actuarial Society (CAS)	
	Associate Member	1971
	Fellow	1981
	American Academy of Actuaries (AAA)	1975
	Conference of Consulting Actuaries	2002-2004
	Fellow	
	International Actuarial Association	
	Midwestern Actuarial Forum	
	Chartered Life Underwriter (CLU)	

PROFESSIONAL ACTIVITIES:	CAS Committee on Risk Classification,	
	Member	1982-1984
	Chairman	1983-1984
	CAS Committee on Principles of Ratemaking	
	Member	1985-1987
	Chairman	1991-1992
	CAS Examination Consultant	1987-1990
	CAS Long-Range Planning Committee	1993-1994 1997-2000
	CAS Board of Directors	1992-1993 2001-2003
	CAS Officer,	
	Vice President – Research and Development	1993-1996
	CAS Task Force on Non-Traditional Practice Areas	
	Chairman	1998-2000
	CAS/SOA Joint Task Force on Financial Engineers	1998-2001
	AAA, Liaison Committee to the National Association of Insurance Commissioners	1985-1988
	Actuarial Education and Research Fund Board of Directors	1994-1996
	AAA, Casualty Practice Council	1990-1993
	Property Casualty Committee of Actuarial Standards Board, Member	1987-1993
	Chairman of Ratemaking Subcommittee	1987-1988
	Chairman of Property/Casualty Committee	1989-1993
	Midwestern Actuarial Forum	
	Education Officer	1986-1987
	President	1988
EMPLOYMENT HISTORY:	State Farm Insurance	1967-1984
	M. J. Miller and Company	1984
	Tillinghast	1984-1993
	Miller, Herbers, Lehmann, & Associates, Inc.	1994-2002
	EPIC Consulting, LLC	2003-2004
	Tillinghast/Towers Perrin	2004

PROFESSIONAL PUBLICATIONS:

"Private Passenger Automobile Insurance Ratemaking", Proceedings of CAS, Volume LXVI.

"Review – Risk Classification Standards by Walters", Proceedings of CAS, Volume LXVIII.

"A History of the Rating and Regulation of Personal Car Insurance in the United States", The Institute of Actuaries of Australia, February, 1990.

"An Evaluation of Surplus Allocation Methods Underlying Risk Based Capital Applications", CAS Discussion Paper Program, Volume I, 1992.

"How to Successfully Manage the Pricing Decision Process", CAS Discussion Paper Program, 1993.

"Building a Public Access PC-Based DFA Model", CAS Forum, Summer 1997, Volume 2.

"Auto Choice: Whose Fault Is It Anyway", Contingencies, January/February 1998

"Actuarial Implications of Texas Tort Reform", CAS Forum, Spring 1998.

"The Relationship of Credit-Based Insurance Scores to Private Passenger Automobile Insurance Loss Propensity", June 2003.

PRESENTATIONS:

Faculty member on National Association of Insurance Commissioners' orientation program for new insurance commissioners, 1987-1994.

Faculty member on National Association of Independent Insurers' seminars on ratemaking and loss reserving.

"Key Provision in Rate Filings", Society of State Filers.

Numerous presentations at educational seminars and meetings conducted by the Casualty Actuarial Society on topics including ratemaking, loss reserving, underwriting, risk classification and rate of return.

EXPERT TESTIMONY:

Rate Regulatory Hearings in Alberta, California, Florida, Georgia, Louisiana, Maryland, Massachusetts, Michigan, Mississippi, New Brunswick, New Jersey, New York, North Carolina, Ohio, Oklahoma, Ontario, Pennsylvania, Texas, Vermont, West Virginia, and Wyoming.

Courts in Alabama, California, Florida, Minnesota, Mississippi, New Hampshire, Pennsylvania.

Competition and Title Insurance Rates in California

Prepared by

Bruce E. Stangle, Ph.D.

and

Bruce A. Strombom, Ph.D.

Analysis Group, Inc.

January 23, 2006

Competition and Title Insurance Rates in California

Summary

The title insurance industry has recently experienced one of the largest real estate booms in U.S. history. Since the industry is so closely tied to the fortunes of the volatile real estate sector it is necessary to take a long view to understand the true nature of competition. The data show that the title insurance industry in California is competitive and rates are not excessive. For the median priced home in California, the base price of a standard owner's title insurance policy per thousand dollars of coverage has declined significantly from $6.89 in 1962 to $3.06 in 2005. Prices for refinance loan policies have fallen even further. Title insurance prices in California are now among the lowest in any of the ten largest states. Competition among title insurance companies forces firms to provide more innovative products and services and to offer lower prices through modified pricing programs. If California instituted a more stringent form of rate regulation for title insurance it is likely that consumers would pay more for insurance and be denied the benefit of new, innovative insurance products.

I. Introduction

Most consumers buy a home relatively infrequently over their lifetimes so they are unfamiliar with title insurance and its features and pricing. Since the demand for title insurance is derived from home purchases it is not surprising to see a tight link between home sales and title industry operating revenue as shown in Exhibit 1. Extremely low interest rates during the past five years have fueled a rapid expansion of home sales, refinancings, and associated title revenues. But the real estate business in the U.S. is notoriously volatile and this affects the title industry as well. Over the last 25 years, title industry revenues have dropped by significant amounts during several periods of downturns in home sales and prices, e.g., the mid 1990s. In order to understand the economic performance of the title industry it is necessary to take a long view, spanning several housing cycles rather than focusing on a narrow window of time, such as the recent boom in housing prices, construction, and refinancings. It would be wrong to base major public policy changes on the peak experience of the past few years since industry conditions are likely to change.

Title insurance protects property owners and mortgage lenders from losses resulting from defects in the title to real estate, or claims against a property that were not discovered in the title search. Owners' policies are typically purchased by homebuyers and remain in effect as long as the buyer owns the property. Loan policies, which are required by virtually all lenders in order to obtain a mortgage, remain in effect until the loan is paid off. Development of standardized title insurance coverage has been a major contributor to the availability of mortgage financing and the resulting increase in home ownership since the 1950s. In part due to the growth of the secondary mortgage market, the development of which was facilitated by the availability of title insurance, national home ownership stood at 69 percent in 2005, the highest level ever.

An important difference between title insurance and other forms of insurance is that the title insurance premium is paid only once when the policy is issued. Most other types of insurance, such as homeowner's insurance, require that premiums be paid periodically over the term of coverage. Exhibit 2 compares the total premium over the full term of ownership for title insurance with that of homeowner's insurance for the median priced home in California in 2004. Over a typical 14.1 year period of ownership, the premiums for homeowners insurance total over $31,000 compared to just $1,552 for title insurance. By this benchmark, the price of title insurance is relatively modest.

II. The Issues and Findings

We were retained by Counsel for First American Title Insurance Company to examine competition in the title insurance business in California.[1] We were asked to study the extent of price competition, whether rates are excessive, the extent of product innovation, and whether profit rates in the title insurance industry indicate a lack of competition. We were also asked to evaluate whether having relatively few title insurers harms price competition, and whether marketing and distributing title insurance products to third parties, rather than directly to homeowners, harms consumers.

Our examination of the data reveals that title insurance prices in California have declined significantly as a percentage of a typical home's purchase price since the 1970s, and by a far larger amount since California home prices began their rapid rise in the year 2000. Title insurers frequently offer reduced price programs filed with the Department of Insurance at rates below filed base rates, demonstrating the existence of price competition. Similarly, filed rates vary across title insurance firms, providing price choices for buyers and further indicating price competition between providers. Prices in California are among the lowest available in any large state, including the states where prices are set under rigid state rate regulation, including Florida and Texas.

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[1] California Commissioner of Insurance John Garamendi funded a study on the extent of price competition among California title insurance companies. (Birny Birnbaum, Report to the California Insurance Commissioner, *An Analysis of Competition in the California Title Insurance and Escrow Industry*, December 2005. Hereafter "Report to the Commissioner.") The Report to the Commissioner concluded that price competition did not exist and that California home owners were being charged excessive prices for title insurance. Contributing to this alleged lack of competition, the Report to the Commissioner found that insurers were earning excessive profit rates, title insurance in California is controlled by a few firms which contributes to excessive prices, there is a large barrier to entry into the industry, prices have not changed in the last five years even through costs had declined, and marketing title insurance to third parties drives up costs and prices to homeowners. In an accompanying press release, Commissioner Garamendi concluded that prices had skyrocketed in recent years, consumers are systematically overcharged, and that title insurers refused to compete on price. (2005 Press Release, "Insurance Commissioner John Garamendi Blasts Title Insurers for Excessive Rates – vows to Lower Prices to Consumers," December 16, 2005.)

In addition to price declines, there has been extensive innovation in title insurance products offered to homeowners since the 1960s, providing greater value for the price. Profit rates for title insurance holding companies, which are generally equal to or less than those of property and casualty insurers, homebuilders, and the broader Standard & Poor's 500, indicate no lack of competition in title insurance markets. While consolidation in the industry has reduced the number of insurers, there is no necessary connection between the number of firms and price competition; many industries with only a few competitors are highly price competitive. More directly, the data indicate extensive price competition in California. We found no significant barriers to entry and expansion, indicating that if prices were excessive, entry could occur to hold down prices. Finally, criticisms of third party distribution are misguided as an alleged source of excessive costs and prices. If marketing directly to homeowners were more economical, competitive pressure would have led to the adoption of such distribution methods. Marketing to third parties has historically been the most economical channel to provide title insurance to homeowners, reducing costs.

