

AMERICAN
LAND TITLE
ASSOCIATION



TESTIMONY OF ANNE L. ANASTASI
ON BEHALF OF
THE AMERICAN LAND TITLE ASSOCIATION

“Title Insurance Rates and Practices”

BEFORE THE
PENNSYLVANIA INSURANCE DEPARTMENT

*Thursday, May 28, 2009
10:00 a.m.*

My name is Anne Anastasi and I am President of Genesis Abstract, LLC in Hatboro, Pennsylvania, which I opened in 1994 after spending 17 years with a regional title insurance underwriter. I hold Pennsylvania's Certified Land Title Professional designation, which is the highest form of designation available in the title industry. I am also the President of Troon Management Corporation a consulting company dedicated to the creation and administration of compliant Affiliated Business Arrangements.

I am currently the Chairperson of the Abstractor and Agent Section and a member of the Board of Governors of the American Land Title Association, which I am here to represent today. ALTA is the national association for the land title industry, representing nearly 3,000 members, with more than 100,000 employees, including title insurers, title insurance agents, abstractors and attorneys. Our members operate in every state and county throughout the country.

On behalf of ALTA, I appreciate the opportunity to appear before you today to discuss questions – and misconceptions – that exist about the title insurance industry. All of us who work in the land title business are justifiably proud of the essential role that our industry has played, and continues to play, in making the United States real estate market the envy of the world. Despite our country's real estate and economic downturn, nowhere else in the world is the creation and transfer of interests in real property accomplished more efficiently and securely than in the United States.

The internationally respected economist Hernando de Soto has focused on a concept that the lack of formal property rights is the source of poverty in poor countries. His main thesis is that economic success in America relies on a clear system of

property rights that were created during the times of the American frontier which are the basis for entrepreneurship and the creation of wealth and capital. De Soto holds,

You are able to hold, transfer, assess and certify the value of such assets only through documents that have been legally authenticated by a global system of rules, procedures and standards. Ensuring that the relationship between those documents and each of the independent assets they represent is never debased requires a formidable system of legal property rights. That system produces the trust that allows credit and capital to flow and markets to work.¹

Our property recording system, served by local public officials and the title industry, gives us the legal underpinning that makes property ownership possible.

Despite the fact that real estate interests can be divided into at least three dimensions – on the surface of the earth, below the surface (e.g., oil, gas, and other mineral interests), and above the surface (e.g., rights within condominium units in high-rise buildings, air rights easements.); despite the dizzying array of loans that the mortgage lending industry has created to meet the diverse needs of consumers and other borrowers; and despite the enormous range of liens and encumbrances that authorities allow to be attached to real estate, the products and services provided by the title insurance industry have resulted in a level of security, stability, speed, and efficiency in real estate transactions that is unparalleled in history.

Have you ever wondered why parties seeking debt recovery include the desire to have their debt filed as a lien? Commercial real estate brokers sought the statutory right to place a lien on the property prior to the closing of a commercial transaction. Pennsylvania, along with twenty other states, have given such rights because, as a lien, they know the title industry will get them paid. The Pennsylvania Department of Welfare

¹ De Soto, Hernando. "TOXIC Paper: The Obama administration must tackle a problem that has bedeviled the emerging markets for years." Newsweek Mar 2, 2009.

came to the title industry seeking assistance in the collection of delinquent child support payments. We were only too happy to help and we were not surprised that they came to the title industry, because they knew we would get the job done. It is what we do.

In 2008, ALTA conducted a study on the benefits that our land title system provides the U.S. economy. The figures are impressive:

- Because of the title insurance industry, Americans close their loans faster than any other country – 30 days on average – and the speed of the transaction saves consumers tens of billions of dollars annually in additional interest costs.
- At no cost to taxpayers, the title industry collects \$1.75 billion per year in back income taxes.
- At no cost to taxpayers, the title industry collects \$3 billion per year in delinquent real estate taxes.
- At no cost to taxpayers, the title industry collects \$325 million per year in delinquent child support payments.
- The title industry spends \$225 million per year to correct errors in the public property records that otherwise would lead to serious impairment to the property rights of millions of Americans.
- The title industry is an important source of revenue for local governments, paying \$170 million per year to purchase copies of recorded documents.
- Because of the title insurance industry, people can be confident about purchasing property anywhere in the country because they are insured against fraud and defects in the public record.
- Thanks to the title insurance industry, mortgage lenders are more willing to lend because ownership by the borrower of the collateral (the real estate) is guaranteed.
- Because of the title insurance industry, mortgage-backed securities (MBS/CMBS) can be created and traded, because in the event of a default, recourse to the underlying collateral is guaranteed.

It is because we are so proud of the many good – and unappreciated – things that our industry does to facilitate real estate transactions in America that we are also so

concerned about the adverse publicity that has attended members of our industry. A large part of our frustration over the years has been in attempting to explain a very complex business to those who have little interest in it or time to learn about it, let alone convince them that a particular premise is wrong when they are more interested in a sensational story than the facts. Such publicity led to an April 2007 report on the title insurance industry by the Government Accounting Office (GAO), the investigative arm of Congress, which examined various questions about title insurance and competition in the industry. The report represents more than a year of cooperation between representatives from our industry and the GAO, the U.S. Department of Housing and Urban Development (HUD), and a number of state departments of insurance. The report demonstrates a keen understanding of our highly complex business and recognizes the major differences between title insurance and other lines of insurance, differences which have sometimes led to misunderstanding by consumers, government officials and the news media.

The report reflects the realities of our industry, the important role we play in maintaining the safe and secure real estate market that we enjoy, and dispels misconceptions that so often prevail in the press and elsewhere. Many of the GAO report's findings support what we've been saying for years, and now we have a credible, independent third party saying them. In particular, the report examines in detail how title insurance differs from other lines of insurance including: 1) the cyclical nature of the business; 2) the fact that title insurance covers events in the past, not the future; 3) the premium is a one-time fee; and 4) the work of title agents is extremely labor intensive compared to other lines of insurance where agents effectively serve as salespeople;

and that any comparison of title insurance with property and casualty insurance must consider wide differences in claims and expenses.

We fully recognize that there have been bad actors within the title insurance industry and we support the GAO's recommendations. We have demonstrated this by working with Congress, HUD, the National Association of Insurance Commissioners (NAIC) and state regulators to implement them.

My statement today will address five topics that ALTA believes are important to the Department's and the public's understanding of our industry. First, I will explain what title insurance is, the role it plays in ensuring that buyers, sellers, and lenders in residential and commercial real estate transactions walk away from the closing table with the assurance that their real estate has been properly conveyed, and how title insurance differs in important respects from other lines of insurance. This discussion also addresses the roles of title insurance companies and title insurance agents (collectively, "title companies") in the process by which title insurance policies are issued and are regulated. Second, I will address assumptions based on a lack of understanding of title insurance. Third, I will discuss the use of affiliated business arrangements and their effect on the marketplace. Four, I will point out the effect of RESPA Reform on the title agent operation and finally, I will discuss the role of reverse competition in the title insurance industry. This overview of the industry is enhanced by the attachments to this testimony which provide more detailed information about the title insurance industry's impact on the real estate market.

I. AN OVERVIEW OF TITLE INSURANCE AND THE TITLE INSURANCE INDUSTRY.²

Title insurance plays a fundamental and essential role in facilitating ownership and investment in real estate in the United States. Purchasing a home or obtaining financing for a home are generally the most significant investments most consumers ever make. Beyond residential transactions, every week, even in this depressed market, there are thousands of transactions, some of which involve hundreds of millions or even billions of dollars, relating to the acquisition, development, and sale of commercial real estate – almost all of which are financed with borrowed funds. The willingness of individuals and businesses to invest in real estate anywhere in the United States, or to loan money to those who own or are acquiring real estate, and the ready marketability of those interests and loans, is truly remarkable in light of the inherent complexities that exist with regard to the rights that may be claimed against real estate. The title insurance industry, through the policies title insurers issue and the significant work title agents must perform to be in a position to issue the policies, has rendered such investments safer, more secure, and more marketable than at any time in world history.

