Consumer Federation of America

1620 I Street NW, Washington DC 20006 **202-387-6121**

Testimony of
J. Robert Hunter, Director of Insurance

Before the New York State Department of Financial Services

TITLE INSURANCE PUBLIC HEARING

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Introduction

Mr. Superintendent, I appreciate the invitation to appear before you today to discuss current issues related to title insurance. I am J. Robert Hunter, Director of Insurance for the Consumer Federation of America (CFA).[1]

In 2012, consumers paid almost $11 billion in premiums for title insurance countrywide.[2] In 2012, consumers paid $819 million in premiums for title insurance in New York.[3]

Title insurance remains one of the most costly items at the closing of a real estate transaction, yet consumers poorly understand it. Title insurance assures the lender and buyer that the person selling a property actually has a clear title to transfer to the buyer. Unlike other forms of insurance that protect against future unexpected events, title insurance is essentially a guarantee that the title agent or title insurance company has diligently reviewed the relevant title information and identified any problems with the title prior to the sale.

There are two types of title insurance policies. The lender's policy – demanded by mortgage lenders – protects the lender for the loan amount. Although the lender requires the lender's title insurance policy, the lender never pays for it. Rather, the buyer pays for the lender's policy. An owner's policy protects the buyer up to the purchase price of the property. In addition to errors and omissions in the review of title records, title insurance also protects against unknown problems with the title. Title insurers guarantee that the title ownership is sound, defend the buyer against challenges to their title, and compensate the buyer and the lender if there is a problem with the clear ownership of the title.

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[1] CFA is a non-profit association of nearly 300 organizations that, since 1968, has sought to advance the consumer interest

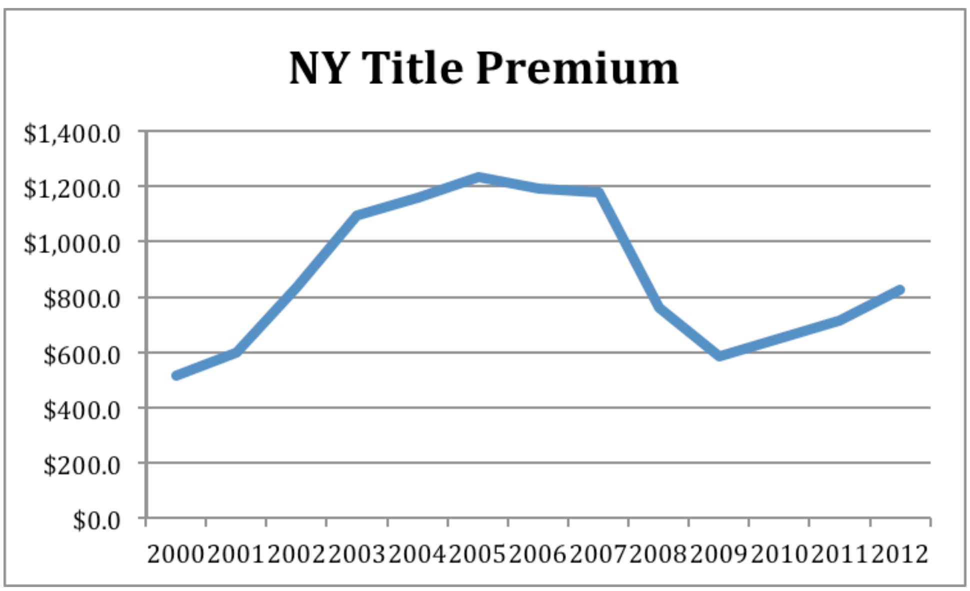
[2] Annual Statement for the year 2012 of the American Land Title Association – Industry.

[3] Ibid, Schedule T.

Title insurance facilitates homeownership by mitigating the risks related to the transfer of ownership for both the buyers and the lenders that finance their purchases. However, if there is a problem with the title, title insurance policies only reimburse the homeowner at the level of the purchase price, meaning that any market appreciation is lost.[4] Title insurance is important because some titles may have problems that are not clearly discernable in the public records due to errors or omissions that have not yet been uncovered, such as an earlier defective transfer due to fraud. However, the overwhelming majority of title problems are discoverable with a routine search of public records, including tax or mechanics' liens, possible heirs, errors or omissions in deeds or possible forgery.

The $11 billion in title insurance premiums paid by consumers in the USA in 2012 was roughly 32 percent less than the amount paid in 2000 but over twice the amount paid ($4.8 Billion) in 1995.[5] The ups and downs in title insurance premiums are driven by decreases and increases in the number of title insurance transactions – home sales and mortgage refinancings – and the increase in home values and mortgage amounts. Title insurance premiums are based on the amount of the sales price or mortgage loan. As home prices soared before 2008 in some parts of the country, title insurance premiums have jumped solely because of the increase in home prices rather than legitimate increases in the cost of providing services. As the financial crisis struck and sales of homes and home values declined, the premiums also fell back.

In New York, a similar pattern appears as the bubble in home sales was followed by the crash and, now, the recovery:



The title insurance industry is highly concentrated, with only four insurer groups controlling 86.7 percent of the market nationwide.[6] Nationally, the market concentration index HHI[7] places the

[4] Romano, Jay, "Title Insurance: Is a Rider Needed?" *New York Times*, March 26, 2006.
[5] Title Insurer Statutory Annual Statements, Schedule T, various years.
[6] 2012 Market Share by Family and State, ALTA
[7] "HHI" is the Herfindahl-Hirschman Index, is the sum of the squares of the seller market shares. The Federal Trade Commission and the Department of Justice have published guidelines for HHIs as part of their consideration of

title insurance market at a highly concentrated 2158. In New York, the top 4 companies have a market share of 90.6 percent, leaving New York with an even more concentrated HHI of 2250.[8]

The costs of the policy (a one-time premium) are usually based on the loan amount and can range from several hundred dollars to $2,000 on a median priced home, depending on the state. Theoretically, buyers have the ability to shop for title insurance and to choose the insurance company with the best rates and fees. In fact, this seldom occurs. Even when they do, rates among the title companies often remain essentially the same.

Numerous studies over the past thirty years have documented how inefficiencies in the title insurance market have harmed consumers through higher premium prices.[9] In 1977, the U.S. Department of Justice examined the impact of pricing and marketing of title insurance on consumers. In 1980, Peat Marwick performed a study for the U.S. Department of Housing and Urban Development of market competition based on price in title services. That study found that the structure of the title insurance market encouraged reverse competition (discussed below), which drove up prices. A 1986 Texas Department of Insurance report found widespread reverse competition as a result of real estate intermediaries driving the market for title insurance and homeowners exerting "no pressure on price at all."[10] These and other studies have documented the fundamental market problem with title insurance – reverse competition.

