Consumer Federation of America

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TESTIMONY OF
J. ROBERT HUNTER, FCAS. MAAA, DIRECTOR OF INSURANCE[1]

Chairman Cahill and Members of the Insurance Committee, thank you for the opportunity to share consumers' views on:

- the Department of Financial Services' (DFS) recent title insurance regulations;
- the concerns expressed in the notice of hearing and your June 2017 letter to the DFS; and
- AB 8467 and SB 6704.

Title insurance markets are characterized by reverse competition – a market structure in which insurers compete for the favor of the people who refer the business rather than competing for the customers who pay for the service. This means the prices paid by consumers are inflated by expenditures of title insurers and title agents to obtain business referrals from real estate professionals involved in the purchase or refinance transaction. As a result of reverse competition, consumers pay significantly higher prices for the title insurance required by lenders than the risk of loss suggests.

We note that in your June 2017 letter to the DFS, you wrote:

> It goes without saying that the ability of insurers and agents to communicate valuable information about their companies and services to their clients is critical to the continued operation of their business.

In almost every other type of business, the "client" is the consumer ordering and paying for a product or service. Yet, in title insurance markets, the purported "client" is not the actual customer but the real estate professional in the position to refer business. Instead of marketing to the people paying the bills, title insurers and agents "market" to those entities involved in the real estate transaction who can deliver the premium-paying consumers.

The "clients" you have identified are not the consumers who pay for the insurance or services, and these "clients" exert no market pressure to rein in inflated prices. Consequently, the concern

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[1] Mr. Hunter also served as Texas Insurance Commissioner and as Federal Insurance Administrator under Presidents Ford and Carter.

raised in the hearing notice -- whether insurers and agents will be able to market themselves to "clients" -- is misplaced. It also ignores a long history of kickback and the difficulty for an enforcement agency to prove intent for referrals.

When the so-called "client" is not the one paying for the service, abuses occur and consumer protections, such as those in the DFS rules, are critical.

The DFS rules attack unreasonable expenditures that drive up title insurance premiums and closing costs, because, as has been well-documented, market forces do not protect consumers when reverse competition is in play. The approach taken by the DFS represents reasonable regulation that is similar to and builds on that used in a number of states to combat reverse competition.

It must also be noted that the rules continue to allow expansive marketing expenses so long as they are "reasonable and customary, and not lavish or excessive." Additionally, the rules provide an option to avoid historic review of the offending expenses in exchange for a 5% reduction in premium. CFA's research described in our 2013 testimony to the DFS on title insurance calculated the cost of these expenses as $79,554,224.34 in 2012, representing 6.3 percent of the premiums in 2012[2]. 5 percent is a reasonable estimate of these costs.

Given the broad allowances in the regs for legitimate marketing costs overall, it is difficult to imagine how eliminating unreasonable expenses from title insurance rates will disrupt the market, particularly when the prohibited expenses – such as tickets to sporting events, ski trips, and gifts of cash to real estate professionals – have nothing to do with the actual provision of title insurance. Indeed, we are puzzled and alarmed by your opposition to the DFS rules. It is simply incomprehensible to consider permitting a title insurer or title agent to spend thousands of dollars lavishly entertaining real estate agents, mortgage brokers, or others in a position to refer business and then charge borrowers required to buy title insurance higher premiums to cover those expenses. To be sure, those casino trips, wine tastings, and cash gifts provide no benefit to the consumers but simply enrich those real estate professionals with the market power to refer business.

Regarding small businesses

While concern for small businesses is welcome, the competitive pressures small title agencies experience is not a result of these rules, but of consolidation in both the lending and title industries, the growing economies of scale due to digitalization and automation and the introduction of new competition from far-flung competitors as a result of digitalization, automation and integration of mortgage service provider systems and products with lender

[2] Testimony of CFA before the New York department of Financial Services dated December 10, 2013, entitled "Title Insurance Public Hearing." (See https://consumerfed.org/pdfs/NY_title_insurance_testimony_final.pdf)

systems. Further, the DFS rules benefit small businesses because mom and pop agencies can never compete with industry giants when it comes to box seats at Madison Square Garden, golf outings, or other lavish efforts to woo potential referral sources. By stopping some of the egregious kickbacks, the rules help level the competitive playing field by allowing smaller agencies to compete on the quality of service and not the quantity of gifts.

We ask, in concert with your obvious concern for the well-being of title-insurance-related businesses, for equal or greater concern for the millions of homeowners and home buyers paying for title insurance and closing services – the millions of consumers who have overpaid over the years to enrich a relative handful of businesses with the market power to refer consumers for title insurance. As we see it, the DFS rules improve homeownership affordability – whether by reducing closing costs or freeing up consumer resources for expenses that actually benefit consumers, like flood insurance and home improvements and believe those are much worthier ways to deploy New Yorkers' resources.

Impact on title insurers and agents

Your letter to DFS and the hearing notice raise a concern about insurers, agents and closers covering their expenses with caps imposed. This ignores the fact that the Department rules give insurers that latitude to charge reasonable rates and gives the title rate bureau the ability to file different rates for different geographic regions to reflect actual cost differences in order to address legitimate expense variations. If, in fact, title expenses are higher in certain parts of the state for whatever reason -- higher labor costs, higher non-labor costs, lack of economies of scale or scope, differing average home values -- the DFS rules do not prevent the rating bureau from filing different rates in different parts of the state to recognize any of these factors or to change the basic rating structure from one based primarily on amount of insurance per transaction amount to a rating scheme that better reflects the actual activities involved in the production of title.

Ensuring that reasonable rates can be charged cannot, however, obscure the need to recognize the reverse competitive nature of title insurance markets and curb its most insidious elements.

Reverse competition has profound implications for regulatory practice. Unlike a normally competitive market for which there may be an assumption that actual expenses incurred by an agent or insurer are reasonable, there can be no such assumption in title insurance. Stated differently, the fact that an agent or insurer shows an expense does not make it a reasonable expense -- it is just as likely or more to be an unreasonable expense unrelated to the provision of the title insurance or closing services. Given this empirical fact, it is necessary for regulators to cap permissible expenses since market forces will not do so.

In our view, the DFS rules address reverse competition in a modest way by better defining the activities included in title insurance, by limiting additional fees to those activities not covered by the title insurance premium, by setting generous caps on the additional fees and by excluding the most egregious kickbacks disguised as marketing expenses. In fact, the DFS rules could have gone much further to protect consumers by attacking other kickback expenses not labeled or reported as marketing and not explicitly permitting political and charitable contributions as expenses permitted in title insurance premiums. The regulations in question today only control a small fraction of the excessive kickback costs and other inefficiencies built into consumer premiums. Therefore, the Legislatures' time would be better spent pushing DFS to go further in protecting New York citizens from excessive title insurance rates than in questioning the baby steps that DFS has taken so far.

We strongly oppose AB 8467 and SB 6704. These bills radically change the definition of an inducement from payment for referrals generally to payment for a specific referral. This definitional change literally legalizes bulk kickbacks. A title agent could give a real estate agent, say, $10,000 dollars a month for referrals, but such "bulk" kickbacks would not violate the proposed legislation because the $10,000 monthly kickback would not be tied to the "particular piece of title insurance business." We are, again, puzzled by the intent of the legislation since it will lead to an explosion in kickbacks and higher title insurance premiums, doing great harm to the residents of New York while putting smaller title agencies at a further disadvantage.

Thank you for your consideration of our comments.