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Hearing Before The House Financial Services Subcommittee on Housing and Community Opportunity

Entitled

“Title Insurance: Cost and Competition”

Testimony of Thomas M. Stevens, CRB, CRS, GRI President

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Chairman Ney, Representative Waters, and Members of the Subcommittee, thank you for inviting me here today. My name is Tom Stevens, and I am the former President of Coldwell Banker Stevens (now known as Coldwell Banker Residential Brokerage Mid-Atlantic) – a full-service realty firm specializing in residential sales and brokerage. Since 2004, I have served as senior vice president for NRT Inc., the largest residential real estate brokerage company in the nation.

As the 2006 President of the National Association of REALTORS[®], I am here to testify on behalf of our nearly 1.3 million REALTOR[®] members who represent all aspects of the residential and commercial real estate industry. NAR's membership includes more than 300,000 REALTOR[®] companies. By joining NAR, licensees pledge to conduct their business according to the association's strict Code of Ethics and Standards of Practice. I appreciate the opportunity to share our views on title insurance costs and competition in the marketplace.

Competition in the Title Insurance Industry

NAR believes that the title insurance industry is highly competitive and that this fact is not in serious dispute among real estate services providers. We do not turn a blind eye to anyone, whether it is a policymaker, analyst or media observer, who raises concerns about purported anti-competitiveness in any sector of the real estate services industry. In fact, just a few months ago, the Government Accountability Office (GAO) was asked to analyze competition in the real estate brokerage marketplace and found that the industry has a number of attributes that economists normally associate with active price competition including the large number of relatively small firms that are active throughout the country and the ease of entry into the profession.¹

While the title companies and their trade associations are in a closer position to discuss the specific aspects of the industry's competitiveness, I would like to make a few observations. Looking at the title insurance industry from a real estate practitioner's perspective, it certainly

¹ U.S. Government Accountability Office, *Real Estate Brokerage: Factors that May Affect Price Competition* (2005).

meets a number of the criteria business analysts consider when examining competition in a particular marketplace. For example, there are many buyers and many suppliers of title insurance; there are limited number of products such as the lenders policy, owners policy informational binder and chain of title, but many different types of settlement services for a consumer to chose from; consumers have access to information on the selection of title companies and services – yellow pages, newspapers, through referrals, property listings, magazines and web sites; relatively low barriers to market entry; and the fact that consumers can shop and compare title insurance rates and settlement service prices. Thus, it seems to me, that with all these factors present to some degree in the title insurance marketplace, it implies that no one player or small group of title companies can significantly impact the overall market and control the price.

NAR does not take a position on the pricing aspects of title insurance because it is regulated at the state level. As you know, some states set minimum rates for title insurance and other title related services and others allow title companies to set their own rates which are filed with the state Departments of Insurance and must be adhered to. But again, speaking for real estate practitioners, we have not seen predatory pricing/rates (cutting prices or rates below costs in order to drive out companies from the market), limit pricing/rates (setting a price low enough to discourage entry), or price/rate discrimination (charging one group of consumers a rate higher than another based on cultural or social factors) in the title insurance marketplace, which if present, are not only unlawful but could be indicative of a concentrated, anti-competitive industry.

My final thought on competition and pricing in the title insurance industry is geared toward those who have questioned why the use of the Internet has not lowered the cost of title insurance as it has done in the selling of airline tickets and other products. Simply, each home has its unique title and history. Each sales transaction requires its own title “chain of title” search, its own title examination and commitment, title policy and settlement/closing. Furthermore, lenders require judgment searches on buyers, who are unique like each home and require individualized attention. The process is complex and time consuming. Because of the risk of liability involved in the transaction, there is no “do-it-yourself” route to issuing title insurance. While one can go

on the Internet and literally 10 minutes later have an airline ticket to virtually anywhere in the world, the home purchase transaction and the accompanying real estate related services required for settlement usually necessitate weeks, if not one or two months, of work. It is, therefore, not surprising that an industry which operates on a property-by-property and buyer-by-buyer basis has not seen costs reduced as a result of the proliferation of Internet commerce.