Reverse competition refers to a market structure in which the seller of a product markets the product to an intermediary instead of to the ultimate purchaser of the product. In the case of title insurance, title insurers market their products to real estate professionals – real estate agents, attorneys, mortgage lenders, mortgage brokers, homebuilders – who, because of their position in the real estate transaction, are able to steer the consumer who is actually paying for the product to a particular title agent or title insurer. The ultimate consumer has little or no market power in the title insurance transaction because title insurance is required for obtaining the loan or purchasing the property and because the consumer, who infrequently purchases real estate, has relatively little knowledge of title insurance. The entities with the market power in title insurance are those people who are able to steer consumers to particular title agents or title insurers. And the competition among title agents and title insurers for the business of the real estate professionals – title insurers identify real estate brokers, attorneys, mortgage lenders, mortgage brokers and homebuilders and not the consumers paying for the title insurance as their customers – causes title insurance premiums to increase as title agents and title insurers spend money and provide various considerations to the referrers of title insurance business. The provision of considerations to real estate professionals by title agents and title insurers takes both legal and illegal forms.

A HUD study concluded that "one of the most prominent criticisms of the title insurance industry is that costs are kept high by reverse competition, kickbacks, or inappropriate

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potential anti-competitive consequences of horizontal mergers. This is discussed in more detail later in this testimony.

[8] Ibid.

[9] *See* Birnbaum, Birny, Report to the California Insurance Commissioner, "An Analysis of Competition in the California Title Insurance and Escrow Industry," December 2005, at 28-37.

[10] Cited in Birnbaum at 35.

referrals...Most agree that reverse competition is inherent in the incentive structure facing settlement agents...(The Real Estate Settlement Procedures Act, or RESPA,) enacted in 1974, is intended to limit reverse competition by prohibiting kickbacks and referral fees and by outlining requirements for acceptable affiliated business arrangements between settlement agents and other parties in the settlement process. Reverse competition is still possible, however, through the negotiation of the premium retained by the settlement agent..." Referring to the "rating bureau" organization that developed rates and rating systems for title insurers, the study goes on to explain that this reverse competition was amplified by other anticompetitive aspects of the title insurance industry. Some have argued, the study explains, that a "rating bureau is essentially a cartel that keeps title insurance prices higher than they are in other states by restricting competition."[11]

Reverse competition makes low price competition useless. As the CEO of Title One, Inc. (a low cost title insurer) put it in Congressional testimony, "We would have to raise our fees to be competitive."[12] A new, lower cost title insurer, Entitle Direct Insurance, started business in 2008 with a 0.04 percent national market share. By 2012 it had grown only to a 0.11percent share of the market (flat at 0.11 percent since 2010). In New York, Entitle is doing a bit better, growing to a 0.60 percent share in 2012.[13] But the low cost should show stronger growth. Title One could not grow because, Mr. Miller testified, his rates were too low, not giving room for the kickbacks reverse competition requires.

I. The Title Insurance Market is Not Competitive

Title insurance remains one of the most expensive items at closing, yet consumers poorly understand it and they have little ability to shop around for this product. Title insurance costs are presented to homebuyers at the point of closing on real estate transactions along with many other closing costs. Purchasing a home is the largest and most complex financial transaction most households undertake. Many homebuyers, especially first time and financially unsophisticated buyers, are especially vulnerable during the closing process and are under the impression that the transaction terms and costs are fixed. If a consumer does question the title insurance charge, the threat of a delayed closing can be raised. Moreover, homebuyers assume that the transaction intermediaries (real estate agents, mortgage brokers and title agents) are acting in the buyers' interests, when in fact most intermediaries are acting in their own financial interests.

Under these circumstances, homebuyers are not positioned to be the most diligent consumers, but they are further hindered by the unique complexities of the title insurance marketplace.

Title insurance is not sold in a competitive marketplace. Consumers lack information about title insurance and are poorly situated to exert pressure on terms or prices. In practice, homebuyers are not even the consumers of title insurance; instead they are driven to title insurance policies through referrals by real estate intermediaries – the actual consumers who get all the marketing attention from title insurers.

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[11] "What Explains Variation in Title Charges," HUD, June 2012.
[12] Testimony of Douglas R. Miller, President and CEO of Title One, Inc., before the House Financial Services Committee, April 26, 2006
[13] Market Share by Family and State, ALTA, 2008-2012 editions.

Additionally, in most states, lenders require homebuyers to pay for both the lender's title insurance policy as well as their homeowner's title policy but do not help borrowers achieve similar savings that lenders receive on their policies through exerting economies of scale. Finally, the market for title insurance demonstrates marked price inelasticity, meaning that even large increases in title insurance prices will not cause consumers to stop buying title insurance. This result occurs because title insurance is a required part of the real estate transaction.

As mentioned above, title insurance is not marketed directly to the consumers who buy it, but instead is marketed to the intermediaries that service real estate transactions. As a result, there is almost no competition for individual consumers as there is with the marketing of auto and homeownership policies. Instead, title insurers compete to secure referrals from the real estate service providers who steer title insurance buyers to their businesses.[14]

Since consumers almost never solicit their own quotes for title insurance and there is very little consumer knowledge or understanding of the title insurance product, consumers can and often do pay more for insurance than necessary. Although consumers can legally purchase title insurance on the open market from any carrier, as a practical matter most homebuyers have title insurance chosen for them by their real estate agent or mortgage broker.

Since the title insurance companies are effectively marketing to the real estate or lender intermediaries, who do not have to pay for the product, the incentives to compete on the basis of cost are eliminated. Since the lenders requiring the insurance and the intermediaries placing it pass the cost on to the homebuyers, they are indifferent to the price. Indeed, lenders may have an incentive for higher prices if they are part of an affiliated business arrangement that profits from title insurance.

Consumers are unable to exert market pressure on title insurance prices because of their weak position in the real estate transaction and because the title insurance cost – while substantial – is a small portion of the total real estate transaction cost. The individual homeowner has an incentive to keep costs low and shop for the cheapest insurance, but because the overwhelming majority of homebuyers use their real estate or mortgage brokers, attorneys or, perhaps, their lenders to choose title insurance the homebuyer's incentive to seek low cost insurance is lost. Instead, the intermediary that is selecting the title insurance policy for the homebuyer has no incentive to hold down the cost of the policy. The real estate intermediaries have incentives to allow the title policies to become more expensive because higher cost policies generate higher rebates, referrals or other financial inducements from the title insurer, while the added costs are merely passed on to the buyers.[15]
Secondly, lenders use this product to protect themselves, yet require consumers to purchase the protection as a separate, stand-alone product. Competitive markets cannot function when the entity making the decision to purchase a product is not the same entity paying for the product.

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[14] Birnbaum at 26.
[15] Guttentag, Jack, "Title Insurance Fees Paid by Borrowers Include Referral Costs," March 21, 2005.