The “ownership” of real estate really involves the ownership of a bundle of rights relating to the use and disposition of the property that we have come to associate with the general term “ownership” or, the more technically correct phrase, fee simple title.

² Additional background information on the nature of title insurance and the title insurance industry is set forth in the ALTA documents “What is Title Insurance?” “Public Benefits of Title Insurance,” and “Title Industry Regulation, Ethics and Standards,” (Tab A); “The Nature of Title Insurance,” by Prof. Harry Mack Johnson, *Journal of Risk and Insurance*, Vol. 33 (Sept. 1966) (Tab B); and “Title Insurers Feel the Pain as Housing Market Ills Continue,” A.M. Best Special Report, Oct. 2008 (Tab C) (hereafter “the A.M. Best Report”).

As discussed in the introduction to this statement, ownership rights in real estate may be divided in a number of ways and over time. Prior owners may have created interests in the property or suffered liens against the property that will have priority over the interests acquired by a new purchaser. Because of the value, permanence, and immovability of real estate, federal, state, county, and municipal governments have created or recognized a vast array of rights, liens, and encumbrances that may be asserted against real estate: rights that may affect the use of the property or otherwise encumber the “ownership” rights of the holder of the fee simple interest. These include:

- liens against the property that serve as security for the payment of an obligation (e.g., mortgage liens, judgment liens for unpaid court judgments, tax liens, state and local liens for failure to pay real estate taxes or assessments, mechanic’s liens to secure payment for improvements, liens for recovery of child support payments or, as in New York City, for unpaid parking tickets);
- easements that have been created by contract or arisen through use or adverse prescription (e.g., rights of way for utilities, rights acquired by neighbors because of a fence encroachment);
- building or use restrictions contained in a recorded plats, agreements or deeds; and
- rights or claims arising out of bankruptcy.

In any real estate transaction, the buyer wants to be certain that he or she will ultimately be acquiring ownership of the property subject only to those liens and encumbrances she knows about and is willing to accept. The seller, who may be conveying the property by a general or special warranty deed (in which he or she will be providing certain warranties of title to the buyer and will be contractually liable to the buyer if those title warranties are not correct), likewise has an interest in ensuring that the title obtained by the buyer will not be subject to any claims that will trigger liability under those warranties. The mortgage lender is willing to provide financing for the

transaction but only on the condition that the buyer, in fact, will own the property and that the mortgage lender will obtain a valid and enforceable first mortgage lien that is not subject to any other lien or claim that could adversely affect that mortgage interest.

While various approaches have been used in the history of the United States and in different parts of the country to provide these assurances, the foremost mechanism by which buyers, sellers, and lenders obtain these assurances today is title insurance – the only form of insurance invented in the United States, right here in Pennsylvania. To understand the reasons why this has come to be the case, one must first understand title insurance and how it satisfies important market demands.

A. The Nature of Title Insurance and Why It Has Become the Predominant Mechanism for Facilitating Real Estate Transactions.

In general, there are two major types of title insurance policies, both of which are typically issued after the closing of a real estate or mortgage financing transaction: an owner's policy and a loan policy.

An owner's policy insures the purchaser against financial loss or damage that may arise from defects in the title as insured, including the assertion of liens and claims against the property that are not otherwise excepted from policy coverage. The policy includes protection against title defects that may be found in public records but were not discovered during the search of those records or their significance was not appreciated, and against those non-record defects that even the most comprehensive search of the records would not reveal. These risks include, among others:

- fraud or forgery in the execution of documents in the chain of title (in deeds, mortgages, mortgage satisfaction pieces, etc);
- mistakes in interpretation of wills, divorce decrees, bankruptcy court directives and other legal documents;

- the execution of documents by minors or incompetent persons who could not legally convey property interests;
- the existence of undisclosed heirs who did not consent to a prior transfer;
- deeds executed under an expired power of attorney or on behalf of someone who has died; and
- mistakes in the recording or indexing of documents in the public records.

The title policy is issued for a one-time fee, paid at the closing, and there are no renewal premiums. Because the protection of an owner's title insurance policy continues so long as the policyholder owns, or has any liability with regard to, the insured property, an owner's policy will protect the policyholder even after he or she sells the property if the buyer later asserts claims under a warranty deed with regard to matters covered by the policy.

A loan policy basically insures the lender that it will have a valid, enforceable lien on the property in accordance with the mortgage interest created by the loan, that the person to whom it is making the mortgage loan has title to the property being mortgaged; and that no other claimant, other than those specifically noted in the policy; has a prior, superior claim. The policy continues in force so long as there is a balance due on the loan and is assignable to a purchaser of the loan in the secondary mortgage market.

Under both policies, the title insurer is obligated to pay for the costs of defending the title as insured against any covered claim. In virtually all areas of the country, if an owner's policy is issued in the transaction, the cost of a loan policy that is "simultaneously issued" with the owner's policy involves a relatively small additional

charge to the cost of the owner's policy. In Pennsylvania the simultaneously issued loan policy is issued at no additional expense to the consumer.

Because the history and current status of each parcel of property is unique, title insurance policies cannot be issued on a "casualty" basis – e.g., by assuming that, statistically, so many properties are going to have certain kinds of claims against them. Rather, title insurance policies can only be issued on the basis of a thorough search and examination of the relevant public records pertaining to the particular property to be insured, so as to determine whether the seller, in fact, owns the fee simple title rights he or she has contracted to convey to the buyer, and what liens or encumbrances exist that would limit the use or value of the property when acquired by the buyer. This title search and examination (discussed further below) is critical not just from the insurer's standpoint in underwriting the issuance of the policy. It is also important from the standpoint of the buyer because the preliminary title commitment (or, as it is sometimes called, the preliminary title report) given by the insurer or its agent to the prospective policyholder will identify the matters of record found in the title search and examination process that, if not taken care of prior to the closing, will be excepted from coverage in the policy as issued. This information enables the buyer (and his or her representative) to determine whether any action needs to be taken by the seller or others to eliminate the lien or claim identified in the commitment before the transaction is closed.

Prior to the widespread adoption of title insurance, this function of searching the title records, examining the relevant documents, and informing the purchaser about the rights he or she may be acquiring was performed by people known as conveyancers, by abstracters, and by attorneys. Because real estate records are generally found in the

locale (typically the county) where the property is located, this was typically a local function. What title insurance brought to the table – and what accounts for its almost universal use today – is that:

- whereas prior to title insurance, purchasers and lenders who obtained an erroneous opinion on the state of the title had to sue the conveyancer or lawyer, could only recover if the conveyancer or lawyer had acted negligently and had enough assets to meet the judgment, and could not recover for damages caused by non-record defects,
- with title insurance, owners and lenders have a right of recovery as a matter of contract and without having to establish negligence, they have these rights against a financially sound and regulated entity with continuous corporate existence, and they also are protected against claims caused by non-record defects.

These advantages of title insurance were critical factors contributing to the growth of the secondary mortgage market – which, in turn, contributed significantly to the continued growth of title insurance.

B. A Brief Historical Perspective on the Growth of Title Insurance.

The need for title insurance arose from the fact that traditional methods of conveying real property did not provide adequate safety to the parties involved. Indeed, the origin of title insurance is directly traceable to the limited protection that was provided through the use of conveyancers.

The 1868 decision in Watson v. Muirhead, 57 Pa. 161, was a watershed event in the history of title insurance. Muirhead, a conveyancer, had searched the title for a parcel of property to be purchased by Watson. In good faith, and after consulting an attorney, Muirhead concluded that certain recorded judgments against the seller would not be liens against the property Watson was buying. Watson went ahead with the purchase of the property, but was subsequently required to pay off those liens against

his seller as the judgments against the seller were found to encumber the property Watson had purchased. Watson sued Muirhead to recover his losses, but the Pennsylvania Supreme Court ruled that, given the state of the law at that time, there was no negligence on Muirhead's part, so no recovery could be had. Watson, an innocent purchaser who had relied on Muirhead's erroneous, but not negligent, conclusion about the state of the title he was purchasing, had no recourse. Shortly after that decision, the first title insurance company – The Real Estate Title Insurance Company – was founded in Philadelphia. The purpose of the infant industry – still relevant today – was expressed in the initial advertisement of the company:

This Company insures the purchasers of real estate and mortgages against loss from defective titles, liens, and encumbrances. Through these facilities transfer of real estate and real estate securities can be made more speedily and with greater security than heretofore.

