Written Statement

Of

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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

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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.