Lastly, there are a number of unique elements to title insurance that make it difficult for consumers to choose policies based on price, a condition known as price inelasticity. First, title insurance policies are never renewed and they do not have periodic premium payments. Title insurance is sold only when houses are purchased or refinanced. Homeowners and auto insurance policies are renewed annually, so consumers can renew with their underwriter or shop for cheaper policies when their coverage expires. Additionally, title insurance is a required precondition for lenders to be willing to write a mortgage. Since the focus is on the new home, not the insurance transaction and since conducting a price comparison for a product about which consumers have very little understanding might also require adjourning the closing of the home sale, few consumers are willing to do it even if they are aware of their right to do so. An inter-related factor is that title insurance premiums are a small portion of the entire real estate transaction. Even relatively higher title insurance premiums do not have a large impact on the aggregate purchase and closing price. While a thousand-plus dollar transaction would give consumers pause in most settings, given the unique context of purchasing a home, the high price of the policy is unlikely to deter consumers from a title insurance carrier presented to them.[16]

Because title insurance is essentially a derivative product dependent upon home sales, the number of title policies sold is unlikely to rise if the price of the policy declined. Because, that is, demand is very inelastic, title insurance underwriters have little incentive to lower prices to capture more of the market.[17]

Various studies have shown the impact of this lack of competition. For instance, there is much evidence that the title fee rises with loan amount, which "may be seen as evidence of market power exercised by title insurance underwriters and agents because the cost of examining titles and insuring their validity are unlikely to rise substantially with the size of the loan involved."[18] The study found that 25 percent of the title fee variation across the nation is because of the borrower's state of residence. "Much of this interstate variation in title fees remains unexplained. Even after controlling for loan amount and demographic characteristics of the borrowers."[19] This is particularly relevant to high cost states such as New York.

In a major review of title insurance, the GAO[20] confirmed these concerns about competition in the title insurance market: "Among the factors raising questions about the existence of price competition and the resulting prices paid by consumers within the title insurance industry are the following:

- Consumers find it difficult to shop for title insurance, therefore, they put little pressure on insurers and agents to compete based on price;
- Title agents do not market to consumers, who pay for title insurance, but to those in the position to refer consumers to particular title agents, thus creating potential conflicts of interest;

[16] Boyer, M. Martin and Charles M. Nyce, "Banks as Insurance Referral Agents? The Convergence of Financial Services: Evidence from the Title Insurance Industry, *"Scientific Series*, Centre Interuniversitaire de Recherche en Analyse des Organisations, 2002s-78, September 2002, at 9.
[17] Birnbaum at 28.
[18] Woodward, Susan "A Study of Closing Costs for FHA Mortgages", HUD, 2008
[19] Ibid.
[20] Title Insurance: Actions Needed to Improve Oversight of the Title Insurance Industry and to Better Protect Consumers, GAO, April 2007.

- A number of recent investigations by HUD and state regulatory officials have identified instances of alleged illegal activities within the title industry that appear to reduce price competition and could indicate excessive prices;
- As property values or loan amounts increase, prices paid for title insurance by consumers appear to increase faster than insurers' and agents' costs; and in states where agents' search and examination services are not included in the premium paid by consumers, it is not clear that additional amounts paid to title agents are fully supported by underlying costs."

II. Product Costs are Excessive

The title insurance industry maintains that it incurs significant costs when offering title insurance policies, but the majority of the costs are not for losses or operating costs to generate the insurance policy. Instead, the majority of the premium is split with title agents who can receive as much as 90 percent (in New York approximately 85 percent) of the premium dollars. Title insurance industry costs include maintaining the title plant database, searching and examining property titles, clearing titles and the claims costs of any title defects.[21]

Title insurers can clear titles very easily and with nominal costs in most cases where modest problems arise.[22]

Examples illustrate the excessive price of title insurance.

1. Iowa has banned the sale of title insurance and, instead, has created the Iowa Title Guaranty, which is a state agency that provides title assurance and fixes the title in the event of a title problem. Iowa Title Guaranty charges a flat rate of $110 for a title guaranty. Combined with typical costs for an abstractor and attorney, the cost of title protection in Iowa is about $500 – less than half of what title insurance costs in other states.[23]
2. In 2005, a number of states took action against title insurers for a form of illegal rebating called captive reinsurance. Under this arrangement, a homebuilder, for example, would establish a captive reinsurer – a reinsurance company owned and controlled by the homebuilder. In exchange for the homebuilder referring homebuyers for title insurance, the title insurer reinsured the title insurance policy with the homebuilder's captive reinsurer and paid a premium to the captive reinsurer. In theory, the reinsurance premium should reflect the likelihood of losses on the policies reinsured. In the case of the title captive reinsurance, the title insurers paid almost half of the title premium as reinsurance premium, while the captive reinsurers paid little or nothing in claims. In essence, the captive reinsurance agreements were a kickback to the homebuilders of almost 50 percent of the premium. The size of the kickback is a further indication of how title premiums are

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[21] DasGupta, Neil and Richard McCarthy, "Clouds on Horizon After Title Industry's Bright Year," A.M. Best Special Report, October 2005 at 7.
[22] Ibid.at 13.
[23] "Iowa's title alternative lifts its game," *The Title Report,* February 20, 2006 at www.thetitlereport.com. Confirmed rate on Iowa web site, visited November 30, 2013. Premium charge is $110 up to $500,000 (plus $1 per $1,000 over that). Owner's coverage is free up to $500,000.

excessive in relation to the costs of providing the product.[24] Captive reinsurance does not appear to be a problem in New York.

3. According to a major study done for HUD, indications that title insurance charges are greater than the competitive level include:
    - Positive correlation with property values although the costs of the search (the major cost involved) does not vary with price.
    - High total service profits.
    - High market concentration.
    - Borrowers in African-American neighborhoods pay on average an additional $120 for title services and those in Latino census tracts pay an additional $110, as compared to borrowers residing in neighborhoods with no minorities.
    - Differences in average title charges (taking loan and borrower characteristics into account) from the lowest-cost state—North Carolina—to the highest cost states—New York, Texas, California, and New Jersey—is more than $1,000. The type of title insurance regulation adopted by states explains only a small fraction of this variation.
    - Title charges are higher when fees paid to lenders, brokers, and real estate agents are also high, again controlling for all relevant loan and borrower characteristics. In other words, the same borrowers are being charged above-average fees for multiple components of their closing costs.[25]

Operating costs for title insurers include any direct title searching, examining and clearing of titles that are not performed by affiliated title agents as well as maintaining the title plant. Updating the plant requires constant and detailed attention, and the intellectual property of the title plants is carried on the books of title insurers as a non-depreciating asset. Operating the title plant is a small portion of the operating expense. Industry consultant Demotech reported that title plant updating and maintenance consumed less than 1 percent (0.67 percent) of annual industry revenue.[26] Title production services consumed about 5 percent (4.73 percent) of annual revenue.