III. Title Insurance Prices and Price Competition

A. Trends in prices. Have California's rates skyrocketed?

An accurate analysis reveals that filed rates for title insurance in California have declined substantially. Furthermore, price declines, which are evident in long-term price data, have accelerated in recent years. For example, as shown in Exhibit 3, in 1962, the price of First American's CLTA Standard Coverage owner's policy for the median priced home in California of $15,100 was $6.89 per thousand dollars of coverage. In the year 2000, the price for the same type of coverage for the median priced home of $241,350 was $4.11 per thousand dollars of coverage. By 2005, the price of coverage for the median priced home of $548,400 had fallen to $3.06 per thousand dollars of coverage. In the 38 years between 1962 and the year 2000, First American's price per thousand dollars of coverage to consumers for a median priced home declined by 40 percent, a compound annual decline of 1.4 percent. In just the last five years, the price per thousand dollars of coverage for a median priced home declined an additional 27 percent, a compound annual decline of 5.7 percent.

Price declines for loan policies issued for a refinancing have been even greater. The premium for First American's CLTA Standard Coverage loan policy in 1962 for a $10,000 refinance was $6.72 per thousand dollars of coverage. In 2005, for a $500,000 refinance it was $1.70 per thousand, which represents a price decrease of approximately 75 percent.[2]

[2] Even if one were to rely on the biased data in the Report to the Commissioner, those data still provide evidence of falling title insurance prices. For example, using data in the Report of the Commissioner, we calculate that title insurance premiums as a percentage of home purchase prices declined in Los Angeles County from 0.44 percent of total purchase price in 1996 to 0.35 percent in 2005 and in Alameda County from 0.43 percent in 1999 to 0.35 percent of total purchase price in 2004. Report to the Commissioner, p. 87.

These calculations and the data in Exhibit 3 are based on filed base rates, even though, as discussed below, Californians now typically pay prices substantially below base rates, so the changes in base rates understate the actual decline in prices. Total premiums paid for title insurance have increased naturally as the price of homes and amount of coverage required in California have increased over time, but premiums have increased far less than the rise in home values, leading to a substantial decline in title insurance prices as a percentage of home value.

B. Price trends, product innovations and the level of service

Changes in product quality must be recognized when analyzing price trends or results may be biased. In the title insurance business, quality is reflected in several dimensions including the level of coverage incorporated in the title insurance policy and level of service provided to customers. Even if prices remained unchanged, if the quality of the product improves, then price in effect has declined because the price per unit of quality has declined. Just as the U.S. Bureau of Labor Statistics routinely adjusts products in the Consumer Price Index such as automobiles, computers, CDs, refrigerators, etc., for quality changes over time,[3] improvements in title insurance coverage must be taken into account when examining price trends over time.

Exhibit 4 shows changes in title insurance coverage features for owner's policies offered by First American in California since 1963.[4] The coverage applies to the policy that was most commonly issued in the year reported. As coverage for basic policies has grown substantially over time, the effective price per unit of coverage has thus declined. The price comparisons between different periods reported above thus understate the price decline because greater coverage, i.e., a superior product, is currently provided relative to past periods.

C. Product offerings at prices below base prices

The price of a CLTA Standard Coverage policy is sometimes used as a reference price or "base rate" when comparing prices for title insurance across firms. Base rates can be thought of as "list prices" rather than actual transaction prices. An analysis of price competition that relies on list prices is fundamentally flawed and can be misleading because most consumers do not purchase title insurance at these prices.[5] For example,

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[3] See seminal article by Zvi Griliches, "Hedonic Price Indexes for Automobiles: An Econometric Analysis of Quality Change," in *The Price Statistics of the Federal Government*, General Series No. 73, New York: Columbia University Press for the National Bureau of Economic Research, pp. 137-196. For current BLS methods see: National Academy of Sciences [2002], At What Price? Conceptualizing and Measuring the Cost-of-Living and Price Indexes , Panel on Conceptual, Measurement and Other Statistical Issues in Developing Cost-of-Living Indexes, C. Schultze and C. Mackie, eds., Committee on National Statistics, National Research Council.

[4] In addition, all basic loan policy coverages have likewise increased.

[5] The pricing analysis in the Report to the Commissioner is fundamentally flawed in at least three respects: first, it only includes base rates or list prices, second, it does not account for title insurance quality changes, and third, it does not account for inflation.

First American estimates that in 2005 the majority of owner's policies issued by First American in California were at rates different than the base rate.

Instead of paying the base rate, many consumers, or lenders on their behalf, purchase title insurance at lower prices through modified pricing programs and policy forms that have been filed for use with the Department of Insurance. The effective rates for title insurance have declined over time as these reduced price programs have been introduced and expanded, even though base rates may not have changed.[6] Many of the new products and pricing programs offered by First American included prices that were lower than the base rate that existed at that time. The following are examples of reduced price programs in California.

<u>Short term rates</u>: Title insurers offer prices lower than base rates on policies for which an earlier policy had recently been issued. When first introduced in 1965, First American's short term rate provided a discount of 15 percent on one-to-four family properties if another policy had been issued within one year of the current policy. This program has been expanded on several occasions so that now reductions of 20 percent are available on all property types if a policy has been issued within five years of the current policy.

<u>Affordable home ownership programs</u>: Discount programs for low to moderate income families are available. First American's Affordable Home Ownership Settlement Package ("AHOSP"), introduced in 2003, offers qualifying families a discount of approximately 25 percent when purchasing a package of settlement services that includes title insurance.

<u>First time buyers and seniors</u>: As of 2004 some title insurers offered discounts of 10 percent or more for qualified first time buyers and seniors.

<u>New lower priced policy forms</u>: Insurers have introduced a number of new policy forms that are offered at prices lower than base rates. For example, First American's EagleEDGE policy, introduced in 2002, provides all of the protections afforded under the CLTA/ALTA Homeowner's Policy of Title Insurance at a price reduction of 20 percent. This reduction is available in addition to the short term rate mentioned above.

<u>Automated issuance</u>: Insurers offer a number of lower priced products to lenders that submit a high volume of orders electronically. For example, in 2001 First American introduced the FACT Master Loan Policy, a limited coverage title insurance policy for equity loans up to $250,000. The premium for $250,000 in coverage under this program is just $65, compared to the $350 base rate for the refinance loan policy used in the Report to the Commissioner.

In addition to reduced rate pricing programs and new lower priced product offerings, significant reductions in rates for refinance loan policies were also introduced

[6] As discussed below, rates for loan refinance policies were reduced by various insurers in 2005.

in 2005. For example, the rate charged by First American for a $350,000 refinance loan policy was reduced from $880 in 2004 to $550 in 2005, a reduction of over 37 percent. Other insurers also responded by filing base rate reductions for refinance loan policies in 2005, although the percent reductions were not as large as those of First American.

Reduced rate pricing programs, new lower priced products, and reductions in rates all provide clear evidence of price competition in California's title insurance industry.[7] Policy makers should not rely on any purported analysis of price competition that does not consider product improvements or the actual prices paid by consumers for title insurance.

D. Are California's rates excessive? California rates versus other states

Comparing title insurance prices across states (and in some cases within states) is complicated by at least two facts: 1) the level of insurance coverage may vary due to regulation or other factors, and 2) the set of services included in the title insurance product may differ.[8] A meaningful comparison of prices must consider potential differences in both of these effects.

In California, the level of coverage available to consumers is among the greatest of any state. Similarly, the bundle of services available in California is among the most comprehensive available in any state. In addition to these two factors, prices may vary for a number of other reasons including differences in the cost of inputs such as labor, the quality of title records, the expected loss ratio, the degree of regulation, and the level of demand, to name just a few.[9]

Policy rates for home owners in most large states are higher than in California. Exhibit 5 compares current prices of title insurance for the median priced home in the U.S. in the ten most populous states. California is the third lowest priced state in this group.[10]

[7] We generally tend to favor using the term "competition" rather than attempting to separately identify various forms of competition such as price, non-price, service, quality, and new product or innovation, etc. Our reading of the California Insurance Code (section 12401.3) is that it speaks to "a reasonable degree of competition" without trying to specify what form of competition should exist.

[8] Title insurance consists of two distinct elements: 1) the search, examination and abstracting of title records and 2) the underwriting of insurance risk and issuance of a title insurance policy. In some states, separate fees are still charged for each element.

[9] Price is determined by more than just cost. Demand must also be accounted for in determining the expected level of prices. It is a fundamental concept of economics that price is determined by the interaction of both supply and demand. Other things equal, if demand increases, prices will be expected to increase. Thus, in a competitive market with declining cost, price could easily increase if demand increases. The demand for title insurance has certainly increased in recent years with the rise in home sales and lower interest rates leading to large scale refinancing. Without accounting for both cost and demand changes, sweeping conclusions about whether price changes in title insurance are consistent with price competition have no economic credibility.

[10] This analysis is based on the price of the median priced home in the U.S. To the extent that prices for homes are higher in California than in other states, the actual cost per dollar of coverage in California will be lower because prices per dollar of coverage fall as the dollar level of coverage increases.

Of the states shown in Exhibit 5, two have lower prices than California: Georgia and Illinois. Lower prices in Georgia are explained by the fact that the two elements of title insurance (discussed above in footnote 2) are priced separately in Georgia. This means that the price shown in the exhibit includes only the price of insurance risk. In short, the title insurance rate available in Georgia is not all-inclusive and therefore not comparable to title insurance rates in California and other states.

Illinois is the only state among the nine other most populous states in which prices for title insurance are lower than prices in California. This is of particular interest because Illinois is the only state shown in Exhibit 5, besides Georgia, in which title insurance rates are not regulated.[11] In contrast, there are two states shown in Exhibit 5 – Florida and Texas – in which rates are explicitly set by the state insurance commissioner, the most onerous form of rate regulation. As noted in Exhibit 5, rates to homeowners in these two states are substantially higher than rates in California (i.e. 56 percent higher in Texas than California and 17 percent higher in Florida than California).[12]

The data presented above indicate that prices of title insurance in California are not excessive when compared to prices in other states. In fact, prices in California are among the lowest available in any large state. Further, the data suggest that prices tend to be higher in states with greater regulation and lower in states where title insurance rates are unregulated.