While the use of title insurance expanded in the decades that followed, as other companies were established in Pennsylvania, New York, Virginia and in other states, the single greatest impetus to the growth of title insurance was the development of the secondary mortgage market following World War II. Transactions in the secondary mortgage market include:

- the sale of mortgages by the originator of the loan to a third party investor who holds that loan in its portfolio (e.g., the sale of a mortgage by an originating bank to a life insurance company); and
- the sale of mortgages to an entity, such as Fannie Mae or Freddie Mac, that thereafter either resells the mortgages or sells mortgage-backed securities based on a portfolio of mortgage loans.

The essential purpose of the secondary mortgage market is to facilitate mortgage financing by broadening the base of investors and increasing the availability of investment funds for mortgage financing. However, the need for safety and protection

from title problems on mortgages that will be sold in the secondary market is more acute than in the historical situation where a local lender might retain the mortgage loan in its own portfolio. The local lender might have been willing to make and retain the loan based on its familiarity with local law and customs, and its reliance on the title opinion of a local attorney whose reputation and work is familiar to the lender. In contrast, a national lender or a purchaser of loans or mortgage-backed securities is not willing to rely on the opinions of title of local lawyers or conveyancers, and is certainly not going to want to have to bring a negligence suit in the lawyer's or conveyancer's home town if the opinion turns out to be wrong or the transaction is mishandled. Secondary market purchasers want – and require – the protection of a standardized title insurance policy, whose terms and coverage they are comfortable with, issued by a financially sound insurer that they know will be there if a title problem or claim needs to be defended, corrected, resolved or paid.

C. How Title Insurance Differs from Other Types of Insurance.

Title insurance differs in fundamental ways from most other forms of insurance, such as auto, homeowner's or life insurance. Understanding these differences is important to avoiding misconceptions that may result from erroneous comparisons with those other lines.

First, most other forms of insurance provide protection for a limited period of time and, hence the policy must be periodically renewed. That is, if the premiums do not continue to be paid, the policy lapses. Title insurance is issued for a one-time premium. There are no renewals. The owner's policy protection extends for as long as the owner owns the property or has liability in connection with the property. The insured lender's

protection extends as long as there is a balance due on the loan secured by the mortgage. Second, other forms of insurance insure against future events after the policy has been issued – such as a fire, an accident or, in the case of life insurance, death. Title insurance protects against existing title defects that arose before the policy is issued. While the claim may not be asserted until after the policy is issued, it has to be based on matters that existed prior to the policy issuance date.

Third, as a result of these fundamental differences in policy coverage, there are fundamental differences how policies are underwritten. Property and casualty or life insurance companies try to minimize claims and losses by taking steps to inspect and assess the risks they are being asked to insure before they issue the policy. However, there is only so much information property and casualty insurers can obtain and assess before the policy is issued that will predict the likelihood of a future claim. Rather, they rely primarily on an actuarial determination of the likelihood of various kinds of claims and losses taking place in the future and then determine the appropriate charge to make in order to generate adequate revenue to pay the level of claims that they know are statistically likely to occur in that single policy year.

Since title insurance insures matters that exist at the time the policy is issued, the underwriting of title insurance operates almost entirely on the basis of identifying, evaluating, and addressing title problems before the policy is issued. It is theoretically possible, through a thorough search and examination of the title, to identify all the record defects (but, of course, not the non-record defects) that may exist and then to address them and either eliminate them, insure over them, or exclude them from

coverage.³ (As discussed in the next section, this process frequently results in title companies taking curative actions to remove invalid or previously paid liens or claims from the public records, or otherwise to repair errors in the public records.) While claims and losses are inevitably bound to occur, title insurers seek to do all they can to minimize the possibility of future claims.⁴

This demonstrates two methods of insuring title. On the one hand, an insurer could use revenue from a one-time premium primarily to identify and, if possible, eliminate title risks prior to the issuance of the policy and therefore reduce the likelihood of having to pay claims. Alternatively, an insurer could perform a less intensive upfront search, examination and correction (or none at all) and use the revenue from a one-time premium primarily to pay claims that will inevitably arise. The benefit of risk identification and elimination is of unquestioned benefit to all policyholders. The importance of this point cannot be over-emphasized. All owners and investors in real estate, whether residential or commercial, want and require the safe, secure, and peaceful use of the property they acquire. If there is a problem with the title that affects the use of the property or its value, the owners and investors want to know about it before they buy or invest in the property. Compensation for the loss of the property or

³ Just as no homeowner's insurance company would insure a house if it knew at the time that a fire was raging in the basement, a title insurer will not insure against a significant lien or claim it knows to exist and to be enforceable against the property. Having informed the prospective insured in its preliminary commitment that the matter will be excepted from policy coverage, it is up to the prospective insured to decide whether to accept that defect as a limitation on the title, to negotiate with the seller for its removal, or to decline to go ahead with the transaction if the defect is serious enough (e.g., it could affect the marketability of the property).

⁴ In this regard, title insurance is somewhat akin to boiler insurance, where significant portions of premiums are devoted to inspecting and correcting any problems with the boiler before the policy is issued.

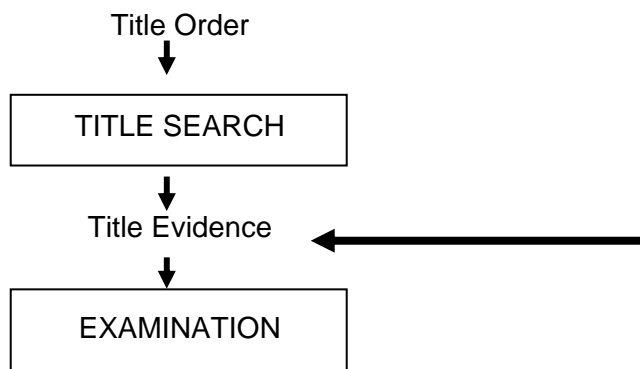
having to be involved in litigation by a party challenging their rights in the property is not what the buyer or lender wants, especially when such claims could otherwise easily be avoided. It is not a matter of money but it is a matter of rights. Who has the right to sell or mortgage? Without a proper title search, anyone could sell your home or mortgage your equity and walk away with the cash.

In fact, a study by Association Research⁵ found if problems were not eliminated prior to closing, one in three of all property purchasers and their lenders would be subject to a claim due to an error in the public record. These claims would cost time, money and great anxiety amongst the homeowners who would risk the loss of their homes and lenders who would risk loss of their investment.