The loss ratio for title insurance is among the very lowest in the insurance industry. This ratio measures the amount an insurer pays in claims relative to the amount it receives in premiums. Title insurance differs from other forms of insurance because it insures against risks in the past (such as incorrect deed recordings), not against future risks. As a consequence, title insurance companies' underwriting is not based on future actuarial risk balancing but on avoiding losses which can be greatly mitigated through due diligence by screening the pre-existing risks on the title.[27]

Title insurers pay out only a small percentage of premium in claims to policyholders, viz.:

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[24] "Insurance Commissioner John Garamendi Announces Major Settlement Agreements With Title Insurers—More Than $37 Million To Be Paid For Illegal Kickback Schemes," California Department of Insurance press release, July 20, 2005. See also charts prepared by Erin Toll, Colorado Department of Insurance for presentation at June, 2005 NAIC Title Insurance Working Group meeting. I do note that New York has not experienced use of captive reinsurance.

[25] Woodward, Susan "A Study of Closing Costs for FHA Mortgages", HUD, May 2008.

[26] Demotic, "Title Insurance Industry Information and Economic Data," 2005 at 65.

[27] Arrunada, Benito, "A Transaction-Cost View of Title Insurance and its Role in Different Legal Systems," *The Geneva Papers of Risk and Insurance*, Vol. 27, No. 4, October 2002.

Year	NEW YORK Direct Premiums Earned	Direct Losses Incurred	Loss and LAE Ratio	USA Direct Premiums Earned	Direct Losses Incurred	Loss and LAE Ratio
2005	$1,113,948	$50,175	4.5%	$16,443,263	$880,562	5.4%
2006	$1,168,670	$44,245	3.8%	$16,193,355	$803,532	5.0%
2007	$1,159,738	$52,870	4.6%	$13,846,817	$1,145,076	8.3%
2008	$755,690	$59,518	7.9%	$10,172,081	$1,231,841	12.1%
2009	$599,766	$31,672	5.3%	$9,470,620	$930,325	9.8%
2010	$661,812	$51,481	7.8%	$9,442,719	$1,018,291	10.8%
2011	$715,521	$47,349	6.6%	$9,365,645	$1,016,727	10.9%
2012	$818,921	$37,270	4.6%	$11,230,369	$765,167	6.8%
Total	$6,994,066	$374,580	5.4%	$96,164,869	$7,791,521	8.1%

Dollar figures in thousands
Source: Schedule T of the Annual Statements of the Industry from the American Land Title Ass'n

Title insurers paid only about 8 percent of premium dollars on claims nationally (5.4 percent in New York), compared to about 75 percent for auto and home insurers.[28] Part of this lower pay-out ratio in New York may be due to the ultra-high prices in the state. New York City was one of 6 cities studied by GAO.[29] It had the highest price for title insurance for a median priced home, viz.:

City	**Median home**	**Owner's Rate**
LA	$529,000	$1,587
NYC	$445,200	$2,190
Chicago	$264,200	$1,025
Denver	$247,100	$1,216
Dallas	$147.500	$ 871
Des Moines	$145,500	$ 700

Most title insurance is sold for title insurers through title agents. Title agents can be affiliated with the title insurer or non-affiliated independent title agents. The bulk of the title insurance premium – 70 to 90 percent, depending on the state (about 85 percent in New York) – goes to the title agent because the title agent is typically the one who does the search, examination and underwriting of the title insurance policy.

[28] Best's Aggregates and Averages Property/Casualty, 2013 Edition.
[29] Title Insurance: Actions Needed to Improve Oversight of the Title Insurance Industry and to Better Protect Consumers, GAO, April 2007.

The real costs to insurers are the amounts title insurance carriers and title agents pay to real estate intermediaries to capture homeowners' policy dollars. Title insurance companies pay commissions to title agents, not to real estate professionals. It is illegal to pay someone for a referral, which is why insurers either do it illegally or via affiliated business arrangements. The expenses of title insurers and title agents are often inflated because of considerations provided to the referrers, which may include money or a variety of free services, such as printing and distributing marketing materials for real estate agents. To secure these referrals, title insurers and title agents offer considerations to the real estate professionals (real estate brokers, attorneys, mortgage brokers, lenders and developers) and these considerations increase the cost of the insurance premium for the homebuyer.[30]

Some considerations are legal in some states, including paying for marketing costs, market analyses and mailing lists, while most forms of considerations and gifts are illegal kickbacks.[31]

The real costs of creating a title insurance policy are very low, a few hundred dollars for the title search and taxes and 5 percent of the premium price for losses, but consumers are being charged considerably more than the cost of the product plus a reasonable amount for profit. For a hypothetical $500,000 home with a $400,000 mortgage in Manhattan, title insurers are charging about $2,140 for the owner's policy.[32] Studies have shown, however, that the direct cost of the policy to the underwriter, may only a few hundred dollars to perform the associated administrative title services and 5 percent of the market premium, for a total of well under $1,000 – much less than the price being charged by title carriers[33]. The remainder may be the split the underwriter pays the real estate agent, mortgage broker or title agent. The title industry maintains that title insurance can't be compared to other insurance products because of much higher operating expenses (i.e., maintenance and records search expenses) than other lines of insurance, but the overwhelming majority of these costs are related to the commission split that is paid to the title agents.

III. Factors Contributing to Excessive Cost

Although consumers know little about it, title insurance is big business. Title insurance premiums written exceed most property and casualty lines including farmowners, mortgage guarantee, medical malpractice, earthquake, products liability, commercial auto physical damage and several other lines of property/casualty insurance.[34] Between 1995 and 2005, total operating revenue for the title insurance industry grew more than three-fold from $4.8 billion to $17.8 billion, according to data from the American Land Title Association (ALTA). After 2005, the recession impacted home values such that in 2012 the figure was $11.2 billion. Operating revenue includes premiums as well as escrow and other services. The revenue was used to pay claims, operating expenses and profits.