E. Profit rates as a measure of price competition

We were asked to evaluate whether the profit levels earned by title insurance holding companies indicate a lack of competition in title insurance markets. A comparison of title insurance profits to profits earned by companies in other industries reveals that title insurers' profitability has generally been below that of other benchmark industries.[13]

Exhibit 6 compares profit margins of publicly traded title insurance holding companies with those of three benchmark comparators: 1) homebuilders that, like title insurers, are tied closely to the real estate sector, 2) property and casualty insurers that, like title insurers, offer insurance products, and 3) the Standard and Poor's 500 ("S&P 500), a broadly diversified index of public companies. Results are compared for the ten years from 1995 through 2004, the last year for which data are currently available. Because title insurer profits are tied so closely to the volatile real estate sector,

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[11] Title insurance rates are also not regulated in Georgia; however price comparisons with Georgia are meaningless because the rate available there is not all-inclusive as discussed above.

[12] In one other state not shown in Exhibit 5 – New Mexico – rates are also set by the state insurance commissioner. As in Florida and Texas, rates in New Mexico are also substantially higher than rates in California.

[13] The analysis that follows is based upon nationwide results for title insurance companies, not just within California. Overall profitability may not be indicative of profitability of title insurance within California due to differences across states in prices, operating costs, levels of coverage, loss ratios, and the inclusion of other business segments.

comparisons must be made over relatively long periods that capture both peaks and troughs in the real estate cycle.[14] The margins presented in Exhibit 6 show profits as a percentage of sales. Over this period, the operating profit margins earned by title insurance holding companies averaged 8.9 percent, below the average margins for all three benchmark groups which ranged from 9.0 percent for homebuilders to 14.5 percent for the S&P 500. Over the same period, the net income margin for title insurance holding companies averaged 5.1 percent, below the average margins of 8.5 percent for property and casualty insurers and 6.1 percent for the S&P 500, and slightly above the average margin of 5.0 percent for homebuilders.

Return on equity is another measure of profitability in which after-tax profits are expressed as a percentage of the book value of stockholder's equity.[15] As shown in Exhibit 7, this measure also does not provide evidence of excessive profits for title insurance holding companies. Title insurance holding companies earned an average return on equity of 12.8 percent, below the average of 16.8 percent for homebuilders and 13.7 percent for the S&P 500, and above the average of 11.1 for property and casualty insurers.

The comparisons in Exhibits 6 and 7 likely overstate the profitability of title insurance because title insurance holding companies have diversified into other lines of business and these new lines are on average more profitable than the older core business of title insurance. For example, based upon the SEC filings of publicly traded title insurance holding companies in 2004, profit margins on the title insurance business segment averaged 10.8 percent compared to 16.2 percent in all other business segments.[16]

The comparison of the profitability of title insurance holding companies with profits earned in other industries supports the conclusion that the markets for title insurance are competitive.

IV. Competition and Market Structure

In evaluating the degree of competition in a given market, a range of factors that may affect the ability of suppliers to raise prices above the competitive level must be considered. While the starting point of such an analysis may be the number and size distribution of sellers in a market, this is only a preliminary consideration. It is well

[14] For this reason, as well as others, the analysis of the profitability of California underwritten title companies included in the Report of the Commissioner, which considers only 2003 and 2004 results, is biased and unreliable.
[15] Accounting rates of return on equity are generally considered by professional economists to be of little relevance in evaluating competition, in part because they are calculated using the depreciated historical cost of assets rather than their replacement values.
[16] Results are based on business segment profit margins for Fidelity National Financial, First American Corporation, Stewart Information Services and LandAmerica Financial excluding the segment "corporate and other." Title insurance was less profitable than other segments even in 2004, when profits for title insurance would be expected to be near their peak as home sales and refinancing activity were at or near all time highs.

established among professional economists that high concentration alone does not result in a lack of price competition.[17] A host of other factors, including the ease with which new suppliers can enter the relevant market or existing suppliers can expand output, must be considered.

While the number of national title insurance companies has declined over the past twenty five years as a result of mergers, this trend has also been evident in many other industries, including retail banking, investment banking, and automobiles, in which there is a high degree of price competition. Further, mergers in the title insurance business must be approved by both federal antitrust authorities and state insurance commissions so as to protect consumers. If the analyses conducted at the times of these mergers had caused regulators to expect adverse effects on competition, then the prior mergers would not have been approved.

While the number of national firms has declined, the number of underwritten title companies ("UTCs") in California has increased recently. For example, between 2004 and 2005 the number of UTCs licensed to do business in the state increased from 83 to 91.[18] The entry of new suppliers, during a period of exceptional profits, is one more indication of competition in the California title industry.

A. Few firms as a measure of competition

The notion that a market supplied by few firms provides the basis for predicting an absence of price competition is at odds with real world markets and, moreover, has little basis in economics. First, the number of firms in a market is not determined by accident. Few firms compete in certain markets because of fundamental, underlying economic conditions. Market structure, the number and size distribution of firms in an industry, is largely conditioned by the costs of production and distribution relative to the size of the market. Where there are large economies of scale relative to the size of the market, fewer firms can profitably compete. A large minimum efficient scale must be reached to attain profitability, and the size of the market limits the number of firms when large scale is required for efficient operation. However, that does not mean that the surviving firms will not compete aggressively on price and product quality for customers.

The real world offers many examples of industries with few firms and intense price competition, indicating that the existence of few firms does not necessarily predict an absence of price competition. Everyday examples include aircraft, beer, and soft drinks. In large commercial aircraft there are only two rivals worldwide, Boeing and Airbus, who are well known for battling each other for months on price discounts to win orders for new aircraft. Aircraft buyers play one manufacturer off against the other to extract a competitive price. Anheuser-Busch, Coors, and Miller account for most beer sales in the U.S. and market aggressively against one another. The industry has been investigated numerous times by the government and price collusion has never been

[17] See for example U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines*, 1997.
[18] California Department of Insurace.

detected. Coca-Cola and Pepsi have long accounted for most soft drink sales in the U.S. and regularly undercut each other's prices in supermarket sales. Other examples of few firm industries engaged in intense price competition include household detergents and cleaners, and household paper products. Economics has long known that two firms are sufficient for competitive pricing to flourish.

Attempting to infer price competition from the number of sellers is also misleading because it ignores the buyers' side of the market. When there are large buyers in a market supplied by relatively few sellers, buyers provide a countervailing force that blocks prices from being raised above the competitive level. In this case, title insurance providers must compete for large lenders, like Citibank, Chase, and Bank of America. These are large scale, highly knowledgeable and sophisticated buyers, who demand the lowest prices available. The threat of such large buyers moving their business to rival title insurance firms prevents pricing above the competitive level.

B. Barriers to entry and expansion

A barrier to entry or to the expansion of existing firms is some unique factor that allows incumbents to sustain above competitive prices in the long run. Historically, the need for insurance companies to establish and maintain title plants was considered a barrier to entering the industry.[19] More recently, the development of "joint plants" and easy access to title information for a modest subscription fee has effectively removed this factor as a barrier to entry.

It has been suggested that the need to overcome established relationships between title insurance providers and the network of contacts that direct homeowners seeking title insurance represents a large barrier to entry.[20] Gaining sales by encouraging customers to switch from rival firms is a problem facing new entrants in any industry, and it is a cost of business that incumbents faced when they entered. Moreover, battling for customers is an every day cost of doing business in all industries. Such a ubiquitous cost is not a barrier to entry or expansion as the term is used by professional economists.

In industries where prices are above the competitive level, new entrants could attempt to overcome established relationships by offering title insurance at competitive prices. Nothing prevents new entrants from marketing their services to lenders, homebuilders, and real estate agents. If incumbents are earning relatively high profit rates (i.e. above risk adjusted competitive returns), then there are strong incentives for new entry. However, entry may be limited in the case of title insurance if, as noted earlier, there are large economies of scale relative to the size of the market, which would restrict the number of firms that can profitably compete.

[19] A title plant is a compilation of records affecting the title to real property maintained by title insurance companies.
[20] Report to the Commissioner, pp. 68-69.

V. Do Middlemen Drive up the Cost of Title Insurance?

We were asked to evaluate whether the common practice of marketing and distributing title insurance products through third parties such as realtors, lenders, and other settlement providers, rather than directly to homeowners, harms consumers. It has been suggested that these so called "middlemen" serve merely to drive up title insurance prices.

But middlemen serve a useful purpose in many markets. They serve to lower the cost of distribution and exchange of economic goods and services. They can provide price and quality information and facilitate the matching of customers to providers. Middlemen often reduce search costs for both buyers and sellers. The ultimate success story for middlemen is currently eBay, which has greatly reduced the cost of bringing together millions of buyers and sellers.

In the 1970s the term "reverse competition" was applied to the title insurance industry to describe the way that title insurance is marketed to homeowners.[21] Providers of title insurance market their products to real estate agents, mortgage brokers, lenders, and developers to secure recommendations (sometimes called referrals) to home owners. Proponents of the concept of reverse competition viewed this avenue of marketing as harmful to consumers because it purportedly raised the cost of gaining business and the costs were passed on to consumers. In effect, expenses for marketing and distribution, normal activities in all markets, were seen as harmful in title insurance because of the cost to consumers. The implication was that title insurance providers should market directly to home owners, rather than use third parties for referrals.

But marketing directly to home owners entails costs as well, such as advertising and other means of reaching potential customers, and price, in the end, must cover costs for a company to remain in business. A range of negative and anti-competitive connotations were originally attached to the term, reverse competition. Since that time, many profound changes have occurred in the real estate and banking industries coupled with a revolution in information technology such that it is not at all clear that "reverse competition" adequately describes the title industry as of 2006.

