

Introduction: Titling America

A Privileged Industry

Capitalism relies on a free market to establish prices, reward innovation and efficiency, and balance the needs of buyers and sellers. In the United States, however, firms that sell real estate titles to property owners and mortgage holders are an exception. Their trade organization, the American Land Title Association (ALTA), lobbies strenuously against any plan to allow market forces to influence the industry's price structure. The title insurance industry, which will be analyzed in this book, is one of America's most highly regulated and legislatively protected business niches. The status quo is increasingly being criticized by consumer-oriented reformers. The resulting public policy differences reveal how greatly the American market economy can be modified when elected officials, irrespective of political party, are under the influence of efficient lobbyists.

In the southern counties of New York State, a lender policy for a \$500,000 home costs \$2,142. The optional owner policy, if purchased at the same time, costs an additional \$633. The total cost of "only" \$2,775 would have been 15 percent higher in 2006 but for the fact that Eliot Spitzer, then the state attorney general, had pressured the industry to accept a 15 percent reduction of its fee schedule. He took the position that the premium schedule in New York State was excessive.

In Iowa, nearly identical lender and owner policies are being marketed profitably for only \$115.

There is no evidence of a criminal conspiracy to achieve state government support for New York's high mandatory premium schedule. It is even higher in some other states. The title insurance industry is owned and operated largely by respected citizens and investors. They take advantage of the fact that in a democracy, elected officials are

often induced to enact laws under which well-organized constituents are quietly enabled to enjoy special benefits.

Real estate titles are certified pieces of paper or digitized data entries that confer legal rights on the buyer. These rights include permanent ownership, access, enjoyment, and other uses, as well as the right to lease or sell the property. Like patents and stock certificates, a title certificate represents capital, which can be sold, bought, invested, or deeded to heirs. Rarely will a title be bought, transferred, sold, or taxed unless confirmed by public registration of ownership.

Paintings, jewelry, and appliances can be bought or sold privately. The ownership of real estate in the United States, in contrast, must be confirmed by public record. Publicly recorded title confers ownership rights, which can be enforced in a court of law. Without such governmental documentation, real property is subject to "squatter's rights," the claim that unchallenged usage over a period of time conveys ownership. Real estate titles are a major component of every country's gross national product. Fortunes can be made or lost through real estate transactions. Not surprisingly, given the amounts of money at stake, an industry has developed to provide insurance against financial losses resulting from defects of title.

Title insurance has become a financially stable and profitable sector of the American insurance business. Its availability contributes to the widespread attainment of home ownership, one of America's remarkable public welfare achievements. More than two-thirds of the U.S. population lives in homes in which they have property rights, ranging from luxury villas on multiacre lots through modest family homes, cooperative apartments, and condominiums to manufactured or self-built homes on titled land. These homeowners can insure their ownership rights against most legal challenges by former owners or their heirs or creditors. Title insurance services are available in every state of the union and in all U.S. territories.¹

For many decades, title insurance was elective. Only a minority of investors was willing to purchase a title policy. Most investors instead relied on an attorney to review the property records and to provide an expert opinion that the property was free of liens and prior claims and would continue to be marketable. Attorneys were not legally liable unless negligence could be proven in expensive and time-consuming litigation. Few attorneys had sufficient assets to compensate an investor for a court-certified judgment for an alleged error or omission.

After World War II, more bankers and other mortgage lenders demanded that buyers provide them with a “no-fault” title insurance policy covering the value of the mortgage in the event that, subsequent to the sale, the transaction turned out to have been based on fraud or had other defects that reduced its value. The title insurance industry was able to convince lenders that they could get the insurance policy free of charge by requiring that the buyer or seller of a property purchase it as part of the package of closing cost services.

The industry expanded its business by offering a separate owner policy, covering the buyer’s investment against the same risks. The incidence of loss is small, but when it occurs, owners may lose some or all of the capital invested in what often is their most important asset, their home. Industry spokespersons are apt to remind wary customers that nearly two centuries ago, Abraham Lincoln’s father lost the family homestead three times as a result of legal difficulties with titles. This is an interesting historical fact, but industry public relations specialists fail to mention that property records have greatly improved since then.²

A title insurance policy costs less than 1 percent of the property value. Nevertheless, there is overwhelming evidence that many people in the real estate industry believe that property owners pay fees far greater than the amounts needed to cover costs and generate a reasonable return on invested capital. Indeed, the title insurance industry in the United States (but not in Canada) has been the beneficiary of special privilege legislation for more than six decades. Monopoly pricing is enforced by mandated floors for prices in forty-one states, and in at least one other state by laws against “unfair competition.” The industry’s “excessive pricing” power is one of many cartel privileges enjoyed by the title insurance industry.

