PREPARED STATEMENT OF
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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.

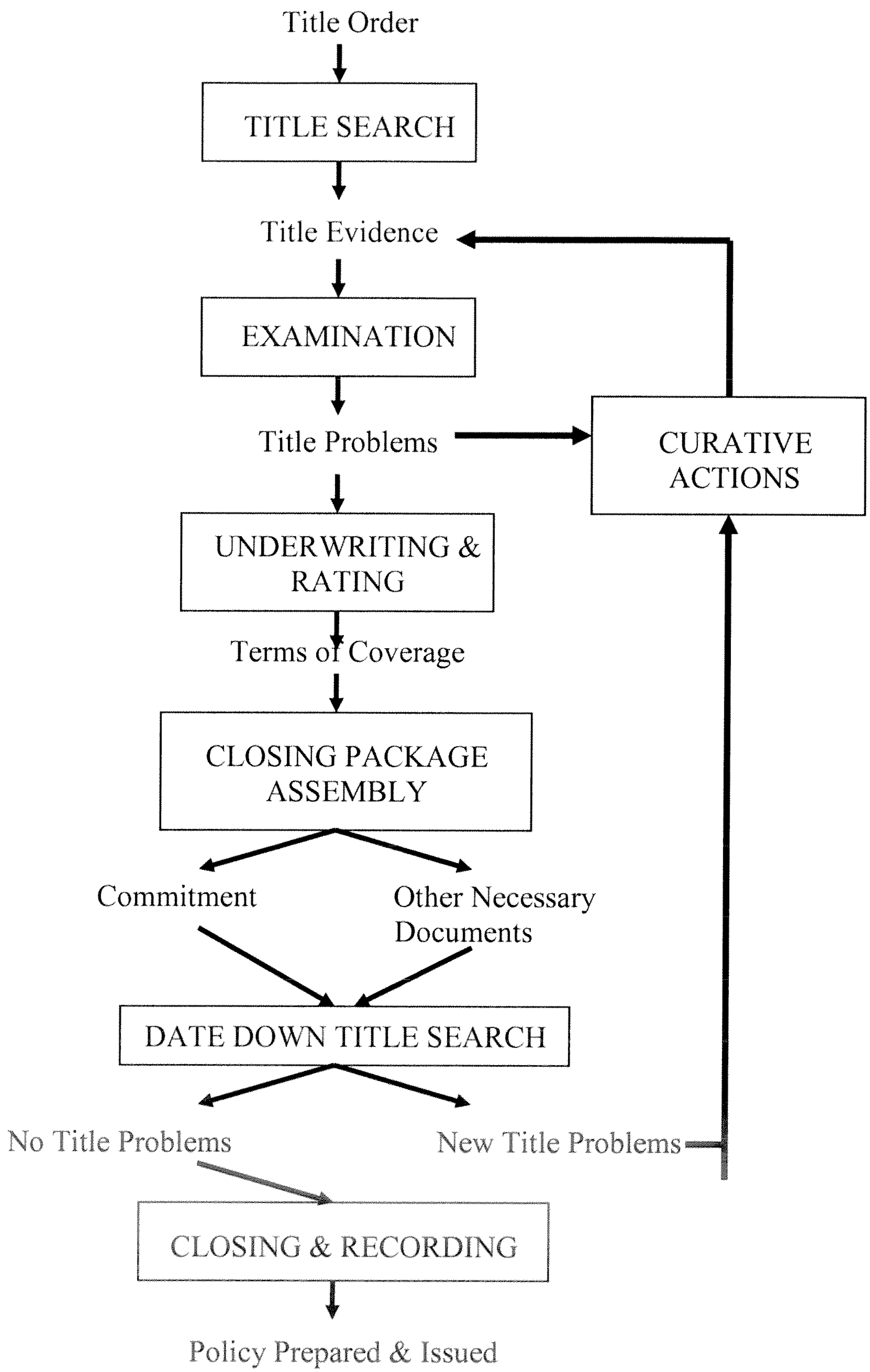
[6] In this regard, title insurance is somewhat akin to boiler insurance, where a significant portion of premiums are devoted to inspecting and correcting any problems with the boiler before the policy is issued.

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.

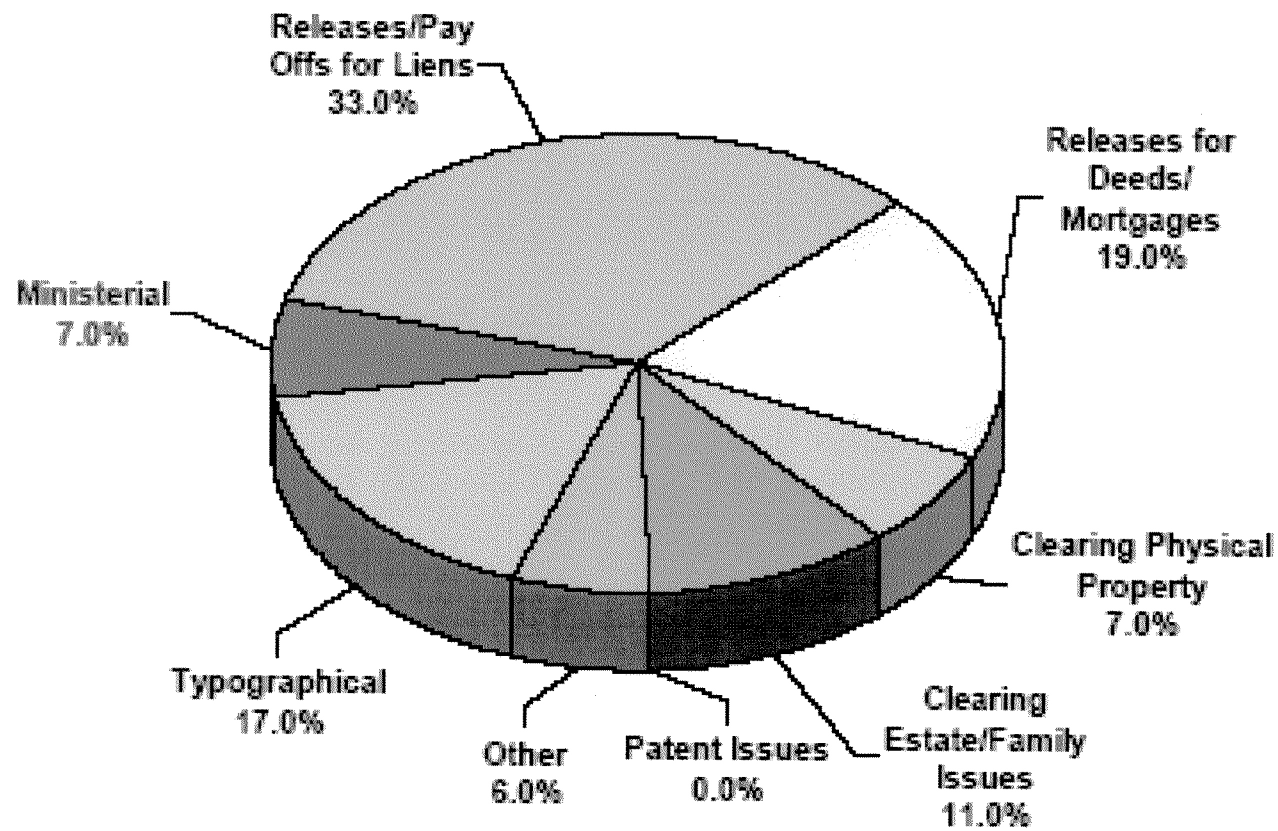
Having collected the title evidence, professionals experienced in real estate law and title insurance principles must then examine the title evidence to reach a determination as to whether the seller can convey fee simple title to the buyer, and what title defects have to be noted as exceptions to the 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

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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. <u>Misconception</u>: 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

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(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).

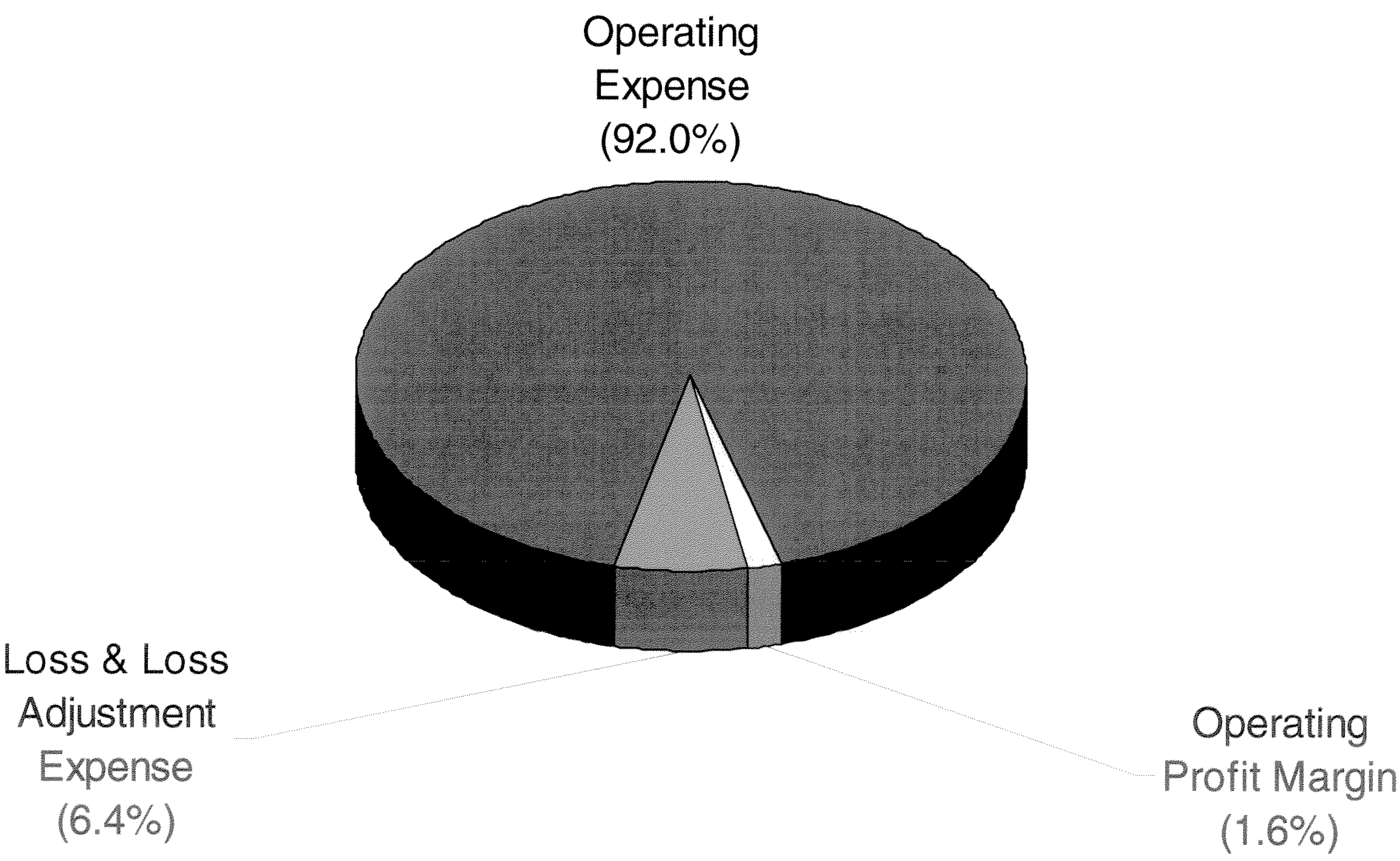
[16] See Exhibit 8 of the A.M. Best Report (Attachment C).