There are numerous industries where middlemen operate, where ultimate consumers may not be well informed about quality or price, and where recommendations are a normal and acceptable business practice. For example, the marketing of prescription drugs was historically most often directed to physicians rather than final consumers, until it became legal for drug companies to advertise to consumers.[22]

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[21] See U.S. Department of Justice, "The Pricing and Marketing of Insurance," January 1977.
[22] The pharmaceutical industry provides an informative example of the cost of marketing directly to consumers. Historically, the marketing efforts of pharmaceutical companies were directed toward the physicians who prescribed medications. Changes in regulations of the Food and Drug Administration in the 1990s expanded the ability of pharmaceutical companies to advertise directly to consumers. In the ten years since 1995, direct to consumer advertising by pharmaceutical companies has increased over 13 fold from approximately $300 million to over $4 billion. Francis B. Palumbo and C. Daniel Mullins, "The

Similarly, professional services such as consulting, architectural and legal services are often acquired via referrals rather than direct marketing to the end consumer, in part because this method is cost effective.

In a residential real estate closing, a consumer will be confronted with dozens of legal forms to read and sign. Numerous checks may be exchanged between buyer and seller. It would be unrealistic to think that a typical buyer would want to do a separate price and quality assessment on every line item on the HUD-1 Form. Rather, the consumer places their trust in the real estate agent or banker, expecting that they have recommended reliable vendors for each of the various closing services. Consider the analogy of home construction. Suppose someone was considering renovating their kitchen and adding a new family room. Most people would search for a reliable contractor, perhaps interview several, ask for bids, and make a final selection possibly after talking to other satisfied customers. The contractor that is retained may need to separately hire subcontractors for plumbing, electrical, flooring, tiles, etc. It would be unrealistic for the homeowner to have the knowledge to manage all of the subcontractors. It is the general contractor's responsibility to monitor the price and quality of the work done by the various subcontractors.

In applying this analogy to the title insurance industry, many of the same conditions apply. Many residential customers do not have the experience necessary to make a fully informed choice about title insurance. Just as it is generally uneconomical for homeowners to search for each required subcontractor when undertaking a major home remodeling project, it is uneconomic for a single home owner to search the market for title insurance, mortgage insurance, escrow services, appraisers, inspectors and all other services required for home financing. Many home owners would prefer to rely on the expertise of the realtor or banker who is a specialist dealing with these issues as a regular part of their trade. As long as RESPA[23] is complied with, lenders and realtors have no incentive to see their customers pay more for title insurance or any other closing costs. Realtors and lenders want to create good will and encourage their customers to return to their firm when they are looking to sell their home or refinance their mortgage, and to recommend the realtor and lender to their friends.

For those claiming that marketing title insurance directly to homeowners is more beneficial to consumers than through third parties for recommendations, the evidence is to the contrary. Competition pushes markets to adopt the most efficient forms of production as well as distribution. If there were more economical methods to market title insurance directly to consumers, title insurance firms would be doing so, in order to reduce costs. The fact that they market to third parties demonstrates that it is the most efficient way to attract business from home owners.

Development of Direct-to-Consumer Prescription Drug Advertising Regulation," *Food and Drug Law Journal*, 2002; The IMS Health Report-Pressure Zone," *Medical Marketing & Media*, May 2005.

[23] RESPA stands for Real Estate Settlement Procedures Act.

VI. Rate Regulation

Title insurance is subject to a variety of different forms of rate regulation in the U.S. Some states such as Illinois and Indiana have very little or no rate regulation. California is a so-called "file and use" state meaning that title insurance companies must file proposed rates with the Department of Insurance and wait thirty days before implementing them. Stricter forms of regulation exist in so called "prior approval" states. Finally, in Texas, Florida and New Mexico there is the most onerous rate regulation where the insurance commissioner "promulgates" the rates that insurers can charge for title insurance. As noted earlier, premiums for title insurance in Texas and Florida are considerably higher than in California. To make matters worse, in Texas and New Mexico there is absolutely no product innovation because every firm is required to sell exactly the same product. Consequently, as one example, First American does not offer in Texas a variety of its products that it considers of higher quality.

If the nature of regulation in California were to change so that title insurance rates were promulgated by the Department of Insurance Commissioner, it is likely that the following effects would ensue. First, the extensive number of reduced price offerings would diminish and perhaps ultimately vanish. Second, firms would no longer have an incentive to innovate with new products. Third, tremendous resources would be brought to bear on formal rate hearings, with companies hiring lawyers, accountants, and rate specialists, and government departments expanding similarly with equivalent expertise to hold rate hearings where the companies and the Department of Insurance would argue about the cost of capital and approved investments. Fourth, price competition would end, and consumers would be paying a higher price for an inferior product. Blocked from competing for customers on price, providers would resort to greater expenditures on marketing efforts to third parties, exactly the behavior the Report to the Commissioner finds harmful to consumers.

There is ample information available to suggest that more stringent regulation of title insurance in California in the form of explicit rate regulation would produce a poor outcome for consumers, with higher prices and fewer product offerings.

About the Authors

Analysis Group, Inc. provides economic, financial, and business strategy consulting to law firms, corporations, and government agencies. We assist law firms with all aspects of litigation, including pretrial discovery, development of economic and financial models, preparation of testimony, and critique of opposing experts. We advise corporate and government clients on a range of business issues that require expert interpretation of economic and financial data, including financial planning, tax and transfer pricing issues, company and asset valuations, cost-effectiveness analyses, market analyses, and evaluation of mergers and acquisitions. We also help organizations create strategies for growth by analyzing market dynamics and organizational capabilities, enhancing innovation in current products and services, and identifying new market opportunities. Since the company's founding in 1981, our professional staff, which now numbers 300, has worked closely with an extensive network of experts at leading universities who help us develop state-of-the-art analyses and compelling insights for our clients.

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A co-founder of Analysis Group, Dr. Stangle has more than 25 years experience directing large research and consulting projects in numerous industries, in such areas as antitrust, regulation, intellectual property, and damages. He has provided testimony on market definition, entry conditions, competitive effects, security valuation, and damages. Dr. Stangle serves as a member of the Board of Trustees of Bates College, the Visiting Committee for the Economics Department at MIT, and the Board of Directors of Wellington Trust Company, a subsidiary of the private money management firm Wellington Management Company. He has also served as a member of the Board of Directors of a venture capital firm.

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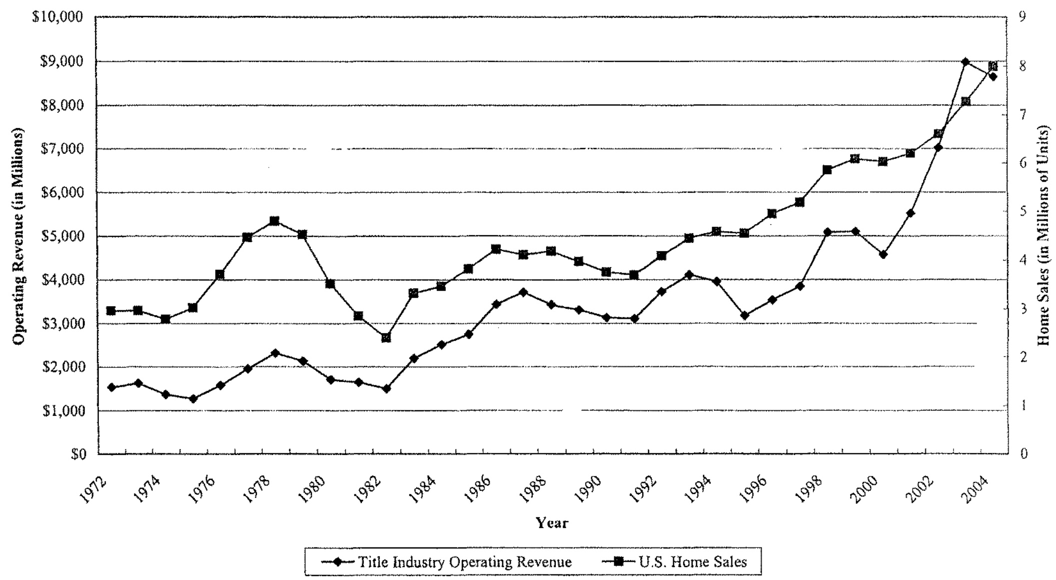
Dr. Strombom is an expert in applied microeconomics, industrial organization and finance. For the past 13 years he has served as a consulting and testifying expert in both commercial litigation and public policy matters. He has conducted economic analyses and damages assessments involving antitrust, intellectual property, fraud, securities valuation, employment, and contract disputes. His clients include private and public companies and government agencies including the California State Auditor, the Securities and Exchange Commission and the Department of Justice.

Exhibit 1

Title Industry Operating Revenue and U.S. Home Sales
1972-2004

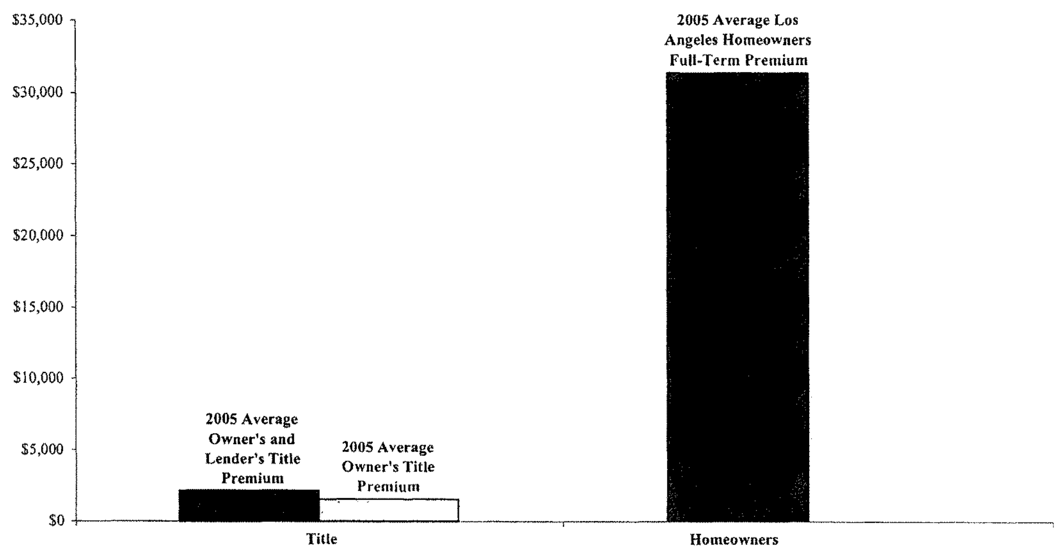


Notes: 1. Operating Revenue is adjusted for inflation using the CPI Index (base year is 1982-84).
2. The correlation between Operating Revenues and Home Sales is 92%.