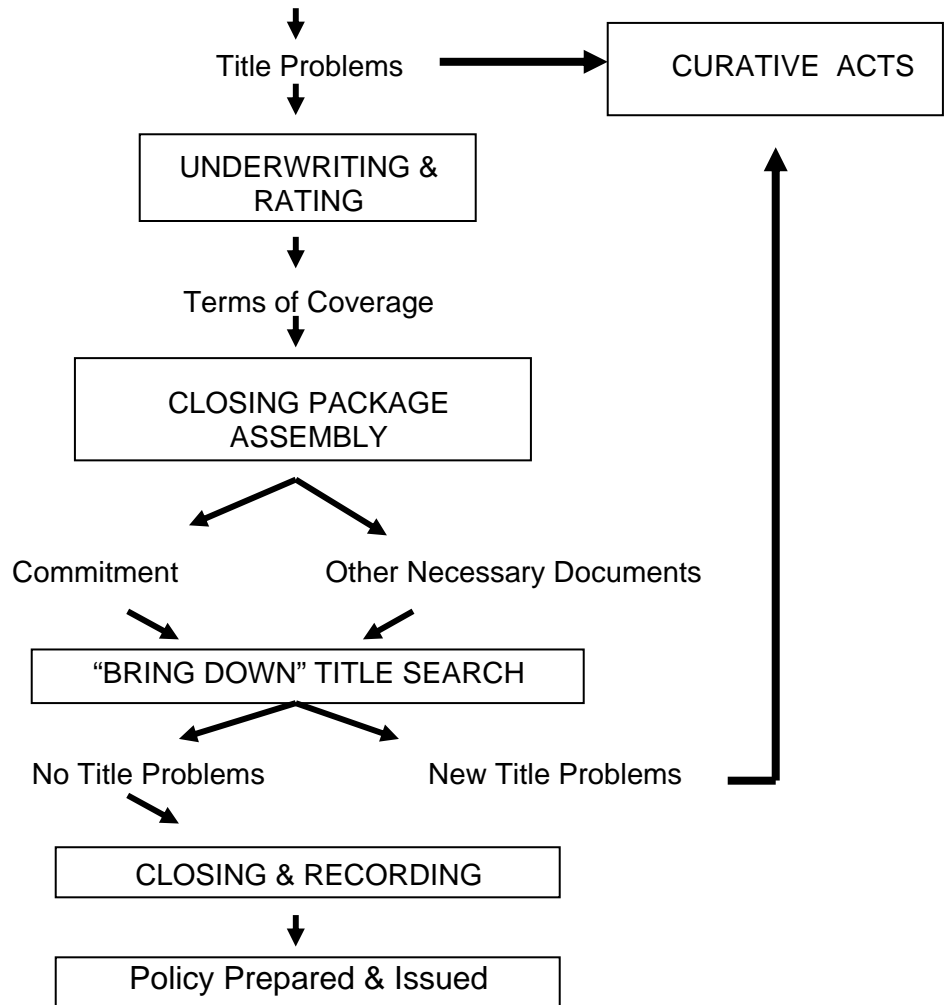
Thus, it serves everyone's interest, especially the policyholder, that title companies spend a high proportion of their revenue on the title search, examination, and curative functions, which, if performed properly, inevitably result in fewer losses and claims payments. This makes title insurance unique.

D. The Process of Issuing Title Insurance Policies and the Unique Role of Agents in the Title Insurance Business.

The process by which title insurance policies are issued is outlined here:



⁵ “2005 Abstracter and Title Agent Operations Survey,” Association Research, Inc. (April 2006) (Tab E)



The first step after an order is received is to collect the relevant records and information pertaining to the property to be insured, and information regarding possible claims against the seller (or owner in a refinance transaction) that could affect the title to the insured property. This is referred to as the “title search,” and the information collected is the “title evidence.” Such evidence can be obtained in any of several ways:

- by conducting a search at the various records centers where relevant information may be located;⁶

⁶ These could include the Office of the Recorder of Deeds (sometimes referred to as the Registrar of Deeds or the County Clerk’s Office) (e.g., for deeds, plats, mortgages, and other documents relating to the property may be located), local or state courts (e.g., for judgments

- by purchasing the evidence from a third party provider; or
- by owning or having access to a “title plant” – a privately-owned facility, now frequently maintained on a computerized basis, in which information and documents from the various public records centers are obtained, and then reorganized and maintained so that a search of any property in the locale can be conducted at any time without having to go to all of the public records sources.

Having collected the title evidence, individuals experienced in real estate law and title insurance principles must examine the title evidence to determine whether the seller has, and can convey, fee simple title to the buyer, what other liens or other objections must be resolved or cured, and what title defect exceptions may have to be included in the policy. It is at this “title examination” stage that the title agent performs one of the most valuable services, which is an inherent part of the title insurance underwriting function: curing defects and problems that may exist in the title records. This curative action includes obtaining releases or pay-offs for discovered liens (e.g., prior mortgage liens, child and spousal support liens, judgment liens, tax liens, homeowner’s association debts, mechanic liens); obtaining releases for deeds and mortgages; and correcting typographical recording and indexing errors that could create problems (misspelled names, incorrect legal descriptions). As previously stated, a study by Association Research indicates that such curative actions are taken, on a nationwide basis, in one in three residential real estate transactions.

During the search and examination process, easements, rights of way, utility company rights and other items that run with the land will be discovered and disclosed to the potential buyer and lender. It is important that the buyer and lender are made

and liens), probate courts (e.g., for records on estates, marriages and divorces, adoptions, changes of name), federal bankruptcy courts, registrar of wills and various other cites.

aware of these rights as any one of them may affect the intended use of the land. The exam function is the reason why title professionals can honestly answer “no” to the question, “Can’t you just push a button to get a title search?”

On the basis of the title examination, a commitment to insure is then sent to the prospective policyholder. It sets forth the conditions that must be met for a title insurance policy to be issued such as documents to be produced (e.g., the execution of a deed, the execution of a new mortgage in favor of the buyer’s lender), items to be removed (payoff of mortgages, judgments, liens, taxes, municipal bills), and exceptions to be taken from policy coverage found during the title search and examination process. All of this information is discovered in the public record, not by simply finding a document but through the tedious reading and reviewing of all the documents. If exceptions pose problems for the prospective policyholder, an attempt may be taken by the parties, with the assistance of the title agent, to eliminate those exceptions. If an exception cannot be removed, the title underwriter may be willing to insure over it, either because the title underwriter concludes that the risk of assertion or financial damage is small, or because an indemnity is obtained from the seller. An exception that cannot be removed will be listed on the policy as an exception. If an exception is serious enough, the buyer may seek to modify the terms of his purchase contract with the seller or, in an extreme case, decline to proceed with the transaction. Because the title industry has been so effective over time in clearing titles errors and preserving the integrity of the public records it is rare that a seller’s title is so defective as to be uninsurable or unmarketable.

The closing package is then prepared and a “bring-down” search is run to ensure that nothing has been filed of record since the date of the original search.

The last steps in the process involve the closing of the transaction. The relevant deeds, mortgage instruments, and other documents are executed and funds are exchanged. The new deed and mortgage lien are recorded and title insurance policies are issued to the lender and the new owner.

Two critical observations are worth noting:

First, all of the steps described in the process of issuing a title insurance policy may be performed by a title insurance underwriter through a branch office it maintains in the locale where the property is located, or by a title insurance agent acting on the insurer’s behalf. Unlike agents in other lines of insurance, who primarily perform and are compensated for sales-related functions, title insurance agents generally perform all of the steps in the title insurance issuance process described above: the search, examination, curative work, issuance of the commitment, handling of the closing, intake and disbursement of all of the funds, recording of the documents, and issuance of the policies. Since a high proportion of the revenue generated by the one-time title insurance premium is used for risk identification, analysis, and reduction of claims, rather than for the payment of claims, it should not be surprising that a high proportion of the premium is paid to the agent for performing these functions.

In transactions involving agents, the insurer will provide the agent with blank title insurance policies pre-signed on behalf of the insurer that, upon being counter-signed and issued by the agent, become binding policies of the insurer. The insurer generally does not know that a policy has been issued by its agent until the end of the month (or

some other period) when the agent remits the “net premium” due to the insurer (i.e., the total premium less the agent’s share of the premium as it is referred to in the title industry) for all policies issued in the most recent period, together with a list of the policy numbers on the issued policies. Copies of the issued policies are kept by the agent and are not sent to the insurer unless a claim arises under that policy at some future date.

Second, because of the historical differences in laws, customs, and practices in various parts of the country – and even within different areas of a single state – the title insurance issuance process described above is subject to numerous variations throughout the country. For example, in some of the eastern United States attorneys still play a significant role in residential real estate transactions and frequently act as title insurance agents on behalf of a title insurance underwriter or a “bar-related” title insurance entity. In some areas, the closing takes place when parties gather together around a “closing table” to sign and exchange documents, funds and keys. In the Midwest, abstracters generally prepare the title evidence (compiled in a document called an “abstract”) from which a lawyer, title agent or a title underwriter will perform the examination. Depending on the region, closings are conducted either around a closing table as described above or through an escrow, where the transaction is closed pursuant to written instructions received by the escrow holder from the parties. In California and other parts of the western United States, title companies or independent escrow companies are available to handle this escrow function.

In addition to the many regional and local variations, customs and practices in the conveyance of real estate and the functions that title insurers and agents perform, there are also variations in what services are included in the title insurance premium. In

some states, such as here in Pennsylvania, the title insurance premium encompasses the issuance of both of the owner's and lender's policies, the risk, the search and examination, and the closing of the transaction.