[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

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[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

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[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

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[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

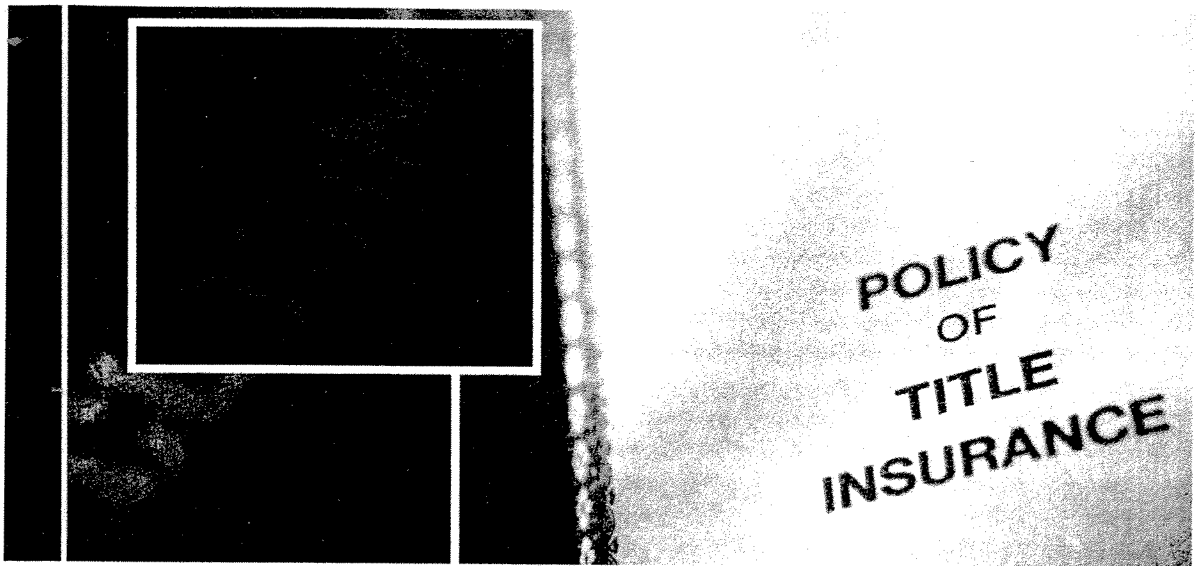
TAB	DOCUMENT
A	"Title Insurance Primer" prepared by the American Land Title Association
B	"The Nature of Title Insurance," Prof. Harry Mack Brown, Journal of Risk and Insurance (Sept. 1966)
C	"Clouds on Horizon After Title Indusry's Bright Year," A.M. Best Special Report (Oct. 2005)
D	"2005 Abstracter 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)

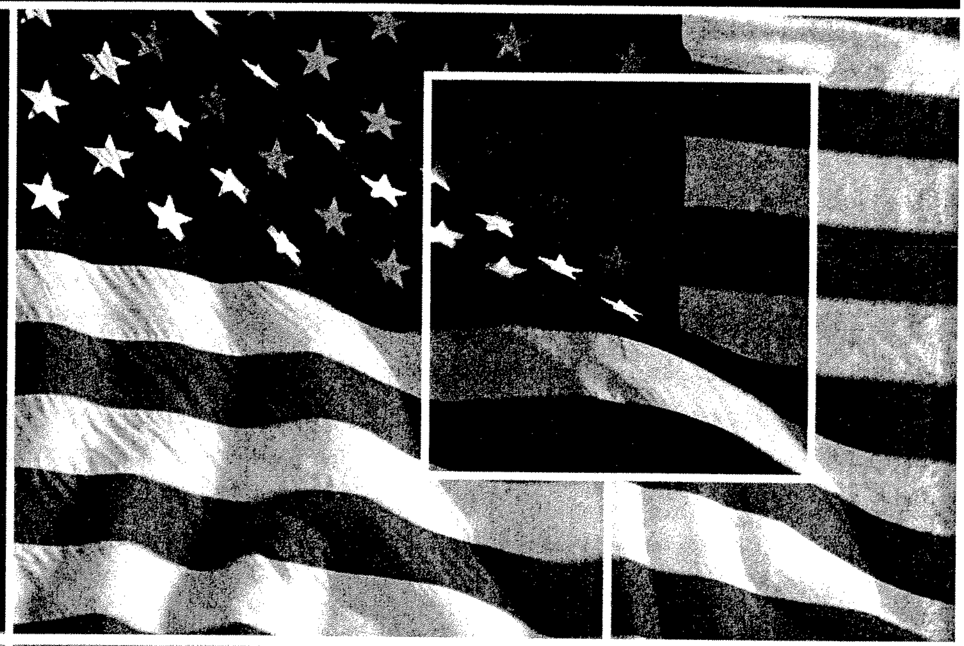
L Letter from James R. Maher, Executive Vice President of the American Land Title Association, to HUD General Counsel Gail W. Laster seeking guidance on application of RESPA Section 8 to captive title reinsurance arrangements (February 23, 1999)

M Response of HUD Associate General Counsel John P. Kennedy to ALTA's letter of February 23, 1999 (August 12, 2004)

TAB A



TITLE INSURANCE PRIMER



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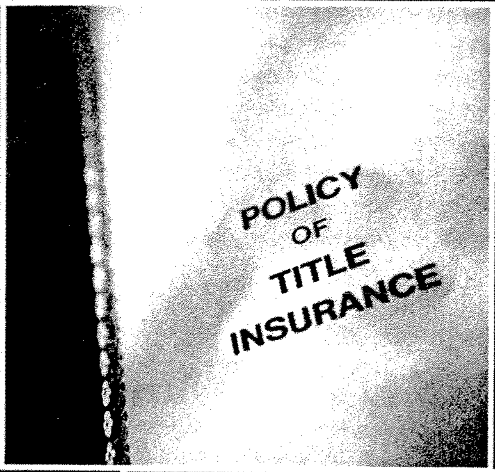
LAND TITLE
ASSOCIATION



PROTECTING THE AMERICAN DREAM ONE HOME AT A TIME

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 25% 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.

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 at closing.

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.

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 serviceman 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 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 defend-

ing 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 statue 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

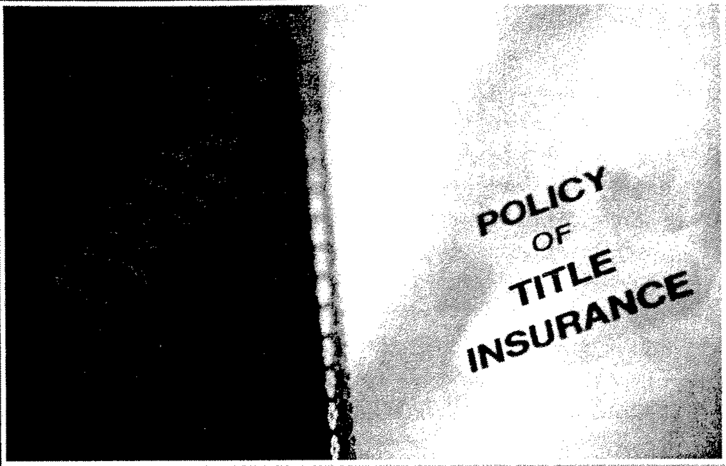
By assuring priority of the first lien mortgage for the lender, title insurance makes construction loan financing considerably more attractive.

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 mechanic's 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.

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.

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.

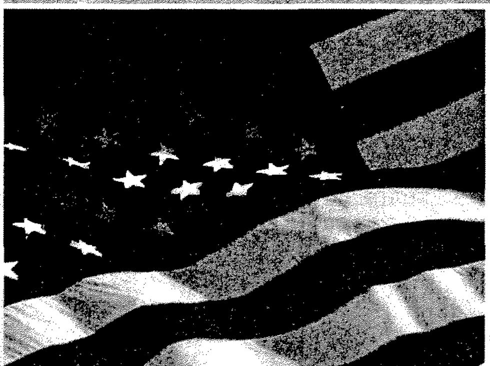
Despite their emphasis on risk elimination, title insurance companies will continue to experience loss—making it necessary to continue offering coverage that pays valid claims and pays for defending against attacks on title. And even the most expert title searching and examination will never be able 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.

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.

TAB B

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.[8] 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

[8] 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 fact-finding 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.[5]

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-

[5] 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.

TAB C

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.

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.

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 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.

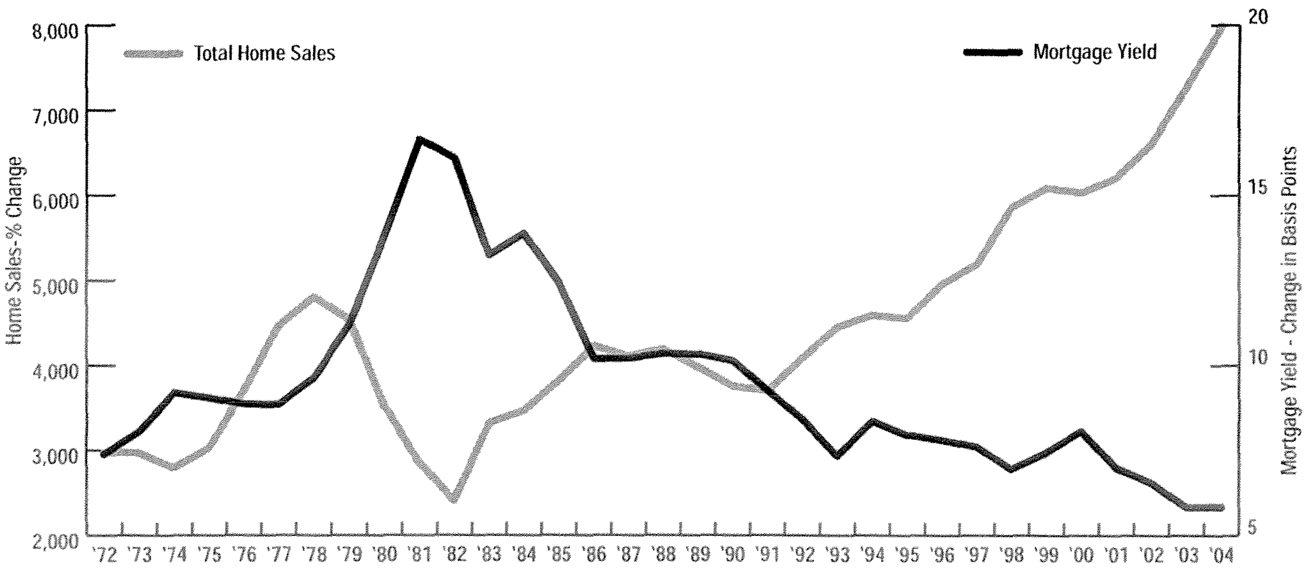
Exhibit 3

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.