Sources: A.M. Best Special Report: Clouds on Horizon After Title Industry's Bright Year, October 2005 (Exh. 5), Bureau of Labor and Statistics.

Exhibit 2

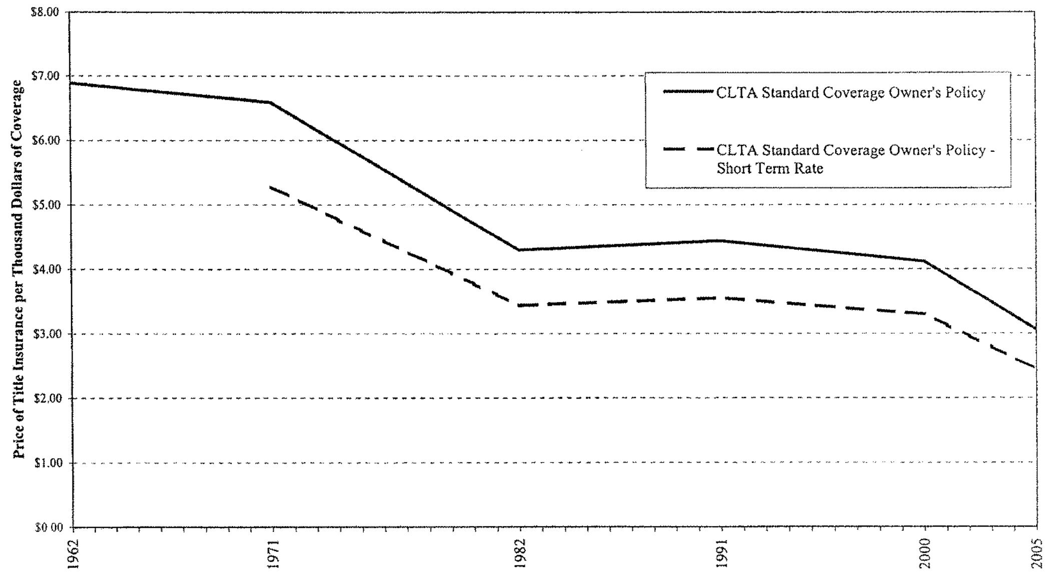
Comparison of Full-Term Premiums on Median Priced Home Purchases for Title and Homeowners Insurance in California



Notes:
Median home price for CA in 2004 was $450,990. Average term length is assumed to be 14.1 years, based on Birnbaum report. 2005 average title premiums, from First American online rate calculator, are an average of Basic and Eagle premiums for non-foreclosure home/land purchases that have not been insured within 5 years. 2005 average Los Angeles premium from CDI survey of rates for 7-15 year-old $500K homes in central Los Angeles, adjusted by value of home.

Exhibit 3

Price of First American's Title Insurance Owner's Policy Per Thousand Dollars of Coverage Based on the Median Priced Home in California



Notes: The price of the median priced home increased from $15,100 in 1960 to $548,400 in 2005. The median priced home during the month of November 2005 was used as the median priced home in 2005. The median priced home in 1960 was used as the median priced home in 1962.

Sources: RealEstate ABC, California Historical Title Rates by First American Title Insurance Company, U.S. Census Bureau.

Exhibit 4

Change in Coverage for California Residential Title Insurance Policies Issued by First American

Coverage	1963	1973	1975	1980	1987	1997	1998
Coverage continues forever							X
Insured parties further expanded to include beneficiaries of a trust and owner/ex-spouse after divorce							X
Type of improvement and address coverage							X
Building set-back encroachment coverage							X
Boundary wall and fence encroachment coverage							X
Forced remedial coverage for zoning violations							X
Forced remedial coverage for building permit violations							X
Access further expanded to provide actual access							X
Coverage for defects in title created post policy							X
Post policy limitation of use of land							X
Coverage for easements created post policy							X
Post policy coverage for identity theft (impersonation) affecting title							X
Coverage for post policy leases, contracts or options							X
Coverage for third parties claiming a post policy interest in the title							X
Insured parties expanded to cover a post policy trust created by named insured						X	X
Map discrepancy coverage						X	X
Post policy structural modification mineral surface entry coverage						X	X
Subdivision Map Act violation coverage						X	X
Post policy encroachment coverage						X	X
Enhanced unmarketability coverage for C, C & R violations (for pre policy violation)						X	X
Expanded C, C & R violation coverage (for pre policy violation)						X	X
Title reversion coverage for C, C & R violations (for pre policy violation)						X	X
Building permit violation coverage						X	X
Access expanded for legal right of pedestrian and vehicular access						X	X
Post policy forgery						X	X
Single family residence use coverage				X		X	X
Forced removal enhanced C, C & R violation coverage (for pre policy violation)				X		X	X
Coverage for loss of use because of zoning violations				X		X	X
Substitute property rental benefit during claims period coverage				X		X	X
Automatic inflation coverage				X		X	X
Unrecorded easement claims				X		X	X
Unrecorded defects, liens and encumbrance claims				X		X	X
Unrecorded adverse ownership claims				X		X	X
Document execution coverage				X		X	X
Mineral right surface entry coverage						X	X
Zoning coverage (regulating area, width and depth of the land)				X		X	X
Basic C, C & R violation coverage (for pre policy violation)				X		X	X
Unrecorded encroachment coverage				X		X	X
Unrecorded mechanics' lien coverage				X		X	X
Basic access		X		X		X	X
Recorded ownership (vesting)		X		X		X	X
Unmarketability of title	X	X		X		X	X
Recorded defects, liens or encumbrances not shown as an exception	X	X		X		X	X

Year

Exhibit 4

Notes:

1. The coverages shown pertain to the owner's policy version indicated by year which was commonly issued for residential transactions from 1963 to present.
2. These coverages, in most instances, were also included in corresponding loan policies in addition to specific insuring clauses in those loan policies having to do with the insured mortgage.

Legend:

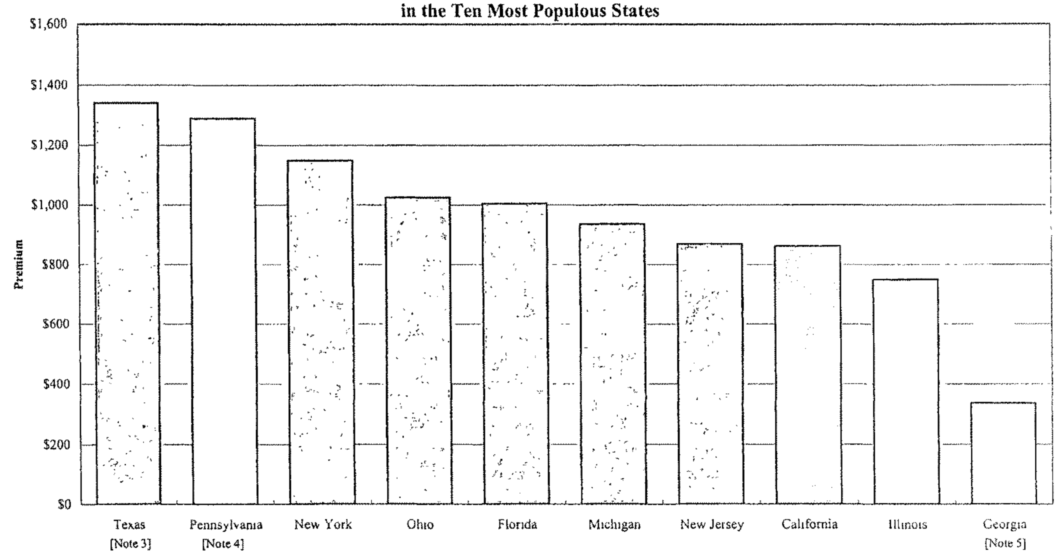
1963 - CLTA
1973 - CLTA
1975 - CLTA with 126 endorsement (issued automatically for no additional charge)
1980 - ALTA Plain Language
1987 - ALTA Plain Language with 11.1 endorsement (issued automatically for no additional charge)
1997 - ALTA Plain Language with EAGLE Protection added "EAGLE Policy"
1998 - CLTA/ALTA Homeowner's Policy of Title Insurance "2nd Generation EAGLE Policy"

Source:

First American

Exhibit 5

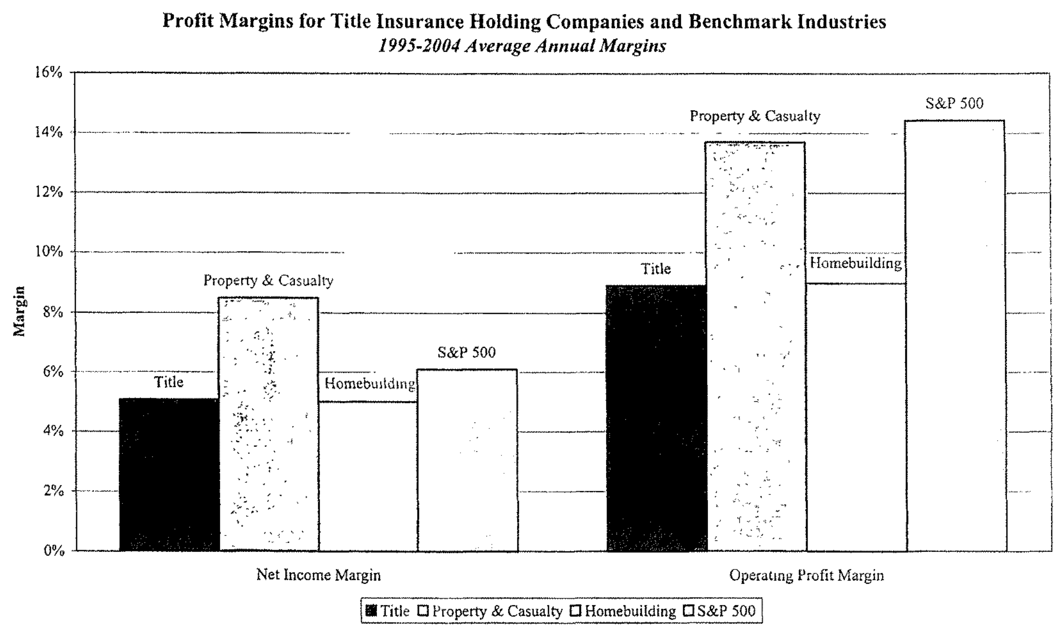
Premiums for First American's Homeowner's Policy for U.S. Median Priced Home in the Ten Most Populous States



Notes:
1. 2004 median home price in the U.S. was $185,200.
2. Top ten states by July 1, 2005 population estimates.
3. Level of coverage in Texas is less than that available in California.
4. Pennsylvania may not be comparable to other states because premium includes escrow fees.
5. Georgia may not be comparable to other states because premium is not all-inclusive.