Because the services that are included in the title insurance premium vary by state, and sometimes even within a state, simple comparison of title insurance premiums between states do not result in an apples-to-apples comparison. Any meaningful and appropriate comparison of title insurance costs between two or more states on comparably priced transactions must consider the services that are included in the premium for each particular state. These state-by-state comparisons of title insurance premiums by state are not simple to calculate. Current attempts to compare title insurance premiums between states are widely inaccurate. Thus, ALTA has worked with the NAIC to provide regulators and the public with descriptions of what services are included in title insurance premium rates in each state. We expect this information to be available in early 2010.

E. Basic Approaches to Title Insurance Regulation.

Because of the important and unique role that title insurance plays in homeownership and in our economy, a more extensive regulatory framework applies to title insurance than is generally applied to other lines of insurance. While the specifics of such regulation vary from state-to-state, certain core elements of regulation remain consistent across all states.

Before discussing state regulation of the title industry, it is important to note that title insurers are subject to federal consumer protection requirements under the Real Estate Settlement Procedures Act (RESPA). One of the purposes of RESPA is to help

consumers become better shoppers for settlement services and to eliminate kickbacks and referral fees that unnecessarily increase the costs of certain settlement services. In 2008, a new rule was proposed. The new rule will be implemented on January 1, 2010.

The requirements imposed in the new RESPA rule will add a great burden on Pennsylvania title agents who perform closings. The HUD-1 settlement statement has been expanded to include the calculation and explanation of fees and loan terms heretofore the responsibility of the lenders. Title agents doing closings will now have to compare the fees on the lender's Good Faith Estimate (GFE) to the settlement statement to determine whether or not the lender's fees match within prescribed tolerances. The closing personnel will also have to reiterate the terms and conditions of the loan causing many agents the concern that they will be precariously close to the unauthorized practice of law.

Proposed changes to the RESPA rule included a requirement that the closer read a Closing Script and even though the Script is not in the final rule, the expanded pages of the HUD1 contain basically the same information. In HUD's own estimation, the reading of the Script would have added an additional 45 minutes to each transaction costing the title industry \$676 million dollars per year. These are HUD's estimates. We conservatively estimate that the added time burden necessary to prepare and explain the new page of the settlement statement will be approximately 30 minutes. Simple arithmetic leads one to believe that this will cost those performing the closing function in the title industry an additional \$450 million dollars per year. In Pennsylvania, under our all inclusive rate system, title agents who perform closings will not be able to recover this additional expense.

Along with the new requirements of RESPA come major software changes and training expenses for all title agents who perform closings, the expense of which was calculated by HUD for the title industry as a whole to be \$62 million for software expenses and training (\$46 million of which will be borne by small businesses), and \$37 million for legal consultation (\$18 million of which will be borne by small businesses). Recognize once again that these fees are not recoverable under the current Pennsylvania rating format, which governs the 5th largest state in title insurance transactions.

While ALTA applauds the efforts of HUD to make the home buying and financing process clearer and more transparent for consumers, the responsibilities and liabilities placed on the title industry come at a great cost. We will continue to work with HUD and stakeholders to implement the rule successfully.

As an insurance product, title insurance is primarily regulated by states. As part of this regulatory regime, title insurance is one of the few lines of insurance that is required to be monoline. A licensed title insurer is not permitted to offer any other line of insurance. Similarly, an insurer licensed to engage in another line of insurance cannot provide title insurance coverage. This restriction is expressly set forth by statute in a majority of states and imposed generally through licensing statutes in most of the remaining states. This monoline restriction was adopted by states following the collapse of the title insurance industry in New York during the Great Depression because title insurers had been allowed to issue mortgage guaranty insurance. During the Great Depression, extraordinary unemployment led to a collapse in home prices and a spike in foreclosures. The holders of mortgage guaranty insurance filed claims wiping

out reserves and making the firms insolvent. Monoline restrictions were imposed in order to prevent this kind of disaster in the future and as a means of ensuring the safety and solvency of title insurers and protection for policyholders where policies remain in effect for indefinite periods of time.

Occasionally, the monoline restriction is mistakenly questioned on the view that this protection somehow limits competition. This is simply not the case. Monoline restrictions do not prevent any other insurer from establishing a title insurer as a separate corporate affiliate. These consumer protections simply prevent insurance companies from mixing title insurance risks with other kinds of insurance risks.⁷

Additional regulatory requirements are imposed to ensure the safety and solvency of title companies. From the financial perspective, states generally impose heightened capitalization and reserve requirements, including statutory premium reserves requirements, recognizing, in part, the longer loss tail for title insurance policies and the fact that there is no revenue collected from the renewal of policies.

⁷ Additional reading can be found in “The Role of the Monoline Requirement in Assuring Title Insurance Effectiveness,” Dr. Nelson R. Lipshutz, Regulatory Research Corporation (June 20, 2007) (Tab F); “Monoline Restrictions, with Applications to Mortgage Insurance and Title Insurance,” Dwight Jaffee, Review of Industrial Organization (2006) (Tab G); “Consumer Impacts of Substituting Radian Lien Protection Coverage for Refinance Lender’s Title Insurance,” Dr. Nelson R. Lipshutz, Regulatory Research Corporation (April 16, 2003) (Tab S); “Analysis of Consumer Issues Pertaining to Issuance of Mortgage Impairment/Lien Priority Title Insurance by Non-Title Insurers,” NAIC Title Insurance Issues Working Group Draft White Paper (July 30, 2004) (Tab T); “Analysis of State Rejections of Mortgage Impairment Products,” NAIC Title Insurance Issues Working Group Draft White Paper (July 30, 2004) (Tab U); “Mortgage Impairment Insurance is Title Insurance,” NAIC Title Insurance Issues Working Group Draft Legal Analysis (July 30, 2004) (Tab V); and Letter from Victor N. DiCiceo, Chief, Field Investigations Division, Commonwealth of Pennsylvania Insurance Department to P. Kevin Brobson, Esquire, Buchanan Ingersoll Attorneys In Re: Radian Guaranty, Inc. Dept. File No. 02-571-00008 (July 24, 2002) (Tab W).

Title insurers are also subject to restrictive limitations on dividend distributions and to specialized financial reporting requirements.

In addition, the extensive search of public records that is performed prior to the issuance of a policy is codified in many states through a minimum search requirement to ensure that a search is always performed and that title insurance is not issued on a “casualty” basis. These requirements are intended to preserve the solvency and integrity of the title industry by minimizing claims. They have the added benefit of protecting the public record by ensuring these records are reviewed on multiple occasions, increasing the likelihood of errors being detected and corrected.

While it should not be missed that title insurer insolvencies are exceedingly rare; the regulatory requirements for title insurance described above have served as an effective backstop during the current down cycle of the real estate and housing market and provide better protection than requirements for most other lines of insurance. However, a significant drop in revenue was reported in 2007 and 2008, leading to the first unprofitable combined ratio in 17 years. Losses and loss adjustments were much higher due to higher incurred claims partly due to foreclosures, mortgage defaults and agent related fraud activity which typically increases during a down cycle. Inadequate loss reserving practices earlier in the decade have been made up by some title insurers through significant reserve increases in recent years. Finally, it is important to note that rates and solvency are interrelated. When rates are increased, the risk of insolvency decreases. When rates are decreased, the risk of insolvency increases.

In the regulation of rates, virtually all states recognize the interrelation between solvency and rates and require that they must not be either excessive or inadequate,

and must also not be unfairly discriminatory. However, there are differences in the specific approaches taken to achieve that objective:

- Three states promulgate the rates that may be charged and the split of the premium between insurer and agent;
- Nine states require title insurers to obtain the prior approval of the state insurance regulator before the rates become effective;
- Twenty-seven states require the filing of rates and then a specified waiting period before they may be used (so as to afford the regulator an opportunity to review the rates before their use);
- Two states have a “use and file” approach; and
- Eight states have no express regulation of title insurance rates.⁸

An important aspect of all title insurance rates is that they avoid the inequities that occur if title charges in a particular transaction are based on the costs incurred in handling that particular transaction. If premium charges were based on the time and effort involved in searching, examining, curing defects, and closing a particular transaction, it would be impossible for the lender to give the buyer a Good Faith Estimate (GFE) of the transaction costs at the outset of a purchase as required by RESPA because nobody would know the time and steps required to search, examine and cure the title. The work required to be done in connection with the issuance of the policy is not known until the process is complete. Such a system would make it impossible for consumers to comparison shop among title companies.