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

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.

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.

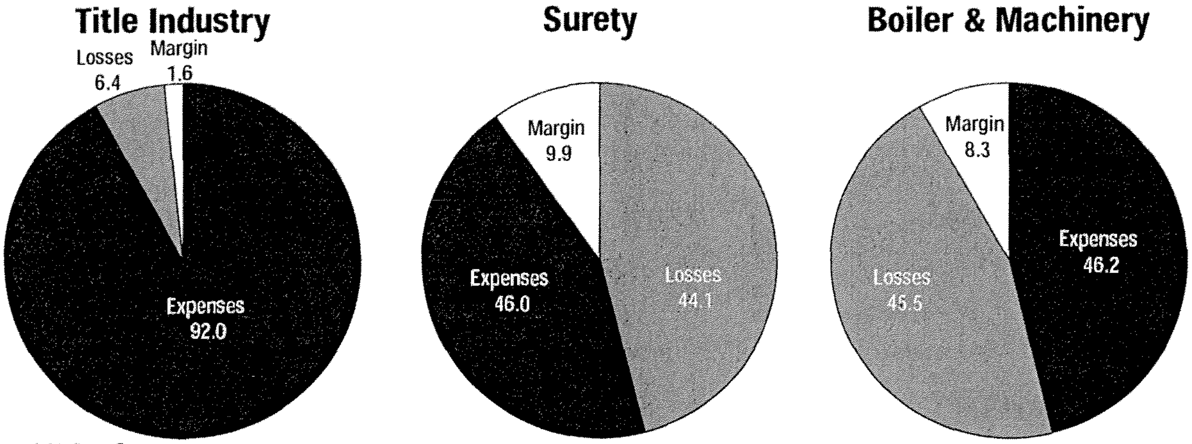
3. File and Use—Insurers set rates, but they cannot be charged until the regulator has been notified and allowed time for review and action if necessary. In some prior-approval states, almost the same result is achieved through a so-called deemer provision. Under a deemer, rates proposed by insurers 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.

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.

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 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	38.3	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.

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.

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.

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	5.38
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&#, 12414.27				X	30		
Colorado	10-11-118, Reg. 88-5-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.

Notes:

Notes:

The Insurance Information Source

A.M. Best Co., established in 1899, is the world's oldest and most authoritative source of insurance company ratings. Best's Ratings are the definitive symbol signifying the financial strength and operating performance of insurance companies worldwide. For more information, visit A.M. Best's Web site at *http://www.ambest.com*, or contact one of our offices:

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Fax: +852-2824-1833
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TAB D

Association Research, Inc.

2005
ABSTRACTER AND TITLE AGENT OPERATIONS SURVEY

conducted for the

AMERICAN LAND TITLE ASSOCIATION

1828 L STREET, N.W. – SUITE 705
WASHINGTON, DC 20036

April 2006

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TABLE OF CONTENTS

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.

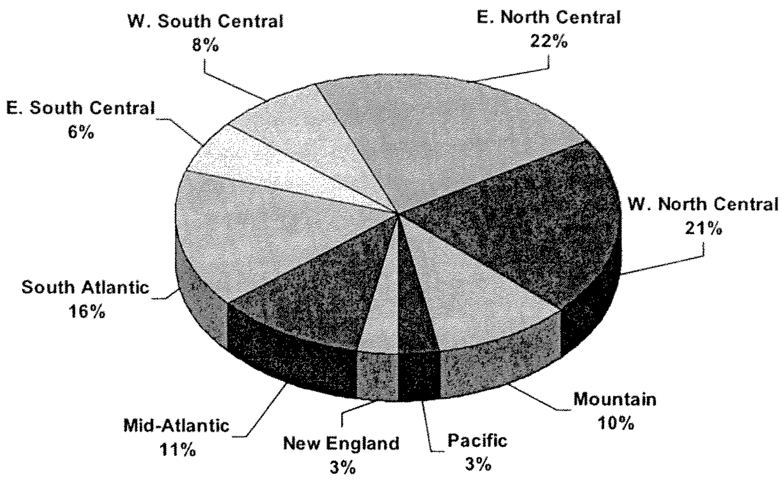
Table 1a and 1b describe relationships between total revenue, orders received, and sources of revenue.

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

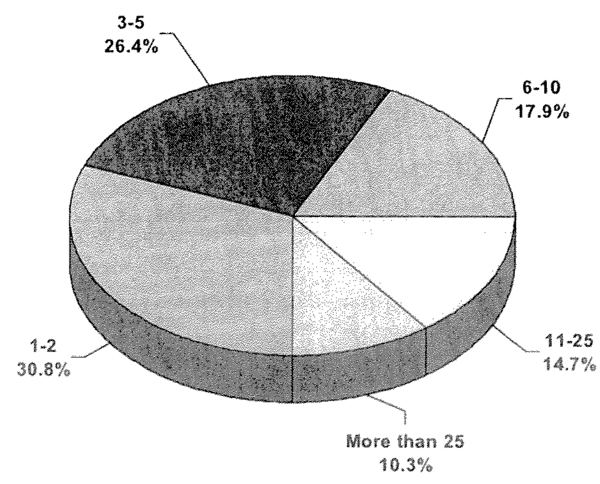


Source: 2005 ALTA Operations Survey

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



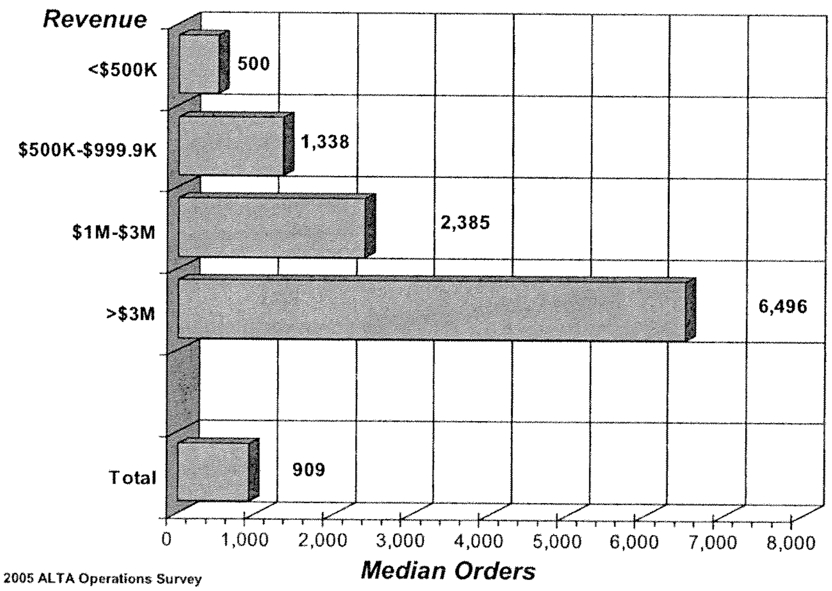
Source: 2005 ALTA Operations Survey

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

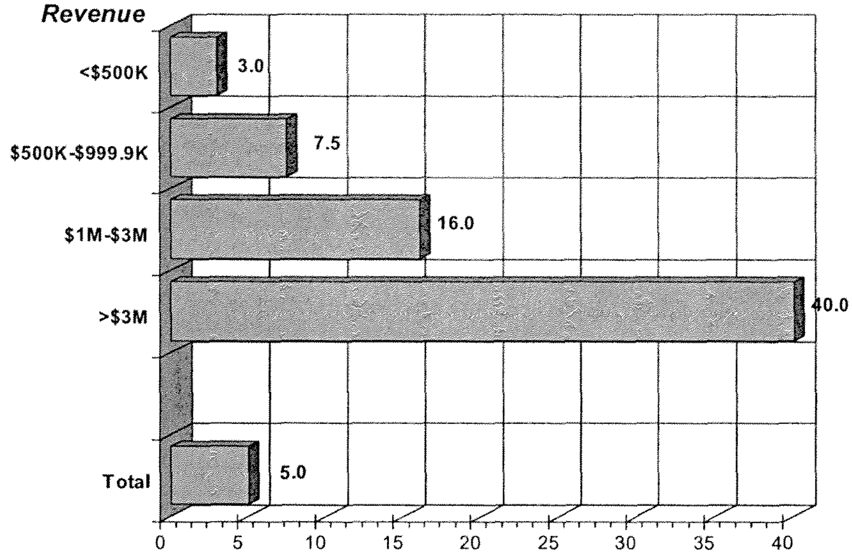
Part-time staff averaged 1.2 employees for all respondents, ranging from an average of .8 part-time employees at companies with less than $500,000 revenue to 2.8 part-time employees at companies with more than $3 million revenue.

MEDIAN ORDERS RECEIVED
BY GROSS REVENUE



Source: 2005 ALTA Operations Survey

MEDIAN FULL-TIME EMPLOYEES
BY GROSS REVENUE



Source: 2005 ALTA Operations Survey

TYPE OF COMPANY

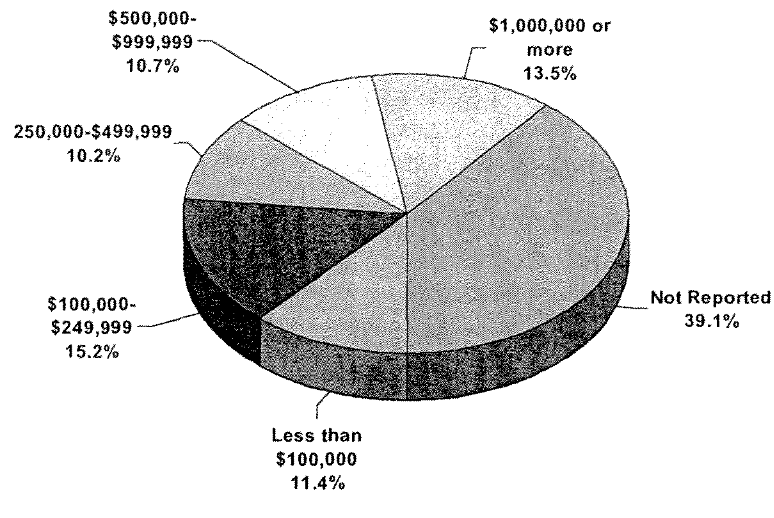
As in 2003, the most prevalent type of organization (43.6%) was Subchapter S. About half as many companies (22.9%) were organized as C corporations. Limited liability corporations (LLC) comprised 20.1% and sole proprietorships made up 11.0%.