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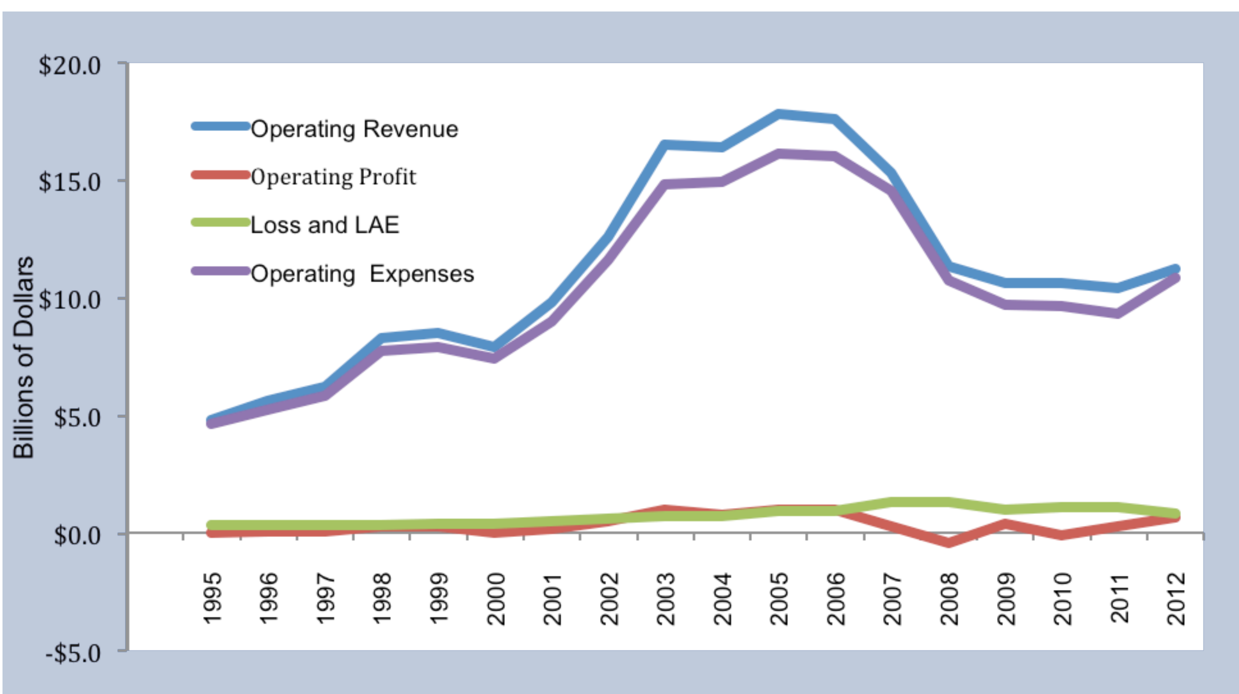
[30] Birnbaum at 27.
[31] Gandel, Stephen, "Congressman Calls for Title-Insurance Investigation," *Money*, February 24, 2006.
[32] Stewart Title Rate Calculator, visited on December 1, 2013.
(http://www.stewartstar.com/SRC/RateCalculator/Main.aspx)
[33] See, e.g., Consumers Union, "California Title Insurance Rates Remain High," April 3, 2003 and the industry magazine *The Title Report, 2003*
[34] Compared to Direct Written Premium in 2012, Best's Aggregates and Averages, Property/Casualty, 2013 Edition.

This broke down as follows over the past decade:

	Operating Revenue	Profit	Loss and LAE	Operating Expenses
1995	$4.8	$0.0	$0.3	$4.6
1996	$5.6	$0.1	$0.3	$5.2
1997	$6.2	$0.1	$0.3	$5.8
1998	$8.3	$0.3	$0.3	$7.7
1999	$8.5	$0.3	$0.4	$7.9
2000	$7.9	$0.0	$0.4	$7.4
2001	$9.8	$0.2	$0.5	$9.0
2002	$12.6	$0.5	$0.6	$11.6
2003	$16.5	$1.0	$0.7	$14.8
2004	$16.4	$0.8	$0.7	$14.9
2005	$17.8	$1.0	$0.9	$16.1
2006	$17.6	$1.0	$0.9	$16.0
2007	$15.3	$0.3	$1.3	$14.5
2008	$11.3	-$0.4	$1.3	$10.7
2009	$10.6	$0.4	$1.0	$9.7
2010	$10.6	-$0.1	$1.1	$9.6
2011	$10.4	$0.3	$1.1	$9.3
2012	$11.2	$0.7	$0.8	$10.8

Graphically, the data moved over time like this:



These data reveal that the huge jump in premium did not result in a similar jump in insurer profits and that the sharp drop in premium likewise did not impact profits significantly, likely because reverse competition forced insurers to pay ever greater amounts to referrers of business. Note that the operating expenses track the revenue but the profits to insurers do not.

Title insurance is a highly concentrated industry with the overwhelming majority of the market controlled by four firms, which control 87 percent of the national market and 91 percent of the New York market. Between 2009 and 2013, the number of title insurance firms declined from 88 to 44.[35]

Title Insurance Market Share Data

New York Data

	2006	2007	2008	2009	2010	2011	2012
Fidelity Family	52.6%	51.5%	50.6%	48.9%	36.7%	36.9%	34.3%
Stewart Family	14.3%	14.9%	16.4%	18.9%	21.4%	21.4%	21.4%
First American Family	24.6%	25.5%	24.3%	17.2%	18.5%	18.5%	17.5%
Old Republic Family	6.4%	6.3%	6.3%	9.0%	15.3%	15.3%	17.4%
Others	2.1%	1.8%	2.4%	6.0%	8.1%	7.9%	9.4%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Countrywide Data

	2006	2007	2008	2009	2010	2011	2012
Fidelity Family	46.5%	45.7%	45.0%	42.3%	34.7%	34.7%	33.9%
Stewart Family	11.9%	11.7%	12.6%	14.2%	13.7%	13.7%	13.0%
First American Family	28.9%	30.0%	28.9%	27.3%	26.8%	26.8%	26.3%
Old Republic Family	5.4%	5.5%	5.6%	7.9%	13.0%	13.0%	13.5%
Others	7.3%	7.1%	7.9%	8.3%	11.8%	11.8%	13.3%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Note: Fidelity Family added to LandAmerica Family prior to 2008.
Source ALTA Market Share by Family and State, various years as indicated.

[35] Performance of Title Insurance Companies, Demotech, 2009 1n2 2013 Editions.

Title insurance markets are heavily concentrated, meaning that a few firms control most of the sales. As illustrated above, only four insurer groups are responsible for 87 percent of the sales on a countrywide basis and 91 percent in New York. In some states and in some counties, the concentration is even greater, with one or two title insurers controlling the entire market.

Another measure of concentration is the Herfindahl-Hirschman Index, which is the sum of the squares of the seller market shares. The Federal Trade Commission and the Department of Justice have published guidelines for HHIs as part of their consideration of potential anti-competitive consequences of horizontal mergers. According to the guidelines, a market with an HHI over 1,800 is highly concentrated.[36] The countrywide title insurance HHI is over 2,100. But even this high figure understates the concentration of title insurance. States or even counties within a state better define title insurance markets because title insurance regulation varies by state and because the raw material for title insurance comes from county courthouses. The HHI for New York is over 2,200. It cannot be ignored, then, that the insurance industry remains largely exempt from antitrust laws.

Three states – Florida, Texas and New Mexico – set rate caps while some other states, including New York, require the prior approval of rates before policies are offered. Other states have file-and-use (permitting state regulators to block the implementation of insurance rates within a short period after they were filed with the state), and some states have no rate regulation.