An important aspect of each state’s title insurance rate is that all rates intentionally incorporate cross-subsidization principles between higher value and lower value transactions to ensure the ready availability of title insurance for moderate and

⁸ For a listing of the regulatory approaches of the various states, see the A. M. Best Report at 16 (Tab C).

low-valued properties. The fact that premiums are based on a rate per thousand of liability results in a situation where higher priced properties subsidize the cost of producing policies on lower priced properties. Since title insurance rates are intended to cover all of the costs involved in producing policies and claims, there is an average cost per policy that the title insurer incurs. The premiums for lower priced homes will fall below this average cost and the premiums for the higher priced homes will generate revenues in excess of this average cost. The incorporation of cross-subsidization into title insurance rate schedules thereby provides a useful social consequence of reducing purchasing costs of lower priced properties.

II. CORRECTING A LACK OF UNDERSTANDING OF TITLE INSURANCE.

The unique nature of title insurance combined with the relative infrequency with which consumers purchase title insurance generates a lack of understanding of the purpose and value of title insurance. Those who do not understand the product and its purpose or those who have not experienced a title problem have questioned the need for, or pricing of, title insurance. This lack of understanding is often reflected in articles in the press which spread more inaccurate information. While the industry, through ALTA and state land title associations, including the Pennsylvania Land Title Association, has undertaken substantial consumer education efforts so that the public better understands the title industry and its service, inaccurate information continues to persist in the marketplace and even among some regulators and elected officials. We here address four of the more common misconceptions.

- A. Misconception: The title industry pays out a relatively small portion of its total revenues in claims which indicates title insurance is rarely used, of little value and too profitable.**

Based on poor comparisons with property and casualty insurance or other lines of insurance, some say that because title insurance companies pay out a relatively small portion of their total revenues in claims, it is rarely used and is therefore of little value. This error in this thinking is that it fails to recognize the significant differences between title insurance and those other lines of insurance that are discussed earlier in this statement.

The purchase of a home generally represents the single most significant financial investment made by a consumer. Before the purchase, the prudent consumer wants and needs the assurance that he or she will be acquiring the safe and secure use of the property, free of title defects. Title insurance policy assures the policyholder that there is an absence of defects and reveals and excepts encumbrances remaining with the property.

As discussed previously, to accomplish its function of minimizing title claims and thereby serve the primary need of policyholders, title companies expend substantial time collecting and evaluating the title evidence, curing defects, making underwriting decisions relative to the issuance of the policy, issuing a title commitment that will enable the prospective policyholder to review and consider the exceptions to coverage. Each of these functions requires highly trained employees and professional personnel. In order to evaluate the condition of title, professionals must be familiar with all applicable legal aspects of title, including real property law (which often varies by state and even communities within a state) as well as bankruptcy, probate and family law. While many title companies maintain or have access to title plants or other electronic means to obtain their title evidence, in many parts of the country and much of

Pennsylvania, title evidence is still obtained through direct searches in each county's courthouse in the Recorder of Deeds office, Registrar of Wills office, Prothonotary, Tax Assessment and Clerk of Courts office. These searches are labor intensive. While approximately only 15% of public records are accessible through computerization, all documents still require direct, physical review of the applicable documents. Even in those counties and localities where title plants are used, the cost of developing these plants is expensive as is the ongoing cost of constantly updating the plant with all new public record filings. Even then, a search of the public records may still be required from the date of the last update of the plant until the date of the transaction.

Historically for title insurance, loss and loss adjustment expenses, which include the expenses associated with settling claims, legal fees, court costs, expert witnesses and investigation costs, have accounted for approximately 6.1% of revenues. In difficult economic times that rate will most likely increase as incidences of identity theft and forgeries in the public record directly affect the title industry. These low loss ratios compare with loss ratios in the property/casualty insurance industry of approximately 75-80%.⁹ On the other hand, operating expenses in the title insurance industry – which include the expenses incurred in the search, examination, curative, and policy-issuing functions – average around 92% of revenue, whereas operating expenses are in the range of 23-28% for property/casualty insurance companies.¹⁰ On a combined basis, the total of operating expenses and loss expenses of title insurance amounts to 98.3%

⁹ See Exhibit 4 of the A.M. Best Report (Tab C)

¹⁰ See Exhibit 6 of the A.M. Best Report (Tab C)

of revenue, while the remaining 1.7% comprises the historical profit margin in the industry.¹¹

Thus, the relatively low loss ratio for the title industry reflects that title insurance properly serves its function of assuring secure access and rights to real estate investments. If title insurers had a higher claims rate, policyholders would be confronted much more frequently with unexpected, unwanted and potentially costly title problems. Moreover, higher claims would lead to substantial increases in the cost of title insurance to cover such claims. Finally, that there is a historical positive profit margin indicates that states' regulation of title rates are not inadequate, while the low profit margin of 1.7% indicates that states' regulation of title rates are not excessive.

To better understand the expenses incurred by title agencies when conducting the loss prevention and elimination steps necessary to issue a title policy, ALTA is working with the NAIC as it considers the creation of a nationwide data call. Currently, Texas is one of the few states that requires title agents to submit detailed information about their expenses and makes them public. The NAIC may follow the Texas format, but with some considerable deliberation factoring in the many regional and local variations, customs and practices of title agents. As a matter of information, the average percentage of expenses incurred by title agencies in Texas in 2005 was 89.4% of total income, in 2006 it was 89.7% and in 2007 it was 93.4% of total income.¹²

¹¹ See Exhibit 15 of the A.M. Best Report (Tab C)

¹² Refer to 2007 Texas Title Insurance Agents Statistical Report Summary of Independent Agents, Affiliated Agents and Direct Operations (Tab B) for more information on Texas agent statistics.

B. Misconception: Compared to other insurance agents or those that receive a commission from the sale of real estate, commissions paid to title agents are too high.

These attacks come from well-intentioned but uninformed sources. We encourage critics of title agents to visit their local land title agency and learn about the work they do and understand better the costs associated with their services.

First, we have to acknowledge that the percentage of premium retained by a title agent is not a commission. Rather, this portion of the title insurance charge should be called an agent's retention. Dr. Nelson Lipshutz of Regulatory Research Corporation, one of the most knowledgeable and experienced economists in the world on title insurance and the operations of the title industry describes this compensation best:

The title insurance agent's retention, however, is not a small sales commission that serves primarily to defray the cost of marketing, as is the case in property and casualty lines. Rather, the title insurance agent's retention is really a subcontracting fee that compensates the title insurance agent for having taken on the responsibility not merely for marketing, but also for the great bulk of all the other activities that would otherwise be carried out by the insurer, including underwriting and policy production.¹³

An exhaustive search of the public record is performed in order to make a sale of property go through quickly and legally. At my title agency, Genesis Abstract, we start at the courthouse with a 60 year search of the property ownership records. We then review all the deeds, mortgages, agreements, court cases and tax records to determine the curative steps needed to clear the title of defects. Many searches reveal that previous mortgages have not been removed from the record even though they may have been paid off. We work to fix the problem by finding the old lender and begging for help to clean the record. After that, we scour the courthouse records to make sure

¹³ Lipshutz, Nelson R. *The Regulatory Economics of Title Insurance*. Westport, Connecticut: Prager, 1994.

there aren't issues affecting the title from a faulty sheriff sales, tax sales, divorce proceeding, outstanding child support, estate issues clouding the title. If our search turns up a problem, we spend the time to resolve it. Finally we close the transaction by gathering all of the parties and all of the documents, we make sure the money goes where it is supposed to go, we update the public record and then we insure the whole search and closing against mistakes – our own and any on the public record itself.