Affiliated Business Arrangements

Real estate professionals interact with title companies in a number of ways. One way brokers and agents work with title companies is via affiliated settlement service providers. As we all know, housing is a high-cost commodity and its sales transaction is a complex matter. Real estate professionals perform significant services for consumers well beyond the traditional duties of matching buyers and sellers. For example, real estate brokers and agents provide guidance to consumers in finding a property, pricing a property, negotiating the best purchase or sales price, arranging inspections, closings and performing a myriad of other tasks that buyers and sellers trust their agent to carry out.

The very unique and often intense services that real estate professionals perform give brokers and agents access to consumers that other real estate-related companies would like to have. In some cases, providers of these services compete for the consumer's relationship; in other cases they cooperate with realty firms. One means of cooperation is through affiliate business arrangements where a person, such as a real estate broker or agent, is in a position to refer settlement business to a settlement service provider, such as a title company, that is owned, in whole or in part, by the referring party. Under this arrangement, the referring party receives no direct payment for the referral to the settlement service provider in which he has an ownership interest, but he can receive indirect compensation based on the financial growth of the affiliated provider.² The affiliated business arrangement exemption allows referrals of business to an affiliated settlement service provider if three conditions are met: (1) the relationship is disclosed in writing to the person referred, (2) the person referred is not required to use the affiliate, and

² Gardner v. First American Title Insur. Co., 296 F. Supp.2d 1011, 1016-17 (D. Minn. 2003).

(3) the referring party receives payment only in the form of a return on ownership interest (or permissible payment for services rendered).³

As a former broker/owner with 39 offices and 200 associates who did have affiliate relationships with real estate related service providers, I can tell you that having such cooperative partnerships was important to the growth of my firm. In my experience, real estate firms that establish joint ventures with title companies do so in order to offer clients the convenience of on-site services, bring efficiency to the transaction, and ensure a smooth and timely closing. I can also tell you that most real estate professionals consider affiliated business arrangements, particularly with title companies and mortgage lenders, an essential component of their future business model for expanding their professional services and profit basis beyond that of traditional brokerage activities. But I always stress to these professionals that entering into such business arrangements is not for the faint at heart for two major reasons: (1) there is no guarantee of financial success; and (2) violations of RESPA Section 8 carry both civil regulatory fines and criminal penalties. In fact, while NAR does not have comprehensive data on nationwide real estate-affiliated title companies, it is my experience in talking with brokers across the country that about 20 percent of real estate professionals have established title company affiliations with an average capture rate (number of transactions completed by the affiliate) generally acknowledged by industry experts at around 30 percent.

To a certain degree, it takes being successful in the business for a number of years before a broker/owner can be financially stable enough to create a new legal entity that performs a *bona fide* service that meets the U.S. Department of Housing and Urban Development's (HUD) "sham" test. For example, one of HUD's "sham" test criteria is that the affiliated business be sufficiently capitalized requires a serious financial investment that many broker/owners might not be in a position to make, especially when it can mean providing enough capital to cover all start-up costs and expenses to operate the business for 90 to 120 days without any income.

Another example that underscores my point about a certain level of business sophistication when it comes to affiliated business arrangements is that the broker/owner should have a good working

³ 12 U.S.C. § 2607(c).

understanding of services to be performed by the type of entity at issue in order to meet the “substantial services” criteria under HUD’s “sham” test, which comes with many years of experience in the industry. For an affiliated title agency, these substantial services are termed “core services” and include: examination and evaluation of title evidence to determine insurability; preparation and issuance of the title commitment; clearance of underwriting objections; preparation and issuance of the title policy; and handling of closing or settlement where the closing is part of an all-inclusive rate. Finally, it takes a very experienced business professional to recognize that creating affiliated business arrangements is in effect structuring an entity qualified to exempt itself from the law and that failure to structure the affiliate company properly or comply with regulatory requirements can mean serious legal and financial consequences. I’ll bet that if you ask the average agent if they would be willing to risk going to jail over a referral fee, the answer will be a resounding “no.”