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.

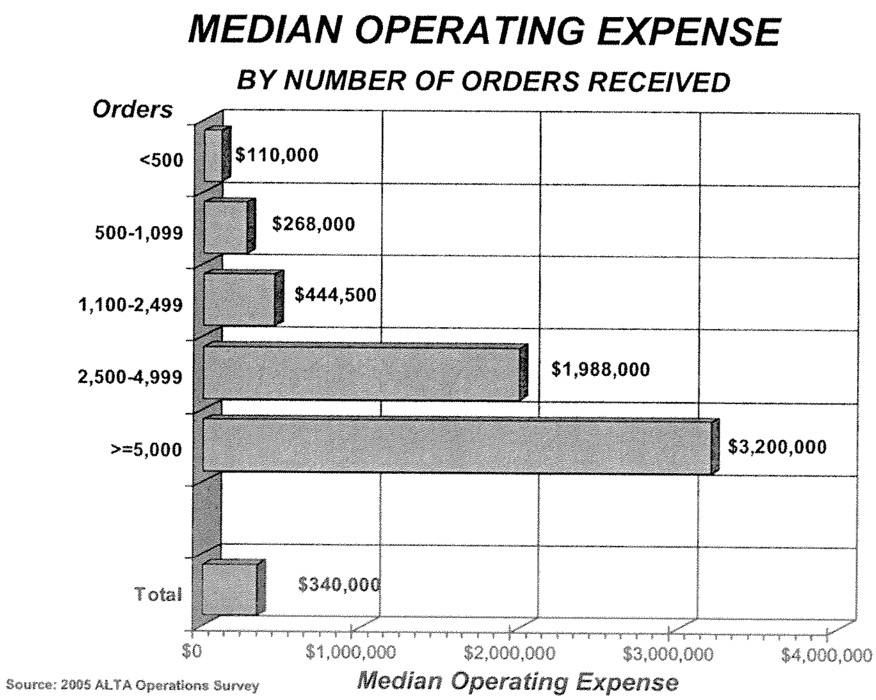
	1998	1999	2000	2001	2003	2004
Payroll/operating expense (median)	62%	56%	59%	49%	53%	54%

Within each revenue category, 2004 payroll averaged between 51% and 61% of 2004 operating expense.

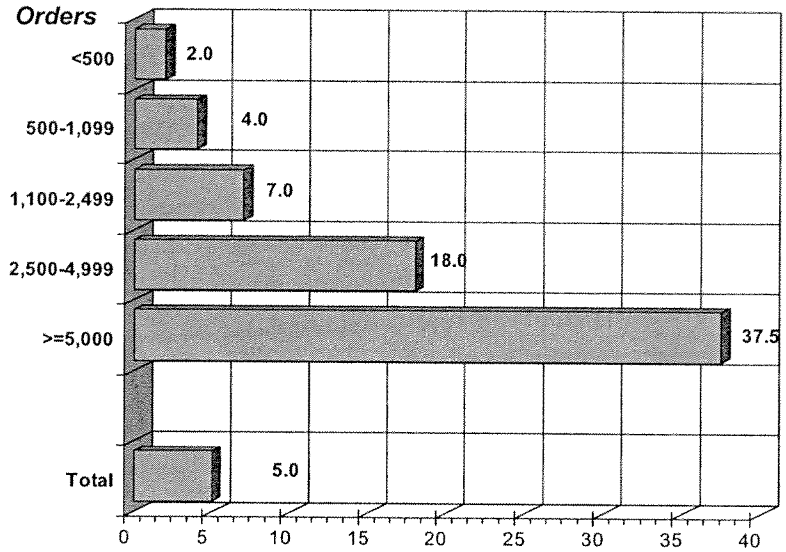
Payroll per order received averaged $285 in 2004, higher than the $258 reported in 2003. The trend of median payroll per order, since 1999, is shown below.

	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 FULL-TIME EMPLOYEES
BY NUMBER OF ORDERS RECEIVED

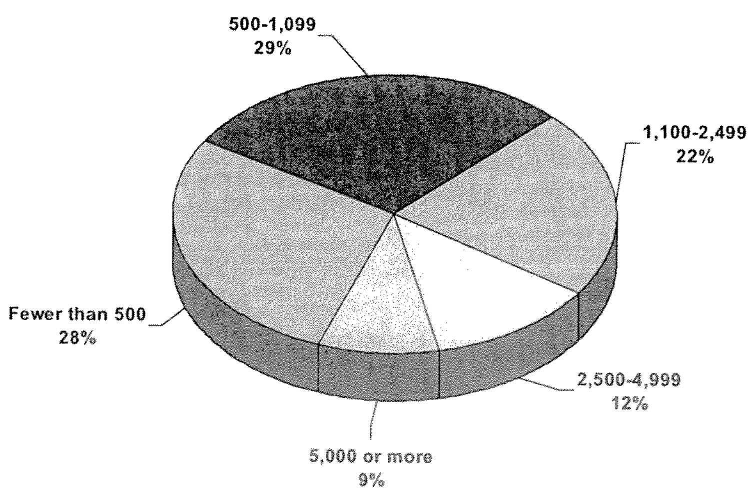


Source: 2005 ALTA Operations Survey

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



Source: 2005 ALTA Operations Survey

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 reported 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.

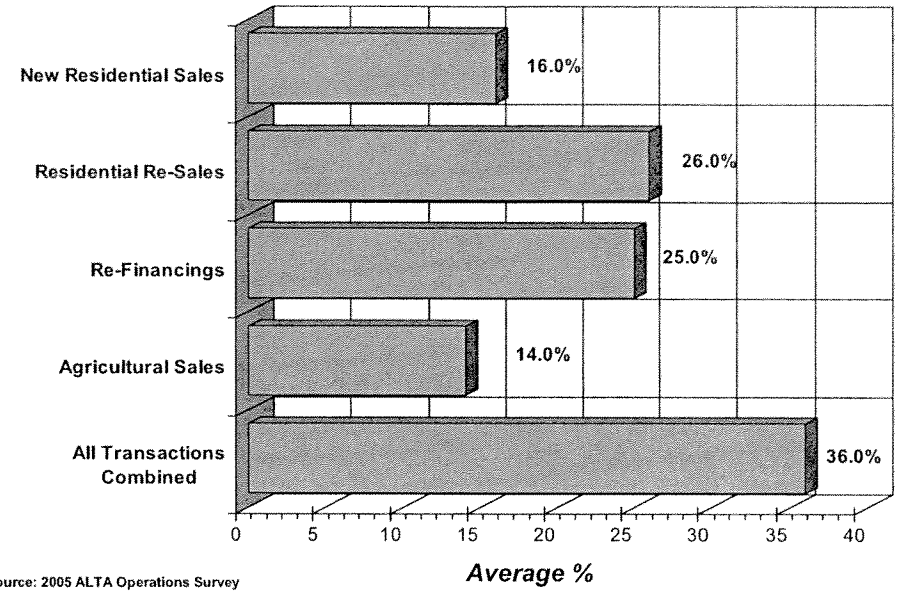
CURATIVE ACTIONS

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%.

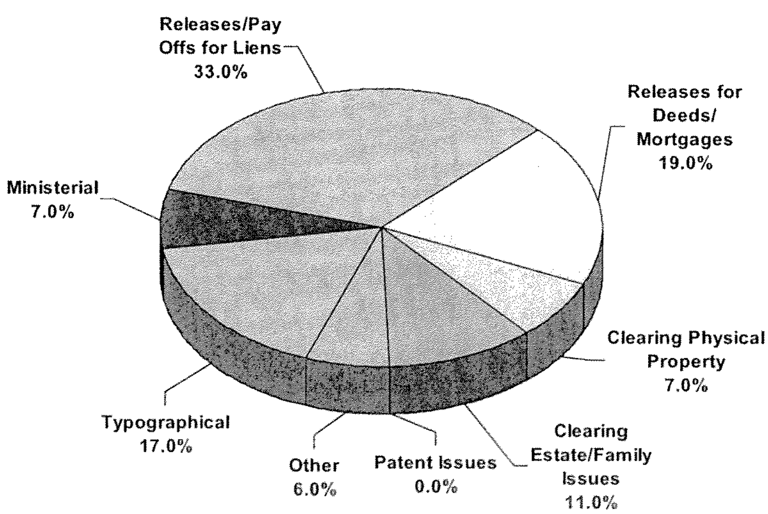
The most likely activity to require curative actions was residential re-sales, where the average value was 26%. Close behind were re-financings, with an average of 25%, and new residential sales at 16%. For residential re-sales and re-financings, the percent was significantly higher for the largest companies.

AVERAGE PERCENT OF ORDERS REQUIRING CURATIVE ACTIONS PRIOR TO CLOSING OR POLICY ISSUANCE



Source: 2005 ALTA Operations Survey

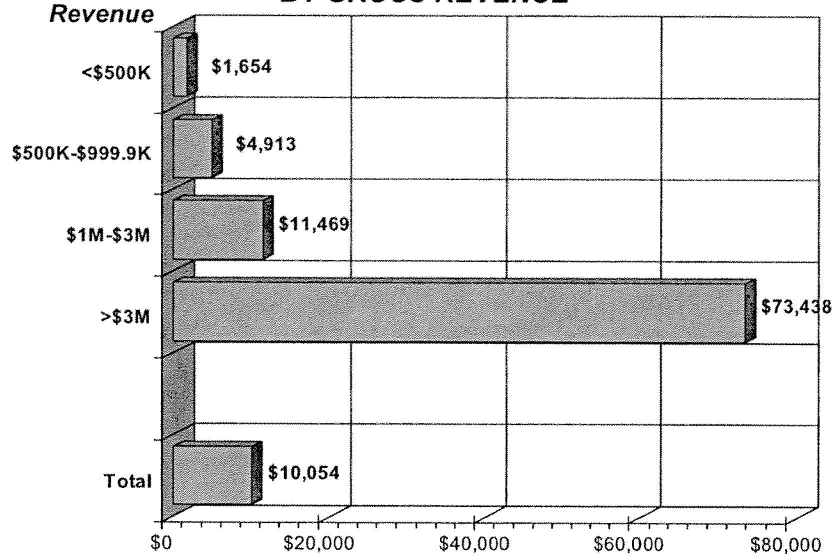
AVERAGE ALLOCATION OF CURATIVE ACTIONS BY TYPE



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.