Our services are risk elimination and prevention – vastly different than the service you buy with other insurance products. One way to compare title insurance to other lines of insurance is to imagine if your homeowners insurance agent came into your home and inspected all of the wiring at no cost to you. The agent then repaired any and all faulty or frayed wiring at no cost to you and guaranteed that none of the wiring that was repaired or any wiring that the agent could **not** see would cause a fire. Finally, the agent charged a one-time fee for the inspection, repairs and guarantee that would be in effect as long as you or your heirs owned the property. The title industry finds the faulty wiring, fixes the faulty wiring and charges a one-time premium to guarantee its work.

Because of the title insurance industry, Americans close their loans faster than any other country, 30 days on average, and the speed of these transactions saves consumers tens of billions of dollars annually in additional interest costs. Without our efficient services and expertise, the cost of closing a home loan would skyrocket.

C. Misconception: The title insurance industry is not competitive.

Some have extended a false idea that there is a lack of competition within the industry. This was fueled by a report prepared in 2005 by Mr. Birny Birnbaum, a

consulting economist for the California Commissioner of Insurance John Garamendi entitled “An Analysis of Competition in the California Title Insurance and Escrow Industry.” Not only does the regulatory purpose of Commissioner Garamendi’s request for the report appear to be contrary to California law,¹⁴ but the report misapplied outdated economic theory, selectively evaluated data, and drew conclusions unsupported by appropriate empirical data. In short, the report is not credible.

Following the issuance of the Mr. Birnbaum’s report, and given the importance of the question of competition, ALTA engaged Dr. Nelson R. Lipshutz of Regulatory Research Corporation to review the report and determine if it was based on sound and appropriate economic theory, and supported by appropriate empirical data. Dr. Lipshutz made that evaluation and determined that the report is incorrect and unreliable.¹⁵

In addition to the evaluation of Dr. Lipshutz, other noted economists reviewed and evaluated the Birnbaum report. Dr. Gregory S. Vistnes of CRA International, who has held positions as an economist at both the Federal Trade Commission and the Department of Justice’s Antitrust Division and who was personally involved in formulating federal policy regarding competition, determined that Mr. Birnbaum’s conclusion that a reasonable degree of competition does not exist in California “has no

¹⁴ The California Insurance Commissioner had publicly stated that he wanted to reduce title insurance rates in California through regulation or otherwise. The Legislature in California, however, rejected such regulation. “It is the express intent of this article to permit and encourage competition between persons or entities engaged in the business of title insurance on a sound financial basis, and nothing in this article is intended to give the commissioner power to fix and determine a rate level by classification or otherwise.” Cal. Ins. Code § 12401.

¹⁵ Dr. Nelson R. Lipshutz, “Incorrect Conclusions About Competition in the California Title and Escrow Markets Asserted in the December 2005 Contractor Report to the California Insurance Commissioner” (January 5, 2006) (Tab H).

basis in fact, and flows from an inappropriate and error-ridden analytic methodology”.¹⁶ Dr. Jared E. Hazleton, Professor of Finance, Insurance, Real Estate, and Law of the University of North Texas, similarly severely criticized the erroneous Birnbaum report.¹⁷ Finally, Michael J. Miller, FCAS, MAAA, evaluated the Birnbaum report from the perspective of an actuary and found the report seriously flawed.¹⁸ All experts who have reviewed the report concur that it is so flawed and inaccurate that public policymakers should disregard it.

Dr. Bruce E. Strangle and Dr. Bruce A. Strombom of Analysis Group, Inc. also studied competition of the title insurance industry in California.¹⁹ They conclude from a careful review of available data and a proper application of economic principles:

The data show that the title insurance industry in California is competitive and rates are not excessive. For the median priced home in California, the base price of a standard owner’s title insurance policy per thousand dollars of coverage has declined significantly from \$6.89 in 1962 to \$3.06 in 2005. Prices for refinance loan policies have fallen even further. Competition among title insurance companies forces firms to provide more innovative products and services and to offer lower prices through modified pricing programs.²⁰

When one considers competition within the title industry it is critical that one recognize that competition exists on several different levels and is not limited to price. There is significant competition in the industry both at the insurer level and the agent level, and even between insurers and agents, with regard to (i) the quality and nature of

¹⁶ Vistnes, “An Economic Analysis of the December 2005 Birney Birnbaum Report to the California Insurance Commissioner” (January 5, 2006) (Tab I).

¹⁷ See Tab J.

¹⁸ See Tab K.

¹⁹ See Tab L.

²⁰ *Id.*, at 1.

services provided, (ii) the speed with which a transaction is handled, (iii) the title products that are offered, and (iv) the ability to attract and retain knowledgeable, trained and efficient title employees and attorneys. With regard to price competition, the analysis of Drs. Strangle and Strombom confirms that there is active price competition in many states where rates are not promulgated by the state.²¹ Where rates are promulgated by the state, title insurers are forbidden from competing on price, and have fixed premium rates. These policies are mandated by states, not the title industry.

D. Misconception: A state guaranty fund, like the one in Iowa, is a better alternative to title insurance.

Attempts to increase competition, lower rates or boost public revenue by establishing government-run title insurers result in less protection for consumers, higher costs to consumers and add an extraordinary burden on already strained government budgets. Only one state – Iowa – has established a government-run title insurer. No other state has adopted this system and there is a reason: proposals to create such public entities are based on well-intentioned ideas to increase government revenue that fail to factor in the extraordinary cost to establish such a program and a lack of understanding of title insurance.

Less protection for consumers

Iowa eliminated competition by banning private title insurance from being sold within the state. Moreover, Iowa's coverage provides substantially less protection than private title insurance policies which provide marketability protection and defense

²¹ Florida, New Mexico and Texas promulgate rates.

against forgeries, environmental liens, new taxes, encroachment, and damage from the exercise of mineral rights.

Government-run title coverage is rarely used in commercial transactions, which require private title insurance. Most residential lenders require a predictable, reliable title insurance product available in 49 other states.

Higher cost to consumers

Weaker protection forces consumers to find the coverage they need outside Iowa. It is common for out of state title companies to provide additional coverage for Iowa property that is not available within the state's monopoly on title insurance putting additional costs on consumers.

Price comparisons between Iowa's coverage and title insurance in other states often do not account for the cost of an abstract, attorney's opinion, curative and closing services which must first be provided before a very limited \$110 Iowa coverage can be issued.

With respect to Iowa, the 2007 GAO study found, "[I]t is not clear that this system would make the necessary changes to the current model or that it would save consumers money," and went on to state:

"Furthermore, while premium rates for Iowa Title Guaranty might be lower, although not the lowest, than rates in many other states, the total costs that consumers pay for title searches, examinations, and clearing of any title problems might not differ substantially. Iowa's total costs were about the same as those in Maryland, Nebraska, South Dakota, Washington State, and West Virginia, where private title underwriters are free to do business."

Iowa's system requires substantially more time to close a transaction which discourages lenders from participating in the market and forces borrowers to obtain longer rate locks which cost borrowers over \$17.5 million more each year in increased mortgage interest.

Additional burden on government budgets

Any revenue increase to the public would be offset by considerable costs. Governments would be required to invest substantial upfront costs to hire experienced and trained staff to conduct title searches, resolve title issues and underwrite title risks; establish operations and systems; and hold money that could be used for other budget priorities to meet the capital requirements of an extensive regulatory framework which requires substantial capital and reserve holdings, statutory premium reserves and investment restrictions to protect insurer solvency and prevent consumer loss.

Additional costs occur because public labor pools are less able to adjust to the changing demand of the real estate market cycle. Governments would face increased liability for risks associated with title insurance's long loss tail which is covered only by a one-time premium and no additional revenue because there is no policy renewal.

State premium tax revenue collected from title insurers would drop as would income tax receipts paid by employees of the title industry. Local authorities would lose the benefits of the \$225 million per year incurred by title agents to correct errors in the public records system, that would otherwise go uncorrected, as well as their portion of the \$170 million per year the industry spends to purchase copies of public documents.

Additional unintended consequences would destabilize real estate transactions as title insurers and agents fill a key role as an independent third party to participants in real estate transactions.