On the issue of sham business arrangements or shell companies, I can tell you that real estate professionals are very frustrated with these problematic entities in the marketplace. Furthermore, NAR takes very seriously the implication from some regulators that real estate professionals may be involved in illegal kick-back schemes from these rogue companies. NAR does not condone violations of RESPA, Regulation X or HUD’s 10 part “sham” test; rather, we applaud HUD and the state regulators for their increased enforcement effort in this area. NAR has proactively taken steps to remind its members about how HUD determines whether a mortgage or title company is a sham company by issuing compliance guidelines from our legal affairs department. Furthermore, our legal affairs department regularly features RESPA compliance as part of its risk management seminars and its REALTOR[®] publications. Last year, NAR elevated the importance of RESPA compliance by launching its “RESPA Realities Awareness Campaign,” which includes compliance seminars at NAR’s Midyear and Annual Governance Meetings; online (webcast) compliance seminars; a one-stop RESPA resource guide on REALTOR.org (www.REALTOR.org/RESPA), and RESPA educational products.

Real Estate Service Recommendations

Another way real estate professionals interact with title companies is via legal referrals of business or customer recommendations. There are approximately 2.5 million real estate professionals licensed by the states (as I mentioned, of which nearly 1.3 million are members of NAR). Nearly all real estate professionals are self-employed independent contractors. These non-salaried entrepreneurs make decisions about marketing plans, professional partnerships, and a host of other independent business decisions.

Like many business professions, reputation is key to the success or failure of a real estate broker or agent. In fact, the reputational factor was recognized by the GAO in their report on real estate brokerage which stated that the industry “has displayed more evidence of competition on the basis of nonprice factors, such as reputation or level of service, than on price.”⁴ Real estate professionals assist in nearly all aspects of the home purchase transaction by serving as a valuable source of information and offering their expertise to both first-time and experienced home buyers. According to NAR’s *2005 Profile of Home Buyers and Sellers*, more than half of first-time homebuyers received a referral for a particular real estate agent compared with over one-third of repeat buyers. The importance of an agent’s reputation is also reflected in the fact that 17 percent of repeat buyers chose an agent based on their previous experience with that agent in an earlier home sales transaction. Although buyers consider many factors when choosing an agent, reputation and a positive experience are by far the most important considerations.

The reputational factor is important to today’s hearing because, to a certain extent, real estate professionals are involved in the marketing of title insurance and settlement services firms via the brokers’ or agents’ recommendation of service providers. As we all know, it is illegal for a real estate service provider to pay a broker or agent to be placed on a recommended service provider list. While HUD’s visible enforcement of RESPA’s Section 8 anti-kickback and referral fee provisions attempts to keep settlement service providers in check, it is the reputational risk, *our livelihood*, which drives compliance among real estate professionals.

⁴ GAO Report at 3, 8-12.

Because clients often seek real estate professionals' recommendations for service providers, it is in their best interest to give multiple recommendations based on the brokers'/agents' experience in working with those firms. Ideally, real estate professionals like to work with and recommend service providers, including title companies and settlement service firms, who are experienced, trustworthy, reliable and committed to providing quality service. If, for example, a home buyer uses one of his real estate agent's recommendations for a settlement agent and that client is dissatisfied with the service he received at or after closing, it reflects poorly on the agent's reputation. And if the agent's reputation is compromised, he not only loses the "customer for life" and likelihood of future business referrals, but may also damage his reputation in the community.

An important point I would like to make regarding client referrals is that, just because a broker has an affiliated title company, you cannot assume agents will automatically recommend the affiliates' service to their clients. This is because the broker/owner has little input as to how real estate agents manage their clientele. Agents are highly motivated individuals who are dedicated to their clients and hope that a high level of customer satisfaction will pay-off via future business referrals. Consequently, the agent's incentive for future business referrals outweighs a broker/owner encouraging an agent to recommend a particular service provider especially if they do not regularly work with that company.

Conclusion

NAR, like many of the trade associations which represent real estate service providers, is greatly concerned about allegations of problems in the title insurance market. We applaud HUD and state insurance commissioners for bringing sunshine to the issue of sham companies and illegal kickbacks. Real estate professionals want to see these rogue companies quickly removed from the marketplace. We are optimistic that HUD's increased enforcement efforts together with additional coordination with federal agencies and state regulators will send a clear signal to the bad actors that they are not welcome in our industry. We also issue a challenge to our industry partners to allocate resources to RESPA education efforts as NAR has done with its RESPA Awareness Campaign. In closing, the NAR is committed to ensuring that REALTORS®

understand RESPA and fully comply with its provisions and we welcome every opportunity to work with HUD on our compliance efforts. Thank you for your time and I will be happy to answer any questions you may have.