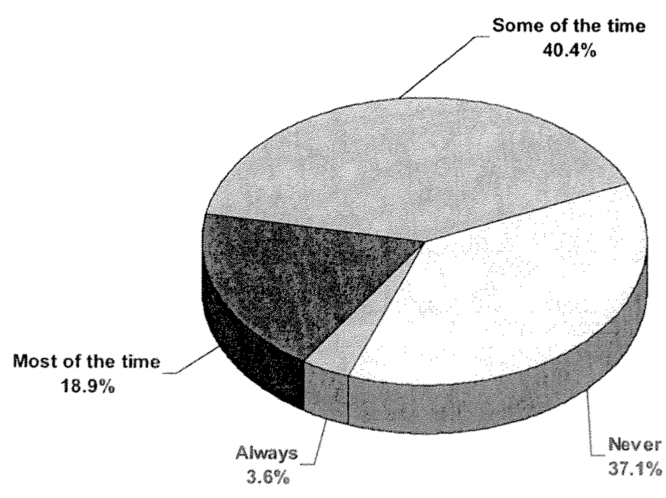
AVERAGE TOTAL ANNUAL DOLLAR AMOUNT OF TITLE-RELATED LOSSES PAID OUT-OF-POCKET BY GROSS REVENUE



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

			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		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?

			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		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

		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
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?

		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		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

		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		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

			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 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	$814,625	$1,569,668
	Median	$340,000	$179,564	$562,056	$1,500,000	$4,200,000	$110,000	$268,000	$444,500	$1,988,000	$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

			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%
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

			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 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

		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%
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

		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
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

		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
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

		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
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

		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
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?

		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%
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?

		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 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

		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
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

TAB E

THE ROLE OF THE MONOLINE REQUIREMENT IN ASSURING TITLE INSURANCE EFFECTIVENESS

By

Dr. Nelson R. Lipshutz
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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 18th 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

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[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

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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]

[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]

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[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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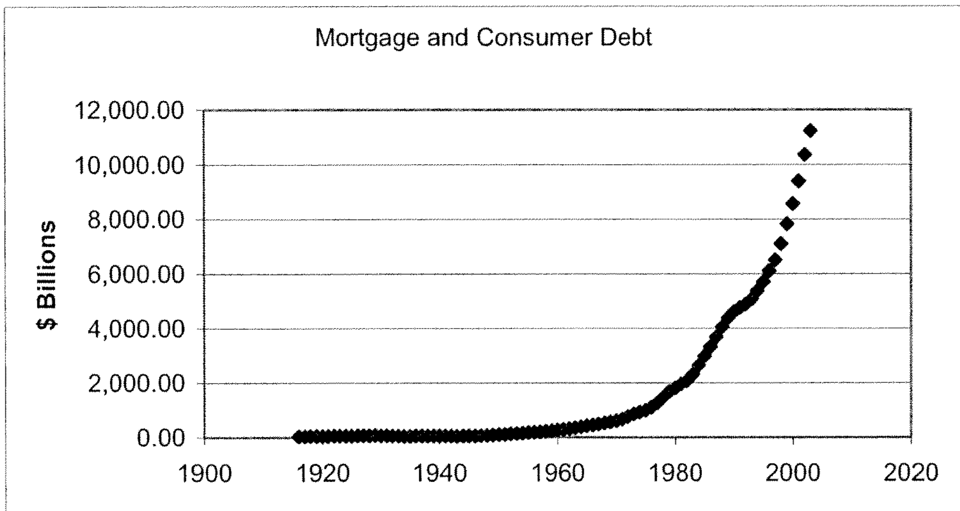
[47] Ibid., Section Four

[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



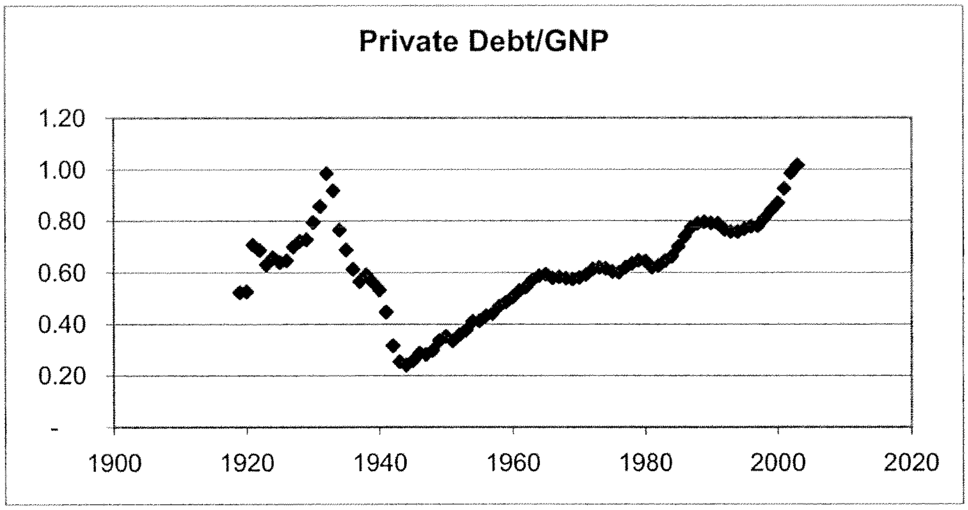
Of course, the economy has also grown enormously over the same period.[50] A better measure of the relative private debt load being born by real property purchasers is the ratio of mortgage and consumer debt to the gross national product. In terms of this metric, the current debt level is not unprecedented. 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

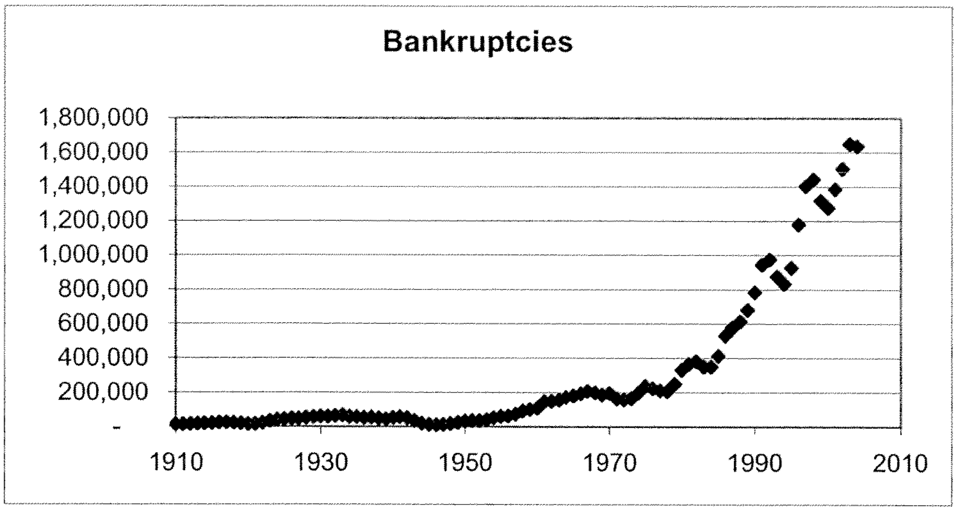
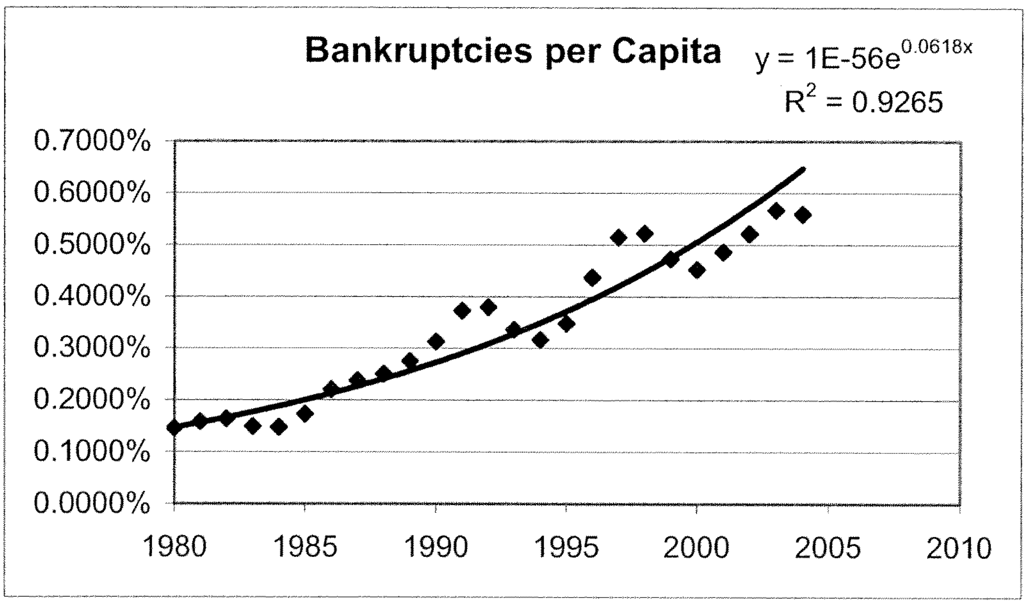


FIGURE 4

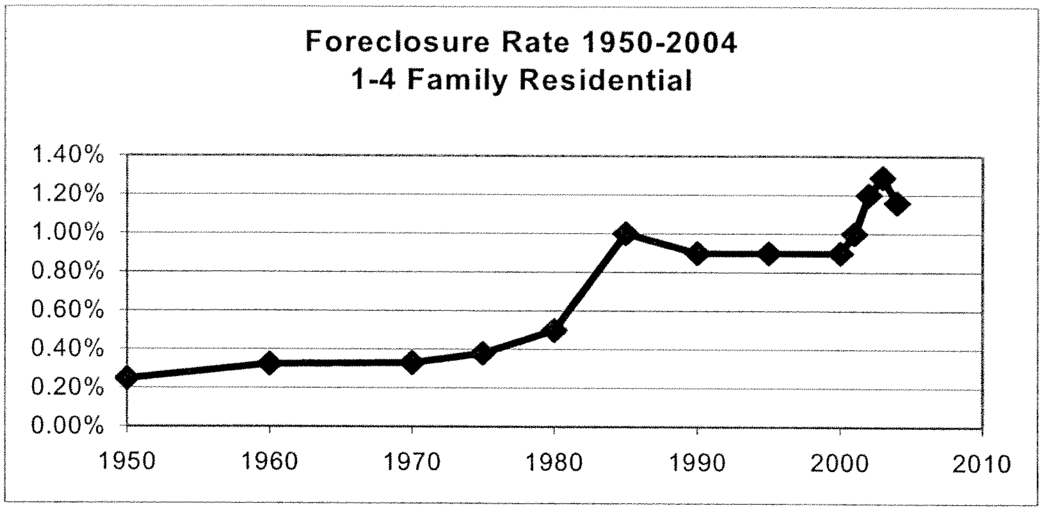


At the same time, mortgage foreclosures have also been rising.[52] In the post-Depression period, annual foreclosure rates averaged around 0.25% until the 1980's. Since 1980, foreclosure

[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

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[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.