III. THE USE OF AFFILIATED BUSINESS ARRANGEMENTS AND THEIR EFFECT ON THE MARKETPLACE.

I mentioned at the beginning of my remarks that I am the President of Troon Management Corp., a consulting company dedicated to the creation and management of compliant affiliated title arrangements (ABAs). Builders and realtors, underwriters, banks and attorneys who seek a better understanding of the rules and regulations governing ABAs as well as their practical application engage Troon.

A compliant ABA is simply a full-service title agency. The only difference between a compliant ABA and an independent full service title agency is in the ownership makeup: ABA owners may be able to direct business. ABA owners must 1) disclose to the consumer that the consumer does not have to use the ABA, and is free to shop for services and 2) provide the consumer an estimate of the ABA's fees. The owners of the ABA may receive a portion of the profit based on their ownership interest only – never based on their production of title orders. The owners of the ABA are also required to invest capital based on their ownership interest and in these tough economic times the owners may be required to invest additional capital to keep the operation viable.

In recent years, there has been noteworthy publicity regarding the practices of some individuals in the title insurance industry and in the real estate profession who have allegedly been in violation of RESPA or state law. One arrangement has received particular attention where title insurers had entered into agency arrangements with builders, lenders, and real estate brokers where the affiliated agency did not perform many, or perhaps even any, of the customary functions performed by independent title

agencies, yet received a substantial payouts. These and other types of illegal entities have been referred to as “sham affiliated title insurance agencies.”

A compliant ABA has full time title employees performing all of the same services (Core Title Services) that are performed by non-ABA title agencies. A compliant ABA has brick and mortar, and incurs all of the attended expenses of a non-ABA. ABA partners are required to encourage the consumers to shop while non-ABA customers have no such requirement. In a compliant ABA there is no payment for the referral of business.

One economic benefit of running an ABA title agency is the vast reduction of marketing, advertising and entertainment costs. RESPA encourages an ABA to solicit outside business and compliant ABAs still have a measure of expense for such marketing, but it is likely far less than the expense incurred by non-ABA agencies. What it gives up in marketing expense can drop to the bottom line. ABAs rarely do “big ticket” entertaining and are not as pressured to step outside the rules in order to get business.

Background: affiliated business title agency rules and regulations

Prior to 1983, there was a substantial question as to whether Section 8 of RESPA, which prohibits the giving or receiving of kickbacks or referral fees in connection with a real estate settlement service, applied where a person in a position to refer settlement business had an ownership interest in a company (e.g., a title agency) to which it referred business and from which it received dividends. Congress debated the issue for several years and in 1983, amended Section 8 of RESPA to make clear that persons in a position to refer settlement service business (e.g., builders, attorneys, lenders, and real estate brokers) can establish or own title companies and other

settlement service providers to which they refer business provided that three conditions are met:

- the person making the referral provides an Affiliated Business Disclosure Statement to the consumer explaining the nature of the affiliation between the person making the referral and the affiliated business entity, and an estimate of the charges to be made by that entity;
- the person making the referral has not required the use of that provider; and
- the only thing of value to the person making the referral is a return on the ownership interest in the affiliated business entity.

In 1996, HUD promulgated regulations implementing these statutory provisions which provided further guidance on what parties needed to do to avoid their affiliated business arrangements being considered “sham arrangements” that would not fall within the statutory safe harbor. These regulations, which apply to the establishment of affiliated title insurance agencies, oblige an affiliated provider to be a *bona fide* business entity with sufficient capital and employees to manage its own affairs and provide substantial services.

Thus, a clear and lawful regulatory path exists for builders, attorneys, lenders, or real estate professionals to establish affiliated business title insurance agencies. In fact, the overwhelming number of affiliated business title agencies that exist today were created and are operated in compliance with these RESPA rules. All of the major trade associations whose members are involved in such arrangements, including ALTA, provide guidance including educational seminars and other material for their members on the do’s and don’ts of establishing such lawful arrangements.

There there is no need for the establishment of “sham” agencies when a lawful and appropriate vehicle exists for builders, attorneys, lenders, and real estate

professionals to offer title insurance through a legitimate affiliated business title agency. Whether the impetus for the establishment of such “sham” arrangements comes from the party controlling the business or from the title insurance company who is seeking the additional business is irrelevant. In either event, ALTA opposes such arrangements and believes that the enforcement activity by HUD and state insurance departments directed against such arrangements has had a significant impact in cautioning all of the affected industry participants against the risks of such arrangements.

As these and other practices have been the subject of increased federal and state regulatory attention and civil actions demonstrates that, in great measure, regulatory regimes are in place today that are able to address and correct these problems. In fact, HUD has taken more enforcement actions in the past 3 years than in any other period since RESPA was enacted in 1974. Moreover, enforcement actions by various state insurance departments further demonstrate that state regulators focus on these competitive issues and are capable of taking meaningful action.

However, there is more that can be done to minimize these problems in the future, and it is important for the Commissioner to appreciate that ALTA and its members strongly support the principles of RESPA and its objective to ensure that illegal referral fees and other kickback practices do not skew competition. The reason for that support is clear: such payments and practices cause ALTA members that are complying with RESPA to lose business. Thus, the more we can encourage all companies to comply with the letter and the spirit of the law, the better off our members – and their consumer customers – will be.

Our industry therefore has a strong interest in working with the NAIC, state insurance departments, and federal authorities to maximize the clarity of the rules that guide competition in our industry, and to ensure that these rules are enforced fully and fairly. Indeed, many of the enforcement actions that have been taken by those authorities have been the result of information provided by members of the industry who are concerned about the competitive advantage their competitors may be gaining through a bending, or breaking, of the rules.

IV. REVERSE COMPETITION

Despite the industry's best efforts, much of the public does not understand title insurance. Because title insurance is generally purchased only in connection with a real estate transaction – either a sale transaction or a mortgage refinance transaction – and is paid in a one-time premium, rather than through reoccurring premiums, most consumers do not have the familiarity with title insurance or title insurance providers that they have with other forms of insurance which they purchase on a recurring basis.

Fortunately, consumers today are generally more knowledgeable about real estate and mortgage transactions – and title insurance – than they have been in the past. This is in part because of educational efforts of underwriters, agents, land title associations and ALTA, as well as the fact that consumers buy, sell and refinance their homes far more often than they have in past decades. ALTA created a consumer website, www.homeclosing101.org where title insurance and the home buying process is explained. The fact remains, however, that most consumers still look for advice on the selection of a title company from their real estate agent, attorney or mortgage lender and that is not likely to change in the foreseeable future. Reliance by consumers on the

recommendations of real estate professionals is natural because these professionals are involved in real estate transactions on a day-in, day-out basis, and are in a far better position than the consumer to assess which title companies provide the best combination of service, quality, underwriting, and price. For that reason, it is inevitable that title companies will seek to compete actively for the referrals of those real estate professionals.

V. THE HUMAN SIDE

One very important aspect of the title insurance industry that cannot be overlooked is the humanness of our role. We are the people who sit at the closing table with the first time home-buyers knowing their fear. We know that they are afraid to ask questions because they do not want to appear ignorant but the title people know those questions and answer them without being asked.

We are the people who see the pure relief on the single parent's face when we tell them that we are going to collect all of the past due child support for them.

We are the people that sit at the table with the recently widowed seller and can see the look in her eyes as she signs the deed. We know that she is thinking of the living room she is leaving behind, that same living room where she received guests after her husband's funeral. She pictures standing at the kitchen window remembering her children playing in the back yard when they were young. We are the people who take her hand and hold it just a little bit longer as she leaves the closing.

We are a proud industry – and rightfully so.

VI. CONCLUSION

ALTA appreciates this opportunity to discuss the title industry and the important role it plays in assuring individuals' property rights. This overview of the industry is enhanced by the attachments to this testimony which provide more detailed information about the title insurance industry. An abstract of the information can be found on the following page. ALTA looks forward to continuing to serve as a resource to the Pennsylvania Insurance Department. I am happy to answer any questions.

Respectfully submitted:

Anne L. Anastasi, CLTP
May 28, 2009