Sources: First American, US Census Bureau

Exhibit 6

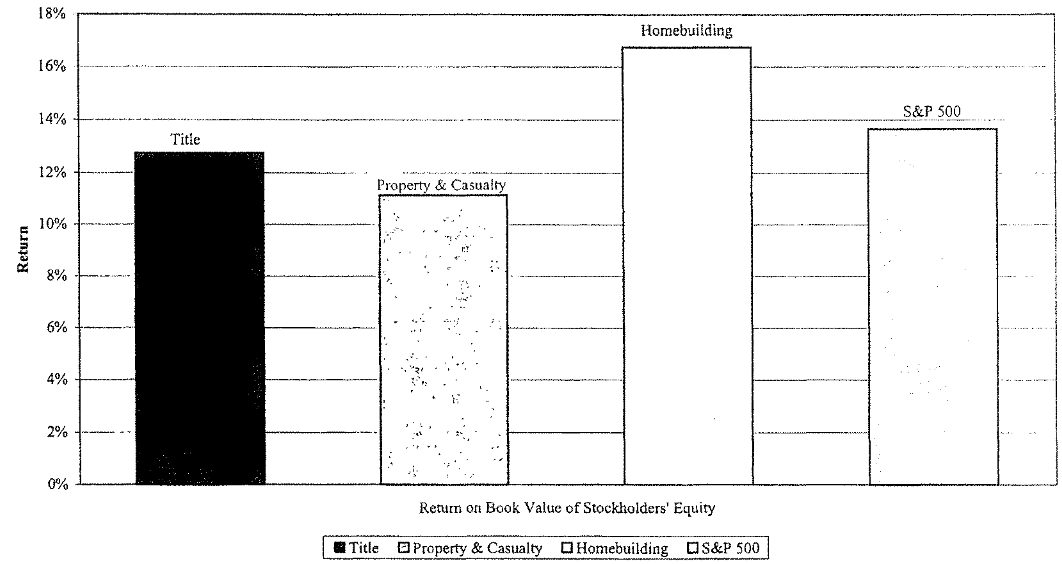


Notes: Title includes the 10 publicly-traded companies in SIC 6361, Title Insurance, that provide title insurance in various years between 1995 and 2004 (Capital Title Group, Fidelity National Financial, First American Corp., Investors Title Co., LandAmerica Financial Group, Stewart Information Services, Firstmark Corp., Chicago Title Corp., Alleghany, and ANFI, Inc.). Chicago Title Corp. was spun-off from Alleghany in 1997. Fidelity National Financial acquired Chicago Title Corp. in 2000 and ANFI, Inc. in 2003. Property & Casualty includes companies in the S&P 500 Property & Casualty Index. Homebuilding includes companies in the S&P 500 Homebuilding Index.

Sources: Compustat and Bloomberg.

Exhibit 7

Rates of Return for Title Insurance Holding Companies and Benchmark Industries
1995-2004 Average Annual Return



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Sources: Compustat and Bloomberg.

U. S. Department of Housing and Urban Development
Washington, D. C. 20410-8000

August 6, 1997

OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

Mr. Sandor Samuels
General Counsel
Countrywide Funding Corporation
155 N. Lake Avenue
Pasadena, California 91109

Dear Mr. Samuels:

Last year the Department of Housing and Urban Development (the Department) sought from you information on the captive reinsurance program of Amerin Guaranty Corporation (Amerin) with Countrywide Home Loans (Countrywide) and its affiliated reinsurer, Charter Reinsurance (Charter). You then requested that the Department clarify the applicability of Section 8 of the Real Estate Settlement Procedures Act (RESPA) to captive reinsurance programs. For the reasons set forth below, we have concluded that, so long as payments for reinsurance under captive reinsurance arrangements are solely "payment for goods or facilities actually furnished or for services actually performed," these arrangements are permissible under RESPA. See paragraph 8(c)(2) of RESPA, 12 U.S.C. § 2607(c)(2). The following details the facts concerning captive reinsurance programs as we understand them, relevant law, and how the Department will scrutinize these arrangements to determine whether any specific captive reinsurance program is permissible under RESPA.

I. BACKGROUND

A typical captive reinsurance arrangement involves a mortgage lender acting in concert with a fully licensed reinsurance affiliate of the mortgage lender and an unaffiliated primary mortgage insurer. The sole purpose of the reinsurance affiliate is to reinsure loans which the affiliated mortgage lender originates and which the unaffiliated, primary mortgage insurance company insures. The primary mortgage insurer and the reinsurer enter into a contract under which the primary insurer agrees to pay the reinsurer an agreed upon portion of the mortgage insurance premiums for loans originated by the lender and insured by the primary insurer. The lender, therefore, has a financial interest in having the primary insurer in the captive reinsurance program selected to provide the mortgage insurance.

Premiums paid for the reinsurance may be net of an agreed upon "ceding commission," which represents the reinsurer's share of the costs of administering the book of insured business.

Under the contract between the primary insurer and the reinsurer, the reinsurer posts capital and reserves satisfying the laws of the state in which it is chartered and may also establish an additional security fund to ensure that, when a claim against the reinsurer is made, funds will exist to satisfy the claim. In exchange for a portion of mortgage insurance premiums (minus a ceding commission, if applicable) to be paid by the primary insurer, the reinsurer obligates itself to reimburse the primary insurer for an agreed portion of claims that may require payment under the contract. Under different reinsurance arrangements, the reinsurance obligations generally take one of two forms. The first is an "excess loss" arrangement, under which the primary insurer pays, and is solely responsible for, claims arising out of a given book of business up to a predetermined amount, after which the reinsurer is obligated to reimburse the primary insurer's claims up to another predetermined amount. Thereafter, the primary insurer is solely responsible for claims in excess of the reinsurer's tier of losses on a given book. A second type of contract is the "quota share" contract, under which the reinsurer would bear a portion of all insured losses.

Under captive arrangements of which the Department is aware, some degree of disclosure is provided to the consumer about the arrangement and some opportunity is accorded to the consumer to choose whether or not to have the loan insured through a captive reinsurance program.

II. LEGAL ANALYSIS

Subsection 8(a) of RESPA provides that "[n]o person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." 12 U.S.C. § 2607(a). "Thing of value" is further described in the Department's regulations as including "without limitation, monies, things, discounts, salaries, commissions, fees, duplicate payments of a charge, stock, dividends, distributions of partnership profits, franchise royalties, credits representing monies that may be paid at a future date, the opportunity to participate in a money-making program...." 24 C.F.R. § 3500.14(d). In addition, subsection 8(b) prohibits the giving or receipt of any portion, split or percentage of any charge made or received for the rendering of a real estate settlement service "other than for services actually performed." 12 U.S.C. § 2607(b). These prohibitions against paying for referrals and against splitting fees are very broad and cover a variety of activities.

Subsection 8(c) of RESPA sets forth various exemptions from these prohibitions. It provides, in relevant part, that nothing in section 8 shall be construed as prohibiting "(2) the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed." 12 U.S.C. § 2607(c)(2).

The Department's view of captive reinsurance is that the arrangements are permissible under RESPA if the payments to the reinsurer: (1) are for reinsurance services "actually furnished or for services performed" and (2) are _bona fide_ compensation that does not exceed the value of such services.

The rationale behind this two-step analysis is that in instances in which a lender selects the mortgage insurer, including under a captive reinsurance arrangement, the lender's actions would constitute a referral of loans to a mortgage insurer, by influencing the borrower's selection of his or her mortgage insurer. _See_ 24 C.F.R. § 3500.14(f) (definition of "referral"). If the lender or its reinsurance affiliate is merely given a thing of value by the primary insurer in return for this referral, in monies or the opportunity to participate in a money-making program, then section 8 would be violated; the payment would be regarded as payment for the referral of business or a split of fees for settlement services. If, however, the lender's reinsurance affiliate actually performs reinsurance services and compensation from the primary insurer is _bona fide_ and does not exceed the value of the reinsurance, then such payments would be permissible under subsection 8(c). Conversely, any captive reinsurance arrangement in which reinsurance services are not actually performed or in which the payments to the reinsurer are not _bona fide_ and exceed the value of the reinsurance would violate section 8 as an impermissible referral fee.

A. Analysis of Specific Captive Reinsurance Arrangements

The Department will analyze captive reinsurance arrangements to determine if the arrangements comply with RESPA. Factors which may cause the Department to give particular scrutiny to an arrangement and cause it to apply the test set forth in Part II(B) of this analysis include, but are not limited to, the following:

1. The amount charged directly or indirectly to the consumer for mortgage insurance in a captive program is greater than the amount charged to the consumer for mortgage insurance not involving reinsurance for a similar risk.