STATE	**Predominant Rating Law**	**STATE**	**Predominant Rating Law**
Alabama	F&U	Montana	F&U
Alaska	PA	Nebraska	PA
Arizona	F&U	Nevada	F&U
Arkansas	No File	New Hampshire	PA
California	F&U	New Jersey	PA
Colorado	F&U	New Mexico	Promulgate
Connecticut	PA	New York	PA
Delaware	F&U	North Carolina	F&U
Dist. Of Columbia	No File	North Dakota	PA
Florida	Promulgate	Ohio	PA
Georgia	No File	Oklahoma	No File
Hawaii	No File	Oregon	PA
Idaho	F&U	Pennsylvania	PA
Illinois	No File	Rhode Island	F&U
Indiana	No File	South Carolina	PA

[36] *See* U.S. Department of Justice, Antitrust Division Manual, Chapter 2: Statutory Provisions and Guidelines of the Antitrust Division, 1.5 Concentration and Market Shares; U.S. Department of Justice and Federal Trade Commission, "Commentary on the Horizontal Merger Guidelines," March 2006 at 15.

Iowa	State Monopoly	South Dakota	PA
Kansas	F&U	Tennessee	F&U
Kentucky	F&U	Texas	Promulgate
Louisiana	PA	Utah	F&U
Maine	PA	Vermont	F&U
Maryland	PA	Virginia	No File
Massachusetts	F&U	Washington	F&U
Michigan	F&U	West Virginia	No File
Minnesota	F&U	Wisconsin	F&U
Mississippi	No File	Wyoming	PA
Missouri	U&F		

F&U = File and Use
PA = Prior Approval
Source: Eaton and Eaton, 2007

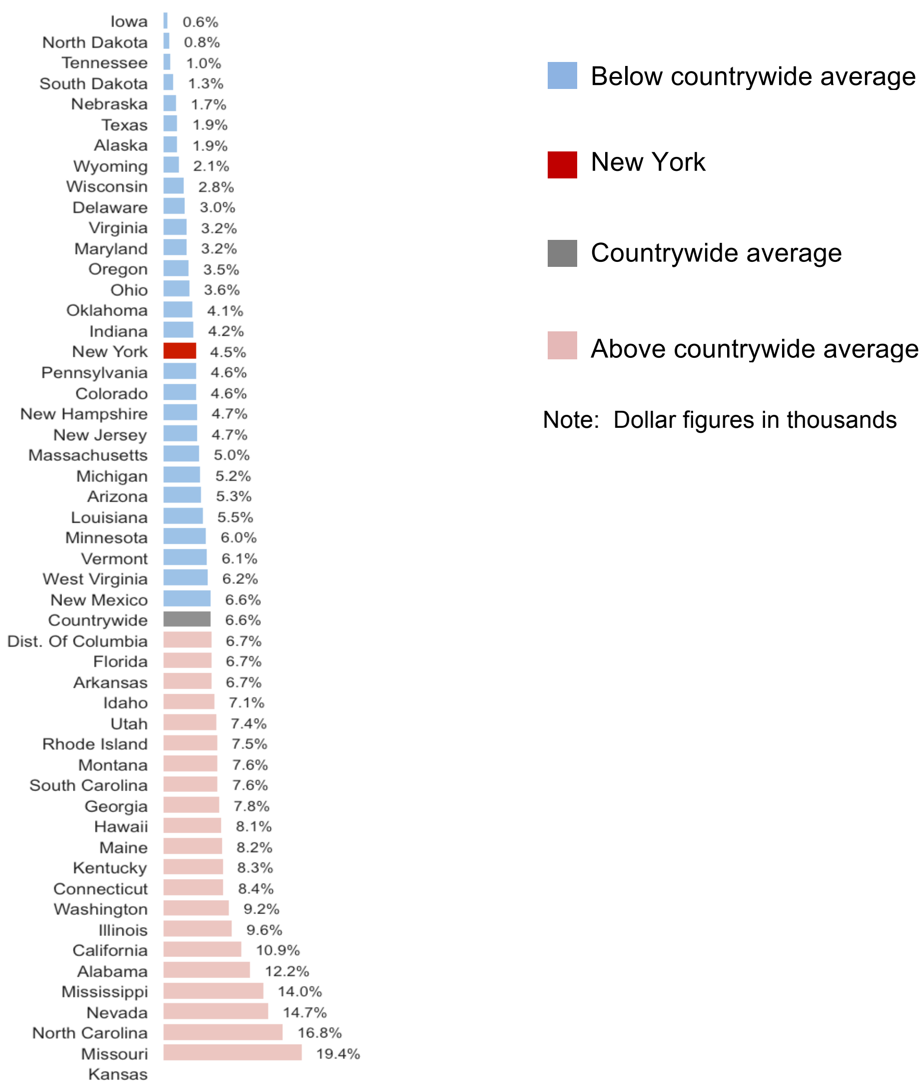
Further exacerbating the concentration problem in title insurance is the fact that the primary four Underwriters also control nearly all rating mechanisms within the title insurance industry, whether directly through their participation on rating bureaus or, indirectly, through their exertion of market dominance and corresponding rate filings in those states where file-and-use rules persist.

Weak price regulation in a reverse competition market is a prescription for excessively high prices for consumers. Reliance on market forces to protect consumers where reverse competition dominates does not work because the market is not responsive to consumers. Real and effective price regulation is required. Consumers don't have the market power to discipline title insurance prices and those that do have the power – referrers of business – have an incentive for higher prices that include funds to pay for considerations for the referral.

The loss ratio (the percentage of premium paid out in claims to home owners) for each state in 2012 are displayed in the following chart:[37]

[37] All states are included except Kansas, which had an unusually large loss ratio of over 90 percent in 2012 although in the 2008-2011 period, the overall Kansas loss ratio ran at just 4 percent. The Kansas Insurance Department is looking into these data and will tell CFA what they find prior to the hearing on December 10, 2013.

Figure 1: 2012 Title Insurance Loss Ratios



New York is 16th lowest in pay out to premium ratio, a sign that rates are too high in the state.

Proposals for Reform

The surest way to make competition work the way it is supposed to is to:

Make Lenders Pay for Title Insurance

To break the reverse competition strangle-hold on title insurance in New York, the lenders should be required to purchase the title insurance policies and include the cost of the title insurance in their APR. The APR is clearly subject to positive competitive forces.

This would help to limit or even eliminate the current lack of incentive to hold down the cost of title insurance premium, since there would no longer be an ability to indirectly pass the cost through to the home buyer. The direct pass-through as part of the APR will pressure the lenders to achieve low title insurance cost, squeezing out the excessive kickbacks from the title insurance product. Homeowners would be protected with lender purchased title insurance coverage for the borrower even after they pay off their mortgages. Title policies remain in force until the property is sold or the loan is repaid. When a consumer refinances, the old lender's policy expires and a new lender's policy is required. However, the owner's policy remains in force with a refinance.

