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TITLE INSURANCE

Preliminary Views and Issues for Further Study

Statement of Orice M. Williams, Director
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Highlights of [GAO-06-569T](#), a testimony before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives

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.

TITLE INSURANCE

Preliminary Views and Issues for Further Study

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

¹Bankrate.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.

²GAO, *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

³Colorado Division of Insurance Order No. 0-06-089 (Nov. 15, 2005).

⁴Pub. 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

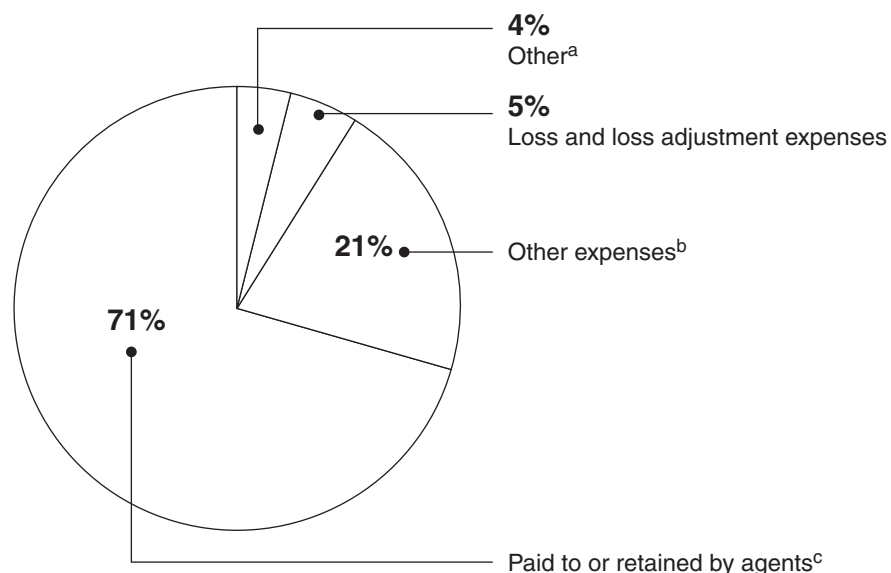
We identified several important items for further study, including the way policy premiums are determined, the role played by title agents, the way that title insurance is marketed, the growth of affiliated business arrangements, and the involvement of and coordination among the regulators of the multiple types of entities involved in the marketing and sale of title insurance.

⁵2005 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. ^cThe “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.

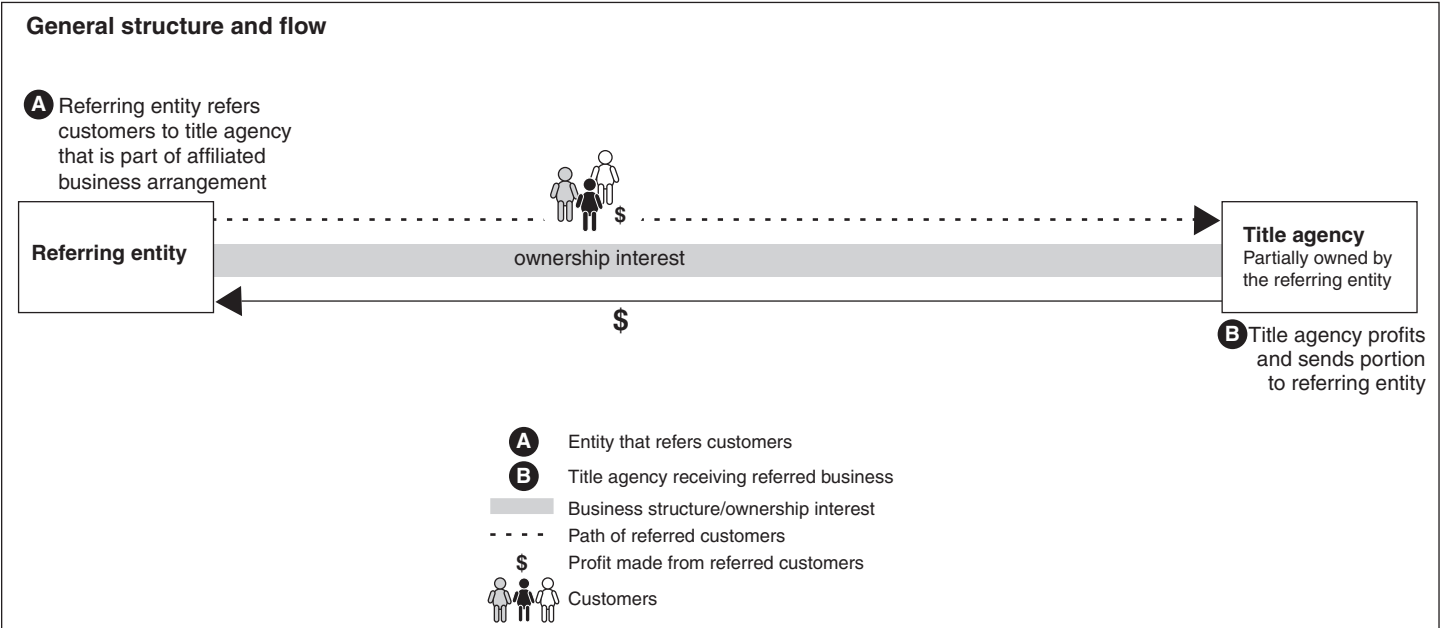
Further Study of the Effect of Affiliated Business Arrangements Could Be Beneficial

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

⁶The 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 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

⁷Reinsurance 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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