Title insurance companies in most states are prohibited from offering other insurance products, such as life insurance or casualty insurance. They are entitled to provide a horizontal menu of related real estate settlement services, including some of the functions generally performed by attorneys, escrow agents, realtors, appraisers, and other specialists. Title companies also generate a considerable amount of investment income from their mandatory reserve funds to cover anticipated and actual claims. Although payment of commissions to referral agents is illegal under both federal and most state laws, the practice is widespread, in spite of periodic convictions. The illegal

“kickback” incentives sometimes amount to 50 percent of the insurance premium.

Other forms of insurance against casualty losses for health maintenance or life insurance have to compete for market share in an open market, without a government-enforced minimum price. Consumers have a good deal of power to decide when and for how much loss they want to be insured, if at all. The title insurance industry alone functions within a unique pro-monopoly framework of governmental oversight.

Division of Labor

The industry is composed of two overlapping businesses, title agents and title insurers, which are surveyed periodically but not yearly by the U.S. Census.³ Title abstract and settlement offices (code 54191 in the North American Industry Classification Systems, or NAICS) include businesses engaged primarily in researching public land records to gather information relating to a real estate title and preparing documents necessary for the transfer of title. The 6,391 establishments enumerated in 1997 reported 53,112 employees and earned revenues of close to \$3.5 billion. In 2004, they handled about 59 percent of all title insurance contracts; their market share has decreased gradually. They solicit business from local customers, search title documents, correct flawed entries, prepare the insurance policy, and often provide escrow services. They retain a high proportion of the title insurance premium and transfer the risk exposure to a direct title insurance carrier, sometimes for less than 10 percent of the fee paid for the policy.

Direct title insurance carriers (NAICS code 524127) underwrite insurance policies. They protect the investment of lenders and sometimes also the owners in a real estate property against the remote risk of a loss related to a title defect. In 1997, the U.S. Census Bureau enumerated 7,142 local offices of such insurance businesses, many of them branches of the few specialized title insurance companies that carry most of the country’s policies. These carriers reported 72,001 employees and about \$7.5 billion in revenues.⁴ In 2004, Demotech reported that these carriers were also handling the title abstract and settlement services for 41 percent of all title insurance contracts though branch offices and agency subsidiaries.⁵ This proportion continues to

grow through mergers and acquisitions of title abstract and settlement offices.

The title insurance industry is of modest size in terms of its volume of business. It employs not much more than 1 percent of the entire insurance industry personnel. But as we shall see, this relatively small insurance specialty is virtually exempt from federal antitrust liability. The industry enjoys a number of additional advantages:

- It sells a nonelective product. Any property sale involving funds from a mortgage requires that the buyer purchase a policy. In the secondary mortgage market, the market makers—Fannie Mae, Freddie Mac, and Ginnie Mae—will not buy a mortgage without a title insurance backing it against the risk of loss resulting from a defective title.
- State regulating officials protect the title insurance industry from competition. Lower title guarantee fees offered by a few lenders have been outlawed in most states because they are offered under programs not licensed technically as “insurance programs.”
- There is much evidence, some of it circumstantial, that in all states title insurance premiums are being sold much above the break-even point to compensate companies for assuming the risk of a loss.

When reform proposals are under consideration in state legislatures or in Congress, industry lobbyists usually succeed in defeating them. Furthermore, the title insurance concept is being exported by U.S. companies. They succeed because premium rates outside the United States are only a fraction of those charged in the United States.⁶

The Controversial Status Quo

We will present evidence that the industry has attained what could be designated as a wealth-dipping empowerment. Wealth dipping is the practice, acceptable in most societies, of extracting a greater than normal economic return from transactions in which relatively large sums of money change hands. In the United States, wealth dipping occurs in defense contracts, public works, and at a personal level in the

pricing of luxury cars, Rolex watches, high-priced resorts, invitations to White House receptions in return for big campaign contributions, formal weddings, funerals, and in all real estate transactions facilitated by mortgages. Wealth dipping is also a rationale for progressive income tax and inheritance tax legislation.