TAB F

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.

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[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	608	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.

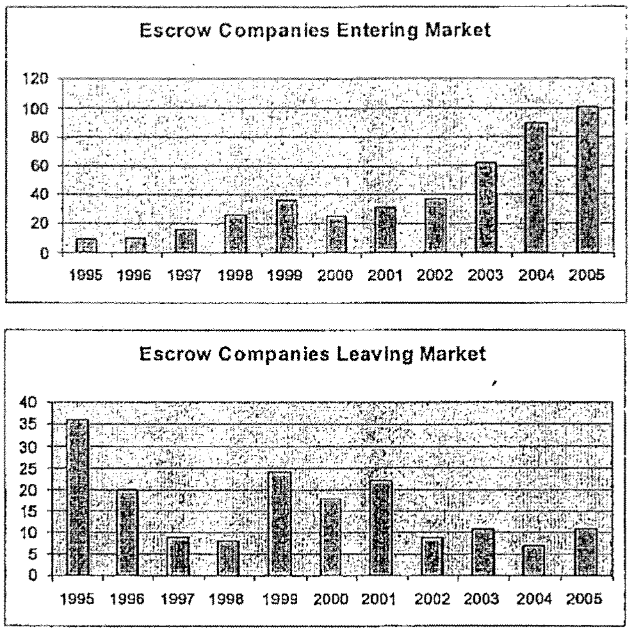
Established business relationships are generally not a barrier to entry. All businesses have business relationships. The very essence of competition is to act so as to change these relationships – with suppliers, with distributors, and with customers. Therefore, the best way to determine if unreasonable 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

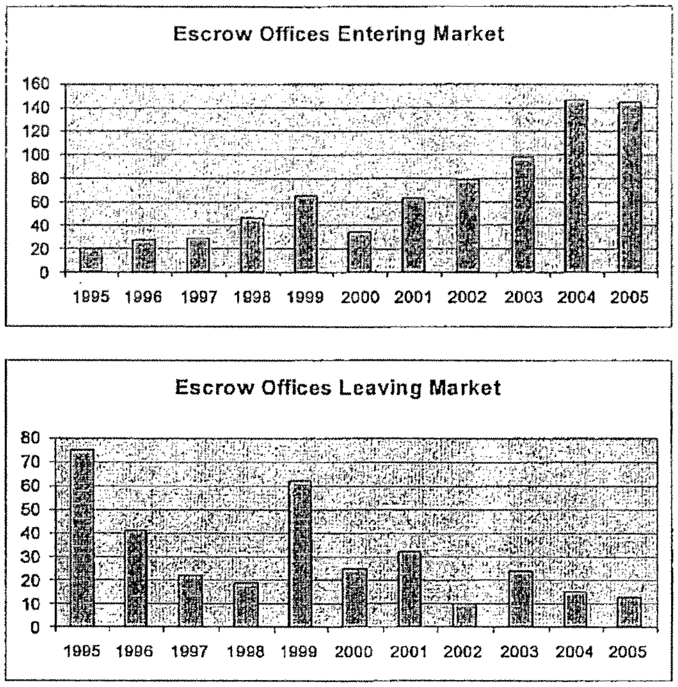
COMPANIES ENTERING AND EXITING THE CALIFORNIA ESCROW MARKET



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	67%
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

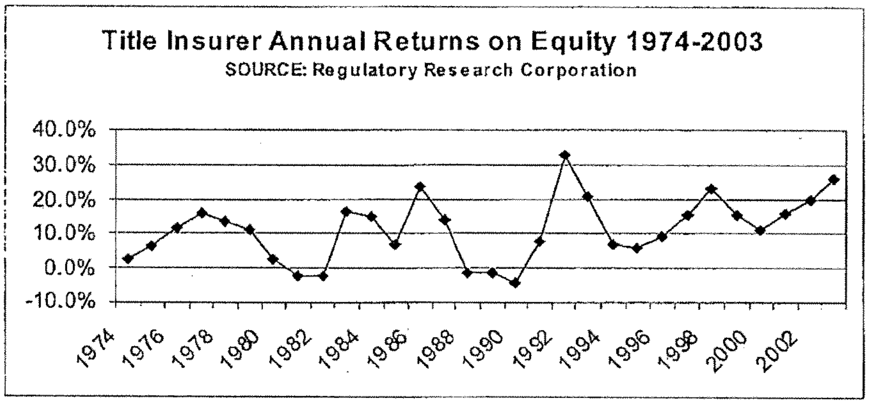
The contractor's report asserts that lack of an immediate price response to any change in cost is indicative of a lack of price competition.[16] This assertion is incorrect.

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]

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[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 Chairman	 1982-1984 1983-1984
	CAS Committee on Principles of Ratemaking Member Chairman	 1985-1987 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 President	 1986-1987 1988
EMPLOYMENT HISTORY:	State Farm Insurance M. J. Miller and Company Tillinghast Miller, Herbers, Lehmann, & Associates, Inc. EPIC Consulting, LLC Tillinghast/Towers Perrin	1967-1984 1984 1984-1993 1994-2002 2003-2004 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.

TAB G

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.

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[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 <u>price competition</u>."[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

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[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 21st 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

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[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

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[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.

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[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.

TAB H

Review and Comment on "An Analysis of Competition in the California Title Insurance and Escrow Industry" by Birny Birnbaum

by

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University of North Texas

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

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[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"

[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.

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[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

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[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

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[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

[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

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[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]

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[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

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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 $l0 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.

TAB I

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 Fellow	2002-2004
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.

TAB J

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.

[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.

> Short term rates: 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.
>
> Affordable home ownership programs: 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.
>
> First time buyers and seniors: As of 2004 some title insurers offered discounts of 10 percent or more for qualified first time buyers and seniors.
>
> New lower priced policy forms: 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.
>
> Automated issuance: 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]

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[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,

[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

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[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.

Bruce E. Stangle, Chairman; *Ph.D. in Applied Economics and M.S. in Management, Sloan School of Management, Massachusetts Institute of Technology; B.A., Bates College*

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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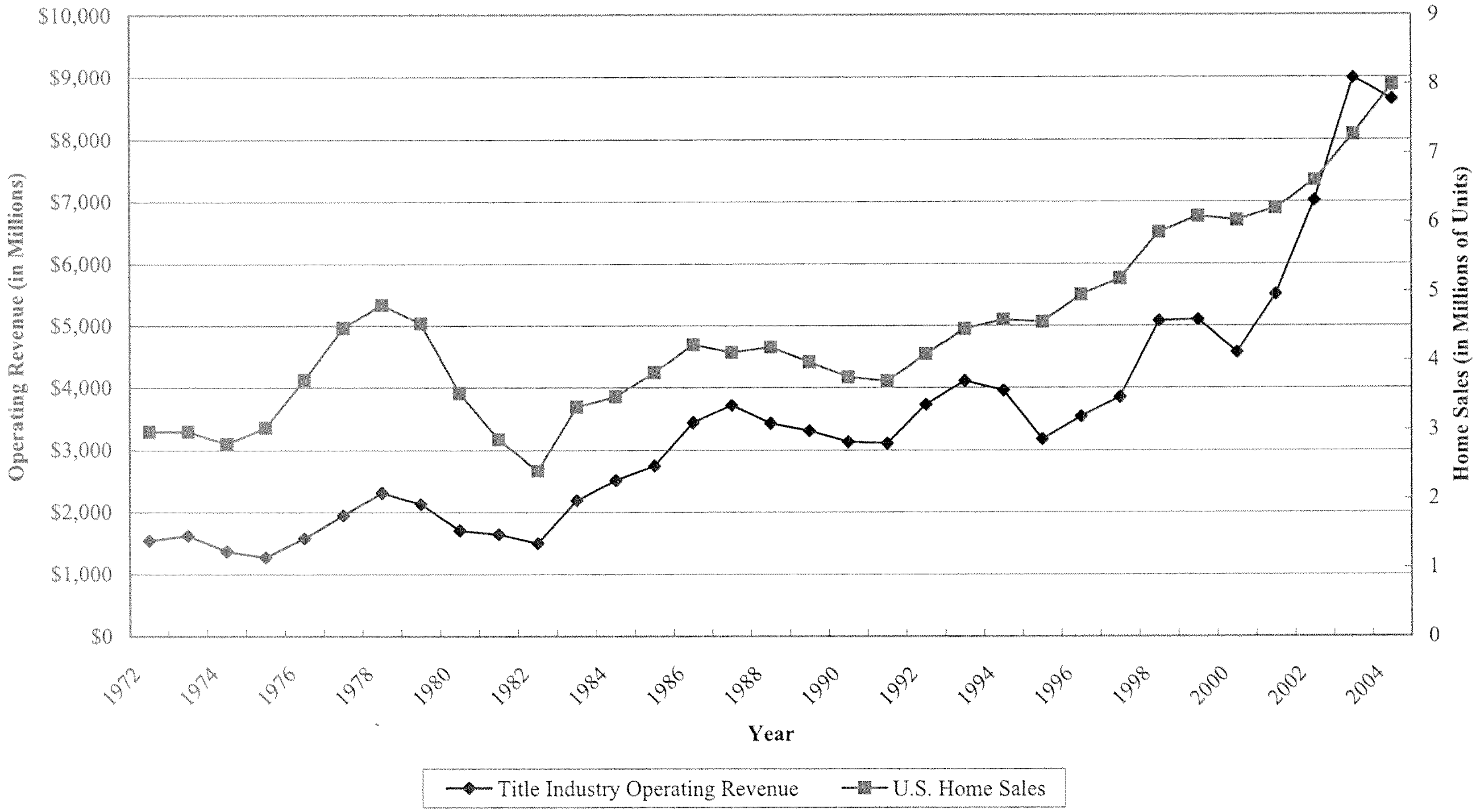
Dr. Strombom is an expert in applied microeconomics, industrial organization and finance. For the past 13 years he has served as a consulting and testifying expert in both commercial litigation and public policy matters. He has conducted economic analyses and damages assessments involving antitrust, 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