2. The costs (premiums minus a ceding commission, if applicable) paid to the captive reinsurer are greater than the cost for comparable non-captive reinsurance available in the market.

3. The lender restricts its mortgage insurance business in whole or to a large extent to a primary mortgage insurer that has a reinsurance agreement with the lender's captive reinsurer.

4. Any major secondary market institution refuses to purchase mortgages insured under a particular captive reinsurance agreement or places special conditions on such purchases.

5. Any credit rating agency reduces the rating of the primary mortgage insurer in whole or in part because of agreements with captive reinsurers.

6. Any State regulatory body questions the adequacy of the reserves maintained by the primary mortgage insurer or the captive reinsurer.

7. The primary insurer's agreement to reinsure is conditioned on the affiliated lender's agreement to refer all of or a predetermined volume of its mortgage insurance business to the primary insurer, or the terms of the agreement (such as the percentage of the premium per loan reinsured that is paid to the reinsurer by the primary insurer) fluctuate depending on the volume of the primary insurance business referred by the lender to the primary insurer. The presence of either of these conditions makes it more likely that at least a portion of the compensation paid to the reinsurer is for the referral of mortgage insurance business.

8. Adequate consumer disclosure is not provided. The Department believes that consumers would be well served by a meaningful disclosure[1] and a meaningful choice[2] for consumers about having their loans included in a captive reinsurance program. A demonstrated willingness to provide such a disclosure may indicate that the arrangement is designed to provide real reinsurance.

The Department does not consider any of these eight factors to be determinative of whether an arrangement merits scrutiny by the Department, nor does it regard the absence of any of these factors to be determinative that further scrutiny is not merited. In addition, as noted in Part II(B), the Department may consider these eight factors in applying the test in Part II(B), to the extent applicable.

B. <u>Test for Whether a Captive Reinsurance Arrangement Violates RESPA</u>

Where the Department scrutinizes a captive reinsurance arrangement, it will apply a two-part test for determining whether the arrangement violates RESPA. The Department will first determine whether the reinsurance arrangement meets three requirements that establish that reinsurance is actually being provided in return for the compensation. If one or more of the requirements is not met, the inquiry will end, and the arrangement will be regarded as an impermissible captive reinsurance arrangement under RESPA. If all of the requirements are met, the Department will determine whether the compensation exceeds the value of the reinsurance. To facilitate its analysis, the Department may use information obtained from the lender, the primary insurer, the captive reinsurer, or other sources, including data on the rate, magnitude, and timing of default losses and mortgage insurance payments and any other

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[1] A meaningful disclosure would reveal that the captive reinsurance arrangement exists, that the lender stands to gain financially under the arrangement, and that the consumer may choose not to have his or her insurance provided by an insurer in such an arrangement.

[2] A meaningful choice whether to participate would provide the consumer an easy, non-burdensome opportunity to opt out by, for example, indicating a preference one way or the other on a form.

information necessary to undertake the analysis and may exercise its subpoena authority pursuant to 24 C.F.R. part 3800 to obtain such information.

1. Determining that Reinsurance is Actually Being Provided in Return for the Compensation

To determine that a real service--reinsurance--is performed by the reinsurer for which it may legally be compensated, the following requirements must be satisfied:

a. There must be a legally binding contract for reinsurance with terms and conditions conforming to industry standards.

b. The reinsurer must post capital and reserves satisfying the laws of the state in which it is chartered and the reinsurance contract between the primary insurer and the reinsurer must provide for the establishment of adequate reserves to ensure that, when a claim against the reinsurer is made, funds will exist to satisfy the claim. Unless the reinsurer is adequately capitalized and adequate reserves (which may include letters of credit or guarantee arrangements) and funds are available to pay claims, real services are not being provided.

c. There must be a real transfer of risk. The reinsurance transaction cannot be a sham under which premium payments (minus a ceding commission, if applicable) are given to the reinsurer even though there is no reasonable expectation that the reinsurer will ever have to pay claims. This requirement for a real transfer of risk would clearly be satisfied by a quota share arrangement, under which the reinsurer is bound to participate pro rata in every claim. The requirement could also be met by excess loss arrangements, if the band of the reinsurer's potential exposure is such that a reasonable business justification would motivate a decision to reinsure that band. Unless there is a real transfer of risk, no real reinsurance services are actually being provided. In either case, the premiums paid (minus a ceding commission, if applicable) must be commensurate to the risk, as discussed in Part II(B)(2).

In evaluating these requirements, the Department may also consider the factors in Part II(A), to the extent relevant. If any of the requirements in this Part II(B)(1) is not met, the arrangement will be regarded as an impermissible reinsurance arrangement under RESPA. If any of the requirements is not met, the "service" being compensated would appear to be the lender's referral of business to the mortgage insurer, which RESPA prohibits.

2. Determining that the Compensation Paid for Reinsurance Does Not Exceed the Value of the Reinsurance

If the requirements in Part II(B)(1) for determining that reinsurance is actually being provided in return for the compensation are met, the Department will then determine whether the compensation paid for reinsurance does not exceed the value of the reinsurance. The Department will evaluate whether the compensation is commensurate with the risk and, where warranted, administrative costs. The Department's evaluation of this requirement may:

-- Compare, using relevant mathematical models, the risk borne by the captive reinsurer with the payments provided by the primary insurer.

-- Analyze the likelihood of losses occurring, the magnitude and volatility of possible losses, the amount of payments received, the timing of the payments and potential losses, current market discount rates, and other relevant factors.

-- Take into account the relative risk exposure of the primary lender and the captive reinsurer.

-- Consider the extent to which the lender or the firm controlling the captive reinsurer is shielded from potential losses by inadequate reserves and a corporate structure that segregates risks.

-- Examine other financial transactions between the lender, primary insurer, and captive reinsurer to determine whether they are related to the reinsurance agreement.

-- Examine whether the ceding commission is commensurate with the administrative costs assumed by the primary insurer.

In making this evaluation, the Department may also consider the factors in Part II(A), to the extent relevant. If the Department concludes that the compensation paid for the reinsurance exceeds the value of the reinsurance pursuant to the analysis in this Part II(B)(2), the arrangement will be regarded as an impermissible reinsurance arrangement under RESPA and the payments exceeding the value of the reinsurance will be considered a referral fee or unearned fee.

III. CONCLUSION

In setting forth this analysis, the Department notes the trend in the mortgage market toward increased diversification of risk. The Department welcomes such trends to the extent that such arrangements increase the availability of mortgage credit. Where RESPA would not preclude such arrangements, the Department would generally support them.

The Department believes the system of mortgage insurance and reinsurance is not necessarily comparable to other types of settlement services. Thus, the Department could analyze other settlement service programs differently, depending on the facts of the particular program.

I trust that this guidance will assist you to conduct your business in accordance with RESPA.

Sincerely,

Nicolas P. Retsinas
Assistant Secretary for
Housing-Federal Housing
Commissioner

cc: Mr. Randolph C. Sailer II
Senior Vice President and General Counsel
Amerin Guaranty Corporation
200 East Randolph Drive, 49th Floor
Chicago, IL 60601-7125

February 23, 1999

The Honorable Gail W. Laster
General Counsel
Department of Housing and Urban Development
451 Seventh Street, S.W., Room 10214
Washington, D.C. 20410

Dear General Counsel Laster:

This letter requests your advice on the application of Section 8 of the Real Estate Settlement Procedures Act, 12 U.S.C. 2607 ("RESPA"), in the context where a title insurance company seeks to obtain reinsurance (a) for title insurance policies issued in residential transactions referred to the insurer by a particular real estate developer, mortgage lender, real estate broker, or other person in a position to refer title insurance business, and (b) where the reinsurance company is owned by or affiliated with the person that referred the insurance business. Our questions do not relate to any specific transaction, but seek guidance that will help our members ensure that any such arrangements are consistent with RESPA principles.

We have reviewed the letter dated August 6, 1997, from Assistant Secretary Retsinas to the General Counsel of Countrywide Funding Corporation, that sets forth HUD's views regarding the RESPA § 8 principles applicable to captive reinsurance programs involving mortgage insurance. In general, the two key principles articulated in that letter are that:

- payments to the captive reinsurer must be for reinsurance services actually furnished, and
- compensation paid to the captive reinsurer must not exceed the value of such services.

What we are seeking through this letter is guidance on how those principles apply in the context of title insurance, and, in particular, your views on several key questions that have arisen in the application of those two principles to the title insurance industry.

In considering these questions, some background information on reinsurance practices in the title insurance industry may be helpful.

In general, title insurance companies obtain reinsurance in one of two circumstances. First, all title insurers will obtain reinsurance in connection with high liability policies so as to avoid catastrophic losses from a single policy or transaction. Such reinsurance, referred to as "facultative" reinsurance, may be obtained because of statutory or regulatory limits on the amount of any single risk that can be retained by the company, because of limits established as a matter of prudence by the board of directors of the insurer, or because of concerns expressed by the potential insured under the high liability policy.

The Honorable Gail W. Laster
February 23, 1999
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In addition to reinsuring specific risks, title insurers may obtain "treaty" reinsurance for their entire portfolio of risks. For example, smaller local and regional title insurance companies, whose reserves and financial strength may limit their ability to accept a significant amount of business, may obtain "treaty" reinsurance for their entire portfolio of policies so as to limit their exposure on any single policy or their annual exposure under all policies. In high-dollar residential transactions, smaller title insurers may also obtain reinsurance. Larger title insurers may obtain "excess loss" reinsurance that would reimburse them if their total losses in any single year exceeded a specific dollar amount.

Such facultative and treaty reinsurance have traditionally been available from several sources. These include other title insurance companies, as well as domestic and foreign companies who provide reinsurance services to the title insurance industry and to other lines of insurance.