The general approach would be to make those requiring the title insurance pay for it – the lender for lender's policies and the buyer for owner's policies. The lender would be prohibited from passing the cost of title insurance on as a separate charge, which would incentivize the lender to seek lower title insurance prices to keep the APR low. Since the lender would be a regular purchaser of many policies, the lender would be in a position to discipline title insurers on price in a more direct market transaction than currently exists. Indeed, if lenders have the title costs in the APR, they will likely look for innovative ways to lower costs of title insurance, including taking a serious look at Torrens and other more efficient systems in use in other states (i.e., Iowa) and other nations (e.g., Australia).

If Lenders are Not Required to Include Title Costs in the APR, then the Following Steps should be Considered to Reform the Title Insurance Market in New York

In a major research project released last month,[38] CFA conducted a review of the national auto insurance regulatory regimes and determined that the best practices included maximizing both competition and regulation for the benefit of consumers. It worked in California under Proposition 103 where tough regulation and removal of impediments to full competition such as the anti-trust exemption produced the lowest rate changes in the nation while keeping the state very competitive (California is the fifth most competitive state in the country for auto insurance) and delivered reasonable profits to the insurers.

CFA proposes that New York look at ways to both enhance competition and regulation in the clearly troubled title insurance market. Below is a discussion of proposals to enhance competition and , as a backstop to those proposals, ideas for to strengthening regulation. Both are needed.

A) Enhancing Competition

In its 2007 report, GAO called for improving consumers' ability to shop for title insurance, including publication of "complete title insurance cost information." This would be most useful if the market were made more competitive, changing it from a reverse competition market where competition drives prices up to a truly competitive market where competition drives prices down.

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[38] What Works: A Review of Auto Insurance Rate Regulation in America and How Best Practices Save Billions of Dollars, Consumer Federation of America, November 2013

In order to set the stage for more competition, we suggest that the rating bureau be abolished and title insurers be required to file their own rates. In order for real competition to flourish, insurers and agents must compete on price. Rate bureaus (and Advisory Organizations) suffer from a fatal flaw, which is that they must produce a price (or an advisory loss cost) that is sufficient for their least efficient/least effective member insurance company to flourish. Thus, the tendency for the bureau is to use actuarial rating factors to jack up the price to the level needed to satisfy the entire membership. The New York department recently demonstrated knowledge of the rate bureau's overreaches, when the Department disapproved an excessive TIRSA filing.

In its 2007 report, the GAO suggested "that state insurance regulators, working through NAIC where appropriate, take two actions to improve the functioning of the title insurance market. Specifically, we are recommending that state regulators take action to (1) improve consumers' ability to shop for title insurance and (2) improve their oversight of title agents."[39]

In order to enhance consumer-shopping capabilities, New York should consider taking these steps:

- Require that the rate be as all-inclusive as possible so that shopping can be simplified.
- Develop an on-line, interactive and simple buyer's guide that includes all aspects of the price the consumer will be charged.
- Require that the buyer of a home be given a simple statement in bold print on a single sheet of paper when an offer is made and accepted on a home. This document will state, in plain language, that the Department develops, that personal shopping for title insurance will save the consumer hundreds of dollars and provide a link to the interactive guide to facilitate shopping.
    - Alternatively, title closers or someone else involved in every transaction could be required to provide homebuyer's with a premium quote sheet from all companies serving the market.

B) Improving Title Insurance Regulation

CFA's recent study of the nation's auto insurance systems showed that regulation and competition are not enemies but allies in ensuring that rates are the lowest possible that give a fair return to the insurers. Therefore, regulatory excellence must be enhanced in New York to achieve best practices for the title insurance system. Here are some regulatory steps CFA suggests:

Improper Expenses, Excessive Expenses and Expense Allocations

Ratemaking for expenses should protect consumers from improperly paying for expenses that should not be borne by them as ratepayers or for paying the cost for kickbacks, inefficiencies and other items that inappropriately inflate these costs.

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[39] Title Insurance: Actions Needed to Improve Oversight of the Title Insurance Industry and to Better Protect Consumers, GAO, April 2007.

States have not done a very good job in controlling insurer expense levels. One exception is California for auto insurance. There, as a result of voters enacting Proposition 103 in 1988, expenses are controlled through an efficiency standard and a prohibition on the pass through of expenses unrelated to the provision of insurance. States could adapt this concept to title insurance in several important ways, including:

- Requiring that expenses that are to be passed on to consumers must be (1) used (actually expended) and (2) useful (an expense that is required to deliver the insurance product to the consumer). Allowable expenses should be limited by rules so that excessive expenses are disallowed for use in setting ratepayer prices.
- Disallowing expenses that should not be passed through to consumers such as fines, bad faith lawsuit payments, political contributions, corporate sponsorships for sporting events such as golf tournaments, and so on. These could be termed improper expenses.
- Limiting the amount of salaries paid to executives that can be passed through to ratepayers (under the California rules, the salary itself is not capped, only the amount that can be passed through in rates. The Board of any insurer can decide to pay much higher salaries to executives if the company wants to pay for them outside of the rate structure).

CFA suggests that efficiency standards be adopted to control excessive expense levels in title insurance in New York. We do not suggest that the Department use the market averages to set these levels as California does, however. New York title insurance efficiency standards cannot be determined by a review of current title insurance costs since reverse competition has skewed costs upward and will always be an area ripe for hidden kickbacks that cannot be accounted for. The Department must set the efficient expense levels at both the insurer and agent level by audit and by study of the activities involved and by determining the reasonable cost of performing such activities. The efficiency standards should be set as overall efficiency standards for every expense line for title insurers and agents in New York.

Until the Department sets efficiency standards, it must protect consumers in the interim in three ways:

1. **Disallow Improper Expenses**: As an example of possible expenses that might be disallowed in title insurance in New York, the Department of Financial Services supplied data on the extent of improper expenses in the state. Improper expenses included such items as golf outings, sporting events, Madison Square Garden suites, tickets and promotions, entertainment, charitable contributions, gifts, dues, giveaways, etc.

The aggregate amount of improper expenses for the title insurance underwriters during the 2008 to 2012 period was a whopping $79,554,224.34, which represents 6.3 percent of the premiums ($1,259,100,651.14) collected by insurers during that time frame.

The aggregate amount of improper expenses for only some of the title insurance agents during three years for which data were collected (2009, 2011 and 2012) was $3805238.97which represents 4.8 percent of the premiums of $79,478,899.46 collected by the agents surveyed during those three years.

These are the sorts of expenses that should be disallowed. Title insurance prices in the future should be calculated excluding these expenses and the Department must regulate to see that this is done.

2. **Control Excessive Salaries:** The Department should also consider establishing regulations to control excessive salary levels from impacting the prices that consumers pay in New York for title insurance. As an example of what could be considered excessive salary levels, Chicago Title's top five executives were paid a combined salary of $33 million in 2012. Research on what would be fair for ratepayers to contribute to the pay of top executives should be undertaken.