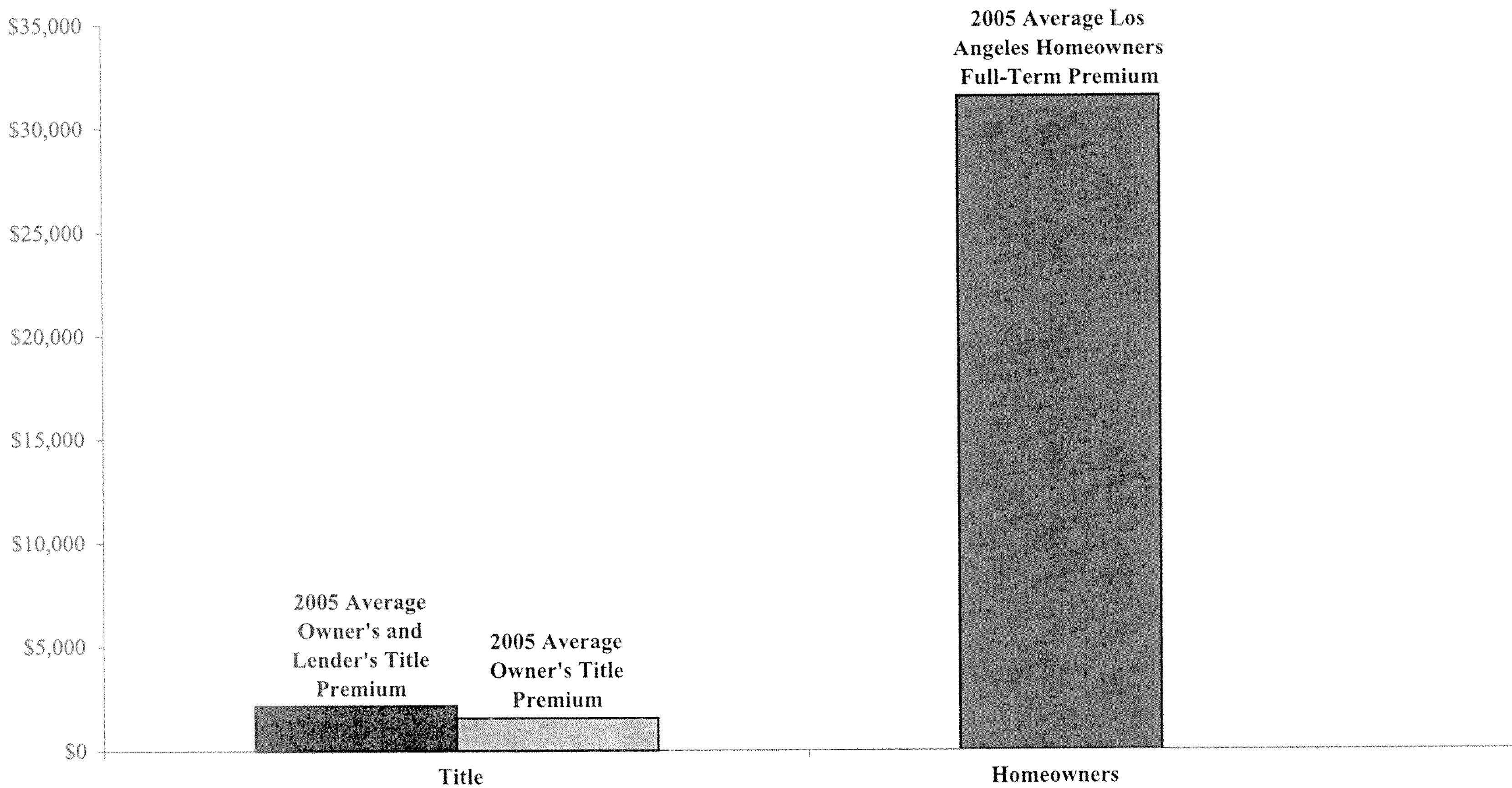


Notes: 1. Operating Revenue is adjusted for inflation using the CPI Index (base year is 1982-84).
2. The correlation between Operating Revenues and Home Sales is 92%.

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

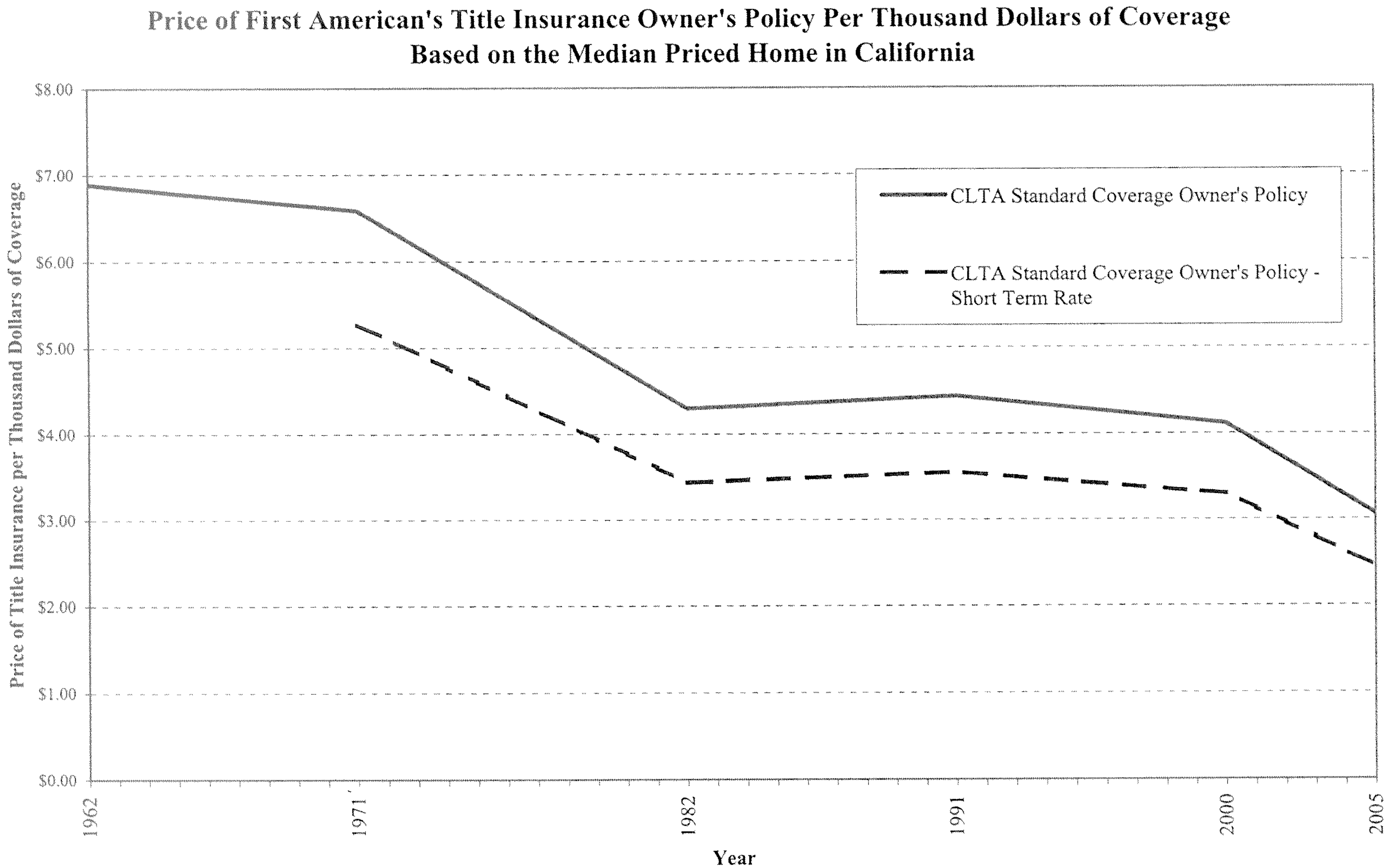
Comparison of Full-Term Premiums on Median Priced Home Purchases for Title and Homeowners Insurance in California



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



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	X
Forced removal enhanced C, C & R violation coverage (for pre policy violation)				X	X	X	X
Coverage for loss of use because of zoning violations				X	X	X	X
Substitute property rental benefit during claims period coverage				X	X	X	X
Automatic inflation coverage				X	FA 11.1	X	X
Unrecorded easement claims				X	X	X	X
Unrecorded defects, liens and encumbrance claims				X	X	X	X
Unrecorded adverse ownership claims				X	X	X	X
Document execution coverage				X	X	X	X
Mineral right surface entry coverage			X			X	X
Zoning coverage (regulating area, width and depth of the land)			X	X	X	X	X
Basic C, C & R violation coverage (for pre policy violation)			X	X	X	X	X
Unrecorded encroachment coverage			X	X	X	X	X
Unrecorded mechanics' lien coverage			X	X	X	X	X
Basic access		X	X	X	X	X	X
Recorded ownership (vesting)		X	X	X	X	X	X
Unmarketability of title	X	X	X	X	X	X	X
Recorded defects, liens or encumbrances not shown as an exception	X	X	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.