In the past, there has been no demand from the title insurance industry for reinsurance in connection with most **residential** title insurance policies. Recently, however, lenders, builders, and others in a position to refer business have approached title insurers with proposals for establishing captive reinsurers for the purpose of reinsuring the title insurer's residential title risks on transactions referred to the title insurer by the lenders, builders, or other similar parties.

In light of your earlier pronouncements on captive reinsurance in the mortgage insurance arena, we request your assistance on how those guidelines relate to captive reinsurance in the title insurance industry. Specifically, we would be concerned about the following:

1. Assuming that these residential reinsurance proposals involve the actual transfer of risk, is it relevant to whether HUD would give "particular scrutiny" to such arrangements if title insurers did not actively seek to reinsure such risks other than through captive reinsurers?

2. Since § 8 analysis involves determining whether payments made were "reasonable" in light of the services rendered, what methodology would HUD suggest for determining whether amounts paid to a captive reinsurer are reasonable?

We would greatly appreciate your consideration of the above questions and your earliest reply. Thank you.

Sincerely,

James R. Maher

xc: William C. Apgar, Jr., Assistant Secretary for Housing
Rebecca J. Holtz, Interstate Land Sales & RESPA Div. Dir.
Kenneth A. Markison, Assistant General Counsel for GSE-RESPA
Peter S. Race, Assistant General Counsel for Program Compliance Div.

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-0500

OFFICE OF GENERAL COUNSEL

August 12, 2004

Mr. James Maher
Executive Director
American Land Title Association
1828 L. Street, N.W.
Suite 705
Washington, DC 20036

Dear Mr. Maher:

This is in response to your inquiry concerning the legality of captive title reinsurance programs under the Real Estate Settlement Procedures Act (RESPA).

By letter of August 6, 1997, the Department took the position that the legality of captive mortgage reinsurance agreements under RESPA depended on whether payments made to the reinsurer are: (1) for reinsurance services actually furnished or for services performed and (2) for bona fide compensation that does not exceed the value of such services. The Department believes that any captive title reinsurance program also should be evaluated in accordance with these standards and that the 1997 guidance on captive mortgage reinsurance will be useful in such an evaluation. I have enclosed a copy of that guidance for your information.

The Department is strongly committed to reform of the mortgage settlement process and will be working with affected industry and consumer groups in the coming months to achieve a workable RESPA reform rule. The Department believes that revised RESPA regulations will provide better, clearer rules benefiting both consumers and industry. We very much look forward to working with you and your association as we move forward with our reform effort.

Thank you for your interest in RESPA programs.

Sincerely,

John P. Kennedy
Associate General Counsel for
Finance and Regulatory Compliance

Enclosure

American Homeowners Grassroots Alliance
Representing the nation's 75 million homeowners
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Testimony of the

American Homeowners Grassroots Alliance

Submitted to the

House Financial Services Subcommittee on Housing and Community Opportunity

Hearing on

Title Insurance: Cost and Competition

April 26, 2006

"Most title companies pay fees to the referring real estate professional, which creates a conflict of interest and raises their rates."
Title One, Inc. website: http://www.title-1.com/about.htm

The American Homeowners Grassroots Alliance (AHGA) is a national consumer advocacy organization serving the nation's 75 million homeowners. AHGA engages on policy issues that significantly impact homeowners and home ownership. The Alliance thanks House Financial Services Committee Chairman Michael G. Oxley and Ranking Minority Member Barney Frank for holding this hearing on cost and competition in title insurance. The past efforts of the Chairman and many of the committee members to expand consumer choice and expose anticompetitive practices in real estate services are greatly appreciated by the nation's homeowners.

Title insurance is an expensive but important part of the home financing process. At its heart is a title search, still done by hand in many courthouses, but increasingly made easier by Internet access. An individual searches the history of ownership of the property to identify any liens or other clouds to the ownership of the property. Many of those liens or other clouds to the title can be corrected, but mortgage companies are reluctant to make mortgage loans if the security for that loan (i.e. the home) is threatened. Those searches may be done by company employees or by independent contractors, who are typically paid about $125 to do a title search.

What is truly stunning about the U.S. title insurance industry is how little money is ever paid out in claims to those insured, compared to other forms of insurance. While health insurers pay out $.86 of every dollar collected, and homeowner and auto insurers pay out $.75 and $.60 respectively of every insurance dollar collected, title insurers pay out between $.01 and $.05 of every insurance dollar collected, according to several different studies. Title insurance company executives point out that the whole purpose of the title search is to avoid having to pay out premiums, and that the cost of the title search is higher than underwriting costs in other insurance sectors.

Both of those points are valid, but the title search and examination costs (lines 1102 and 1103) are listed as separate line on the HUD-1. The cost of the title insurance itself is still exorbitant once these costs are factored out. The price of title insurance in many areas is typically about $1,000 on a $300,000 home. There is some other overhead of course, and an insurer must make a profit, but with $950 left over (after setting aside 5% for claims payments), the title insurers appear to have a very bloated overhead and/or very high profits.

Other evidence also suggests that there is little competition in title insurance. Realtors, not consumers, usually end up selecting the title insurer for most home buyers. We believe that many real estate agents do not tell home buyers that title insurance rates are competitive in states where there is title insurance price competition and do not counsel them on which title insurance companies are most competitive. At the same time, studies have shown that real estate agents are often rewarded by the title insurance companies with lavish vacations and other gifts.

We also believe that many real estate agents often do not disclose the existence of their broker's affiliated business relationships with title insurance companies. Unfortunately, section 1100 on the HUD-1 form, which identifies the cost of title charges, does not currently identify what portions of the various title insurance fees benefits the real estate agent or broker in the form of commissions, payments to their business affiliates, gifts or other remuneration. We believe the HUD-1 should be modified to provide this information. Final HUD-1 forms should be provided to home buyers and sellers at least a day before settlement. This deadline is often not met. Those responsible for the delay should be fined or otherwise held responsible for the delay.

The proliferation of sham title insurance referral companies created as affiliates of real estate companies has caught the attention of state regulators. Such companies offer no value to consumers. They insure the title but pass on all of the title insurance risks by reinsuring all of their risk with traditional title insurance companies. Such companies in fact are nothing more than shells designed to funnel portions of inflated title insurance payments from home buyer's back to the buyer's real estate broker and/or agent. Real estate agents and brokers are already compensated by the buyer and/or seller and have a duty to look out for the best interests of their clients. Those savings should be passed on to the consumer.

Colorado's Insurance Division in early 2005 investigated a number of Colorado title insurers regarding their marketing practices. Among the findings were that marketing costs were an unusually high component of the title insurance costs – 35% in Colorado. Much of those marketing expenditures went to companies affiliated with real estate brokers who added no value to the transaction. It is difficult to understand why a real estate broker's affiliated business that adds no value should receive part of the title insurance premium when part of the fiduciary duty of the buyer's broker and agent should be to help the buyer search for and compare title insurers based on price and service. Similar investigations are ongoing in Florida, California, New York, Washington, Oklahoma, Minnesota, Hawaii, Washington and other states.

A former New Mexico state legislator recently sued a major title insurer in a class action lawsuit that also seeks to strike down parts of the title insurance law and regulations in the state. Former state representative Max Coll in March, 2006 filed a lawsuit seeking class-action status against the insurer and the New Mexico Insurance Department and Public Regulation Commission officials. New Mexico home buyers who paid for title insurance could get partial refunds if the lawsuit is successful.

Coll alleges that the Public Regulation Commission's requirement that title insurance rates be identical is anticompetitive and unnecessary since many other states have no such requirement. In Mr. Coll's case he bought a home in 2003 and paid $2,430 for title insurance. When he refinanced the home two years later, he was charged $2,407 for another policy. This very high title insurance reissue cost is very common in home refinancing. In light of the relatively short window of additional risk to title insurers who had previously done due diligence on the title for the entire prior history of the property's existence, we do not understand why reissue prices are so high.

We urge the committee to consider actions to address the lack of competition in the title insurance sector. Since many states allow price competition among title insurance providers without apparent problems relating to title insurance price competition, there are no apparent benefits to any state mandating title insurance rates. Perhaps the committee could address this issue.

Section 1100 of the HUD-1 form (title charges) does not disclose the amounts of any of the fees or other compensation in that section that are be paid directly to either the buyers or sellers brokers or agents, or to "affiliated businesses" of either the buyers or sellers brokers or agents. Such a disclosure would shine a bright light on the practice and could lead consumers to raise questions about what services are being provided by those "affiliated businesses" beyond simply inserting themselves as a middleman.

Some forms of insurance, like homeowners, auto, and health insurance, are quite competitive and offer a variety of coverage options. Unlike homeowners insurance, most title insurance policies do not offer the option of insuring for the appreciated value of the home at additional cost, and few if any provide coverage relating to mineral or water rights. The lack of such choices suggests a lack of competition in the title insurance sector. It would be useful for the committee to try to find out why title insurance companies do not offer such choices.

Affiliated business relationships can potentially benefit consumers if the affiliated businesses offer consumers value, the relationships are disclosed, and consumers are provided objective information about pricing and service that serves their best interests by their fiduciaries. Some real estate companies have affiliated relationships with mortgage lenders, and there is no reason that they, title insurance companies or mortgage lenders should not be allowed to have such relationships with each other so long as those requirements are met.

We urge the Financial Services Committee to take action to prohibit affiliated businesses that add no value to consumers from receiving fees from real estate transactions. Most major corporations have strict policies prohibiting or limiting the kinds and levels of gifts or other consideration that their employees may accept from the company's suppliers. This policy is clearly not as widespread in the real estate services sector. Individual real estate brokers and other service providers, and their agents or sales representatives who provide consumers the names of other real estate transaction service providers should at least be required to disclose the names of any of them with whom their company has affiliated business relationship. In addition individual agents or sales representatives involved in real estate transactions should also be required to disclose to their clients or customers any commissions as well as any gifts or other remuneration above a minimal amount that they personally receive from those same companies.

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