3. **Study Allocation of Expenses to the State**: CFA's review of the TIRSA testimony in this matter indicates that TIRSA is unaware if allocations of national expenses to New York are valid. This is particularly alarming when the allocation of non-identifiable expenses to New York represented 21 percent of the national non-identifiable expense even though the New York title insurance premiums only represented 9 percent of the national data. The Department must obtain information on exactly how these allocations are made to see if New York is paying too much of the national expense costs and move to correct any over-allocations to the State.

CFA's comments on TIRSA's inadequate assistance to the Department in its role as the State of New York's Statistical Agent are attached as an Appendix entitled CFA Comments on TIRSA Testimony. The Department should replace TIRSA as the official state appointed title insurance statistical (stat) agent with an independent vendor of statistical services who will serve the state rather than the industry. CFA believes this is needed even if the rating bureau is disbanded because:

a. Small insurers will need data for ratemaking purposes;
b. Data from agents should be collected on an on-going basis; and
c. An independent stat agent would be able to assist the Department in research into title insurance markets to make further reforms in the future.

The independent vendor would be asked not only to collect and audit/validate the data, but to be pro-active in suggesting data calls and data stat plans to answer questions vital to making the system work better in New York. The Department would then authorize, amend or reject these proposed data collection tools. If approved by the Department, these tools would be used to collect title insurance data in the state. CFA proposes that this vendor be authorized to also collect data from the agents. As with TIRSA, the cost of data collection would be borne by the insurers and CFA suggests that agents should also bear part of the cost.

Regulate Agents' Costs

As noted above, GAO's second recommendation was to "improve oversight of title agents."[40]

In order to improve agent oversight, New York has much work to do. The typical agent/insurer split of the premium dollar is 85 percent/15 percent. Data collection and research is necessary to

[40] Title Insurance: Actions Needed to Improve Oversight of the Title Insurance Industry and to Better Protect Consumers, GAO, April 2007.

determine exactly how much cost is borne by the agent and by the insurer to determine if the split is proper and if the overall level of the premium is justified. It is shocking that New York agents are not subject to any regulatory oversight, including routine data collection by the Department, given that they garner the lion's share of the costs of the system. This glaring regulatory loophole must be closed.

Only when competition is working properly, can regulators expect the market to be able to establish an appropriate agent/insurer split. Until then, the Department should establish standards based on its audits and expertise that ensure that agents' portions of title insurance premiums do not create excessive prices in the market for title insurance.

Conclusion

Mr. Superintendent, we appreciate your undertaking this important effort to help consumers who have, for too long, been burdened with excessive title insurance charges. New York should consider strong measures to overcome the extreme financial incentives for those in the title insurance business to engage in reverse competition.

APPENDIX

CFA COMMENTS ON TIRSA TESTIMONY

TIRSA essentially says that it collects only data that the Department approves for it to collect and that the data the Department seeks in this hearing are unavailable. TIRSA also admits that it has never audited the data since "TIRSA has never been requested to perform an auditing function." The limited data TIRSA produces to the Department as its statistical agent are therefore unnecessarily suspect.

As you will see in the responses of TIRSA to the Department's questions 1 through 4, excerpted below, the responses are totally inadequate. The apparent lack of interest of TIRSA in the important questions raised by the Department, including the lack of any initiative to suggest approaches to obtain the missing information, is troubling.

On specific questions of the Department:

<u>Topic 1</u> – TIRSA "does not specifically advise underwriters what expense items to include in line 25" ("other expenses"), relying instead on NAIC instructions. "TIRSA has not obtained any breakdown of the 'Other' expense category..." nor have they ever audited "the reporting companies and the work papers that are the basis for their reported expenses, including the detail behind the 'Other' expense category."

<u>Topic 2</u> – "TIRSA does not give the underwriters direct, specific guidance regarding what expense items should be considered non-identifiable expenses and, therefore, require allocation to New York." The allocation "basis is selected by the underwriter" from UFRP instructions. "The determination of which expenses are identifiable and which are non-identifiable is made individually by each underwriter."

<u>Topic 3</u> – As to the categories of searches and services for which title insurers report expenses and income in the data they send to TIRSA, TRISA's "annual Data Call does not produce the specific information..."

<u>Topic 4</u> – "The TIRSA Data Call does not produce the level of information that is being requested in this question...TIRSA does not see the individual data supplied by the agents to their underwriters in connection with the Data Call...Such data may be available to the Department directly, by subpoena or otherwise."

"Title Insurance agents are not subject to regulation by the Department or any other agency of the State of New York. Until legislation is enacted in New York that gives the Department regulatory authority over independent title agents, TIRSA will continue to face issues with obtaining more information regarding agents' expenses and charges."

Topic 5 – Should the TIRSA rate be all-inclusive? On this topic TIRSA ceases to merely defend itself and begins to advocate for the status quo, listing several reasons why all-inclusive rates cannot work:

- The Department has not said what they mean by all-inclusive.
- Questions if a rating bureau has the power to set such a rate under the law.
- Such rates might violate anti-trust law since joint activity in setting rates for things other than title insurance itself would present serious risks – outside the definition in law for title insurance.
- Proposing an all-inclusive rate might mean combining Zones 1 and 2, which is difficult since the Zone 1 (Upstate) rate does not include the cost of a search and the Zone 2 (NYC and downstate) rate does. Also, Zone 1 is characterized by the use of an abstract system, an abstract being maintained by the owner of the property and Zone 2 uses a courthouse search system.

TIRSA has failed to carry out at least one item requested by the Department almost four years ago:

"We acknowledge that the Department's 2006 Report on Examination of TIRSA (issued March 9, 2009) called for TIRSA 'to maintain actuarial data appropriate to the title insurance industry as directed by the Department' to support any zone differential. Although we further acknowledge that TIRSA has not effectuated this recommendation, neither has the Department provided any direction as to how or what it wants... It is clear then that the Insurance Law permits, in principle, different rates for different territories in the state. The standard is whether such an approach is unfairly discriminatory. For the reasons discussed at length above, TIRSA does not believe that the differential rates in TIRSA's Rate Manual for Zones 1 and Zones 2 are unfairly discriminatory."

Rather than offering to assist consumers in the difficult job of finding reasonably priced title insurance when consumers usually have little or no experience in making such a purchase, TIRSA instead offers what CFA believes is an inaccurate characterization of how the market is functioning:

> "Title insurance buyers and their attorneys are perfectly capable in choosing an underwriter or agent, of determining the likely charge for various services and searches and 'shopping' for the most reasonable deal. This does not appear to be a situation where the closing costs are too small or obscure for the consumer to care or to lack the ability to make an informed decision."

As the above testimony established, consumers often don't know that title insurance is not a fixed cost, and such costs are often obscure in the context of purchasing a home, which is the largest and most complex financial transaction most households undertake. In that context, regulation is necessary to ensure that homebuyers are informed and not overwhelmed by an unfamiliar landscape.