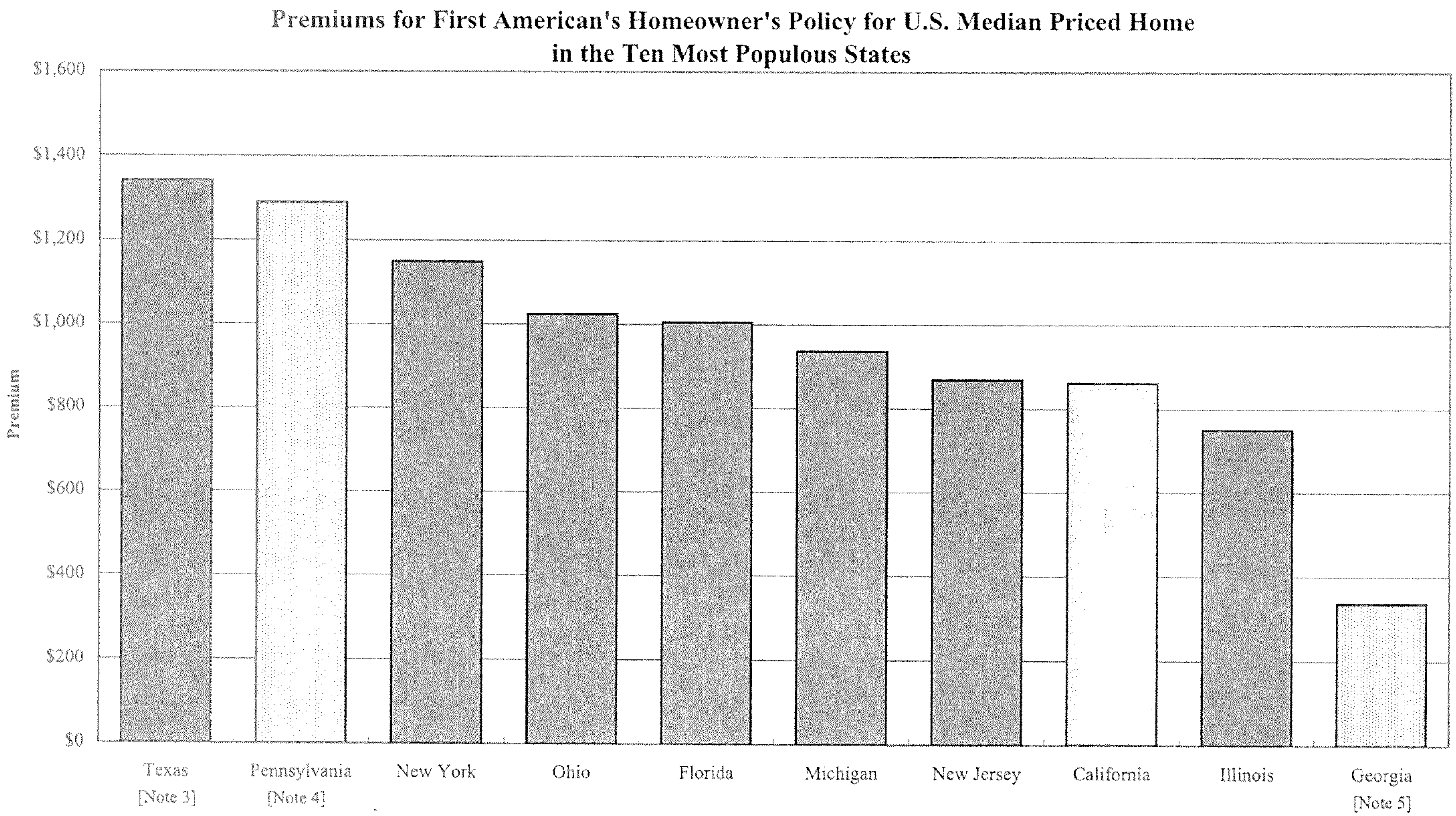
Legend:

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

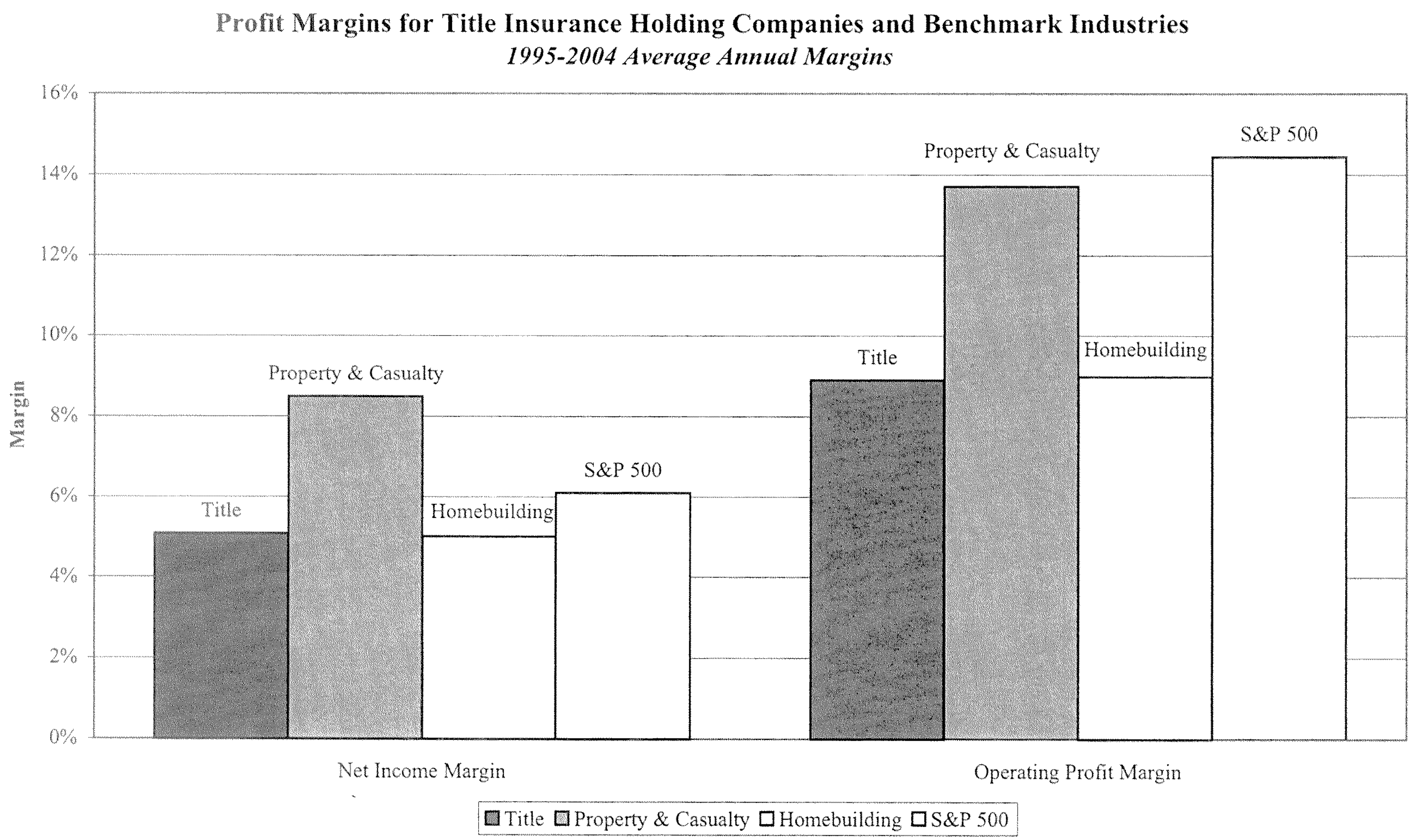
Exhibit 5



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



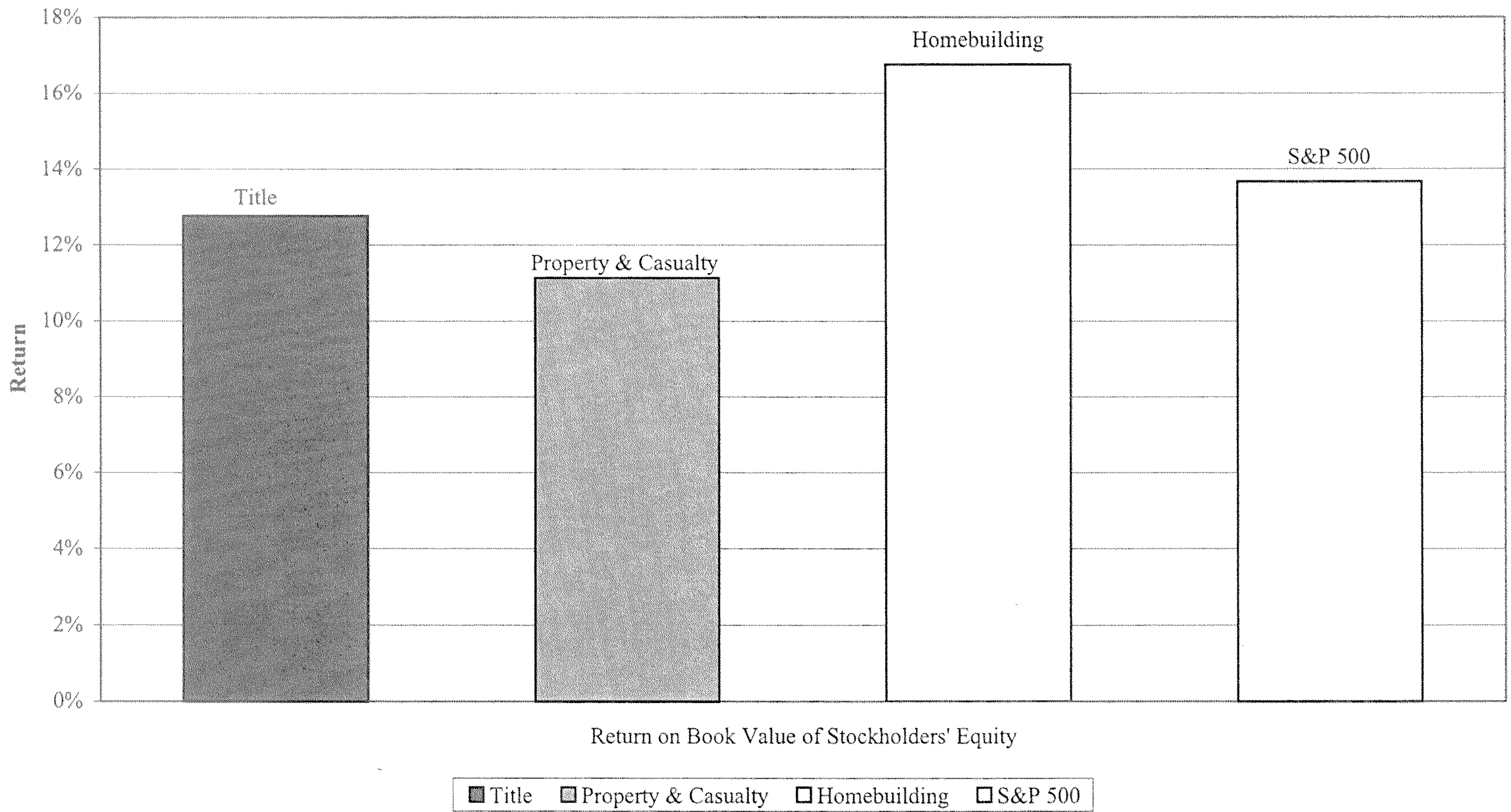
Notes: Title includes the 10 publicly-traded companies in SIC 6361, Title Insurance, that provide title insurance in various years between 1995 and 2004 (Capital Title Group, Fidelity National Financial, First American Corp., Investors Title Co., LandAmerica Financial Group, Stewart Information Services, 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



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.

TAB K

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 <u>bona fide</u> 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. <u>See</u> 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 <u>bona fide</u> 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 <u>bona fide</u> 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. <u>Determining that the Compensation Paid for Reinsurance Does Not Exceed the Value of the Reinsurance</u>

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. <u>CONCLUSION</u>

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

TAB L

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.

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.

TAB M

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