Title insurance prices are not based on evidence of actual losses. For instance, Jessica Swesey, a reporter for the Inman News service for the real estate industry, reported that Toby Bradley, the president of the California Association of Realtors, was indignant over what he referred to as the high cost of title insurance: “We’re quite concerned [in California] about the cost of title insurance,” Bradley said. “It doesn’t seem rational for title insurers to charge these amounts with all the technology that’s available now.”⁷

The costs of title insurance are part of the excessive housing closing costs that are an additional barrier to purchasing even a low-cost home for some Americans. One-quarter of U.S. households in May 2002 were estimated to be “wealth poor” by a joint report of the Consumer Federation of America, the National Credit Union Foundation, and the Credit Union National Association. A “wealth poor” family was defined as one that was only one “lay-off or emergency expenditure” away from financial disaster. “They lack the financial assets which allows investment in a home, an education, a personal business or securities.”⁸

In 2007, the title industry finds itself in a political dilemma. Many leading title insurance companies are being investigated for illegal payments of referral commissions to expand their market share. As part of a commitment to reduce real estate closing costs, the U.S. Department of Housing and Urban Development (HUD) has tried for several years to secure congressional support to reduce them by encouraging free-market competition. A lengthy study reported in the conservative *Money* magazine asserts that closing costs are eight times as high as they were forty years ago. Closing costs have been estimated to total about 110 billion dollars per year in 2005–2006.⁹

Most closing costs, such as the real estate commission and the mortgage fee, are market driven. Others are fixed by law, such as the state and local government transfer taxes and—in most states—the title insurance premium. In order to lower closing costs, recent HUD secretaries have advocated that purchasers be offered bundled packages, covering all closing costs. Competing service providers could

then negotiate discounts from all or most of those involved in the transfer of real estate. Buyers and sellers would acquire more market power over closing costs and could shop for bundled services that suit their preferences for price and the quality of offered services.

The Consumers Union supports this strategy. In an editorial about bloated mortgage costs, Consumers Union informed readers that HUD estimated that homebuyers could save an average of seven hundred dollars per transaction, about 16 percent of their closing cost fees, equal to about eight billion dollars a year. Title insurance fees, among other closing costs, *Consumer Reports* argued, are “embedded in fine print or collected so seamlessly that consumers don’t realize that they are being paid until long after the fact.”¹⁰ Evidence reviewed in this book suggests that the HUD estimate of excessive costs is conservative.

There are other voices, such as the National Community Reinvestment Coalition (NCRC), a trade association of more than six hundred community-based organizations and local public agencies that seeks to increase “fair and equal access to credit, capital and banking services to traditionally underserved populations.”¹¹ The NCRC has lobbied in California in favor of price competitive alternatives to title insurance because “the title insurance industry has been abusing its monopoly by overcharging [the] people of California all too long. There is no reason [that] homeowners should be enriching the title insurance industry for providing a redundant and over-priced title insurance refinancing policy. . . . We ask that the Legislature accomplish what the Insurance Commissioner was unable to do—provide a real alternative to low and moderate-income consumers—a competitive choice.”¹²

The industry has fought all such reform proposals. The board of directors of ALTA threatened to challenge the HUD secretary’s legal entitlement to approve a proposed proconsumer one-bundle-pricing feature. They intervened actively in the 2004 federal and state elections in favor of candidates committed to the status quo. Every industry prefers governmental support and favors minimal limits on how it can cultivate profits. This book will document an extreme case that has persisted for decades virtually unchallenged. The evidence provided in this book has policy implications for legislators at both the state and federal level. Is there a point beyond which governmental support of an industry becomes excessive?

■

This book presents a variety of public policy viewpoints, but it is important to identify how the authors are related to the industry. “Insiders” write most books and articles about the title insurance industry; for the most part, they take the status quo for granted. The authors undertook this study without any prior involvement in the industry other than as occasional consumers. In the process of buying a property, we purchased a title insurance policy. We had several experts helping us, such as a realtor, a mortgage agent, and an inspector, and we could choose the homeowner’s insurance agent. But there was no competitive bidding to solicit our title insurance business. The insurance fee simply appeared on the HUD-1 summary of our closing costs a day before our purchase. We were told that this service was required. No one suggested that the title insurance premium was overpriced. When we inquired if one could find an equally reliable but more cost-effective agency, we learned that “they all charge the same.” This alerted us to the possibility that the title insurance industry was not subject to free-market competition, and we decided to investigate.

Findings in any study must be interpreted in light of the fact that much pertinent information is not available. All businesses control information that they define as “proprietary,” because knowledge of it might benefit their competitors. In this case, the title industry does not publish actual losses by causal factors, such as by type of property, location, time allocated to title searches, or other reason. What is being reported is limited by such gaps in the information base. We hope that this book and the reform proposals it reviews will encourage the title insurance industry or its regulators to elucidate the rest of the story.