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By TERRI CULLEN

Title Insurance Protects Lenders So Why Shouldn't They Pay for It? *February 10, 2005*

Hey lawmakers? If you're really serious about lowering costs for homeowners on closing day, here's a suggestion: Make lenders pay for title insurance.

Though many consumers don't quite understand what title insurance covers, lenders require them to buy it, whatever the cost. The insurance typically is one of the biggest costs at closing, ranging anywhere from a few hundred dollars to \$1,200 on a \$150,000 mortgage, depending on the state you live in.

But while consumers have to get the insurance, they have virtually no bargaining power over its price. Meanwhile, it's the lenders who benefit. These days, lenders sell loans to mortgage investors in a secondary market, and the lenders need the insurance to make those sales.

"Insurers are not competing for the borrower, they're competing for the lender, homebuilder or realtor who is overseeing the sale, so there's no pressure on prices," says Jack Guttentag, professor of finance emeritus at the University of Pennsylvania's Wharton School. "A situation like that is ripe for abuse and almost never to the benefit of the consumer."

What got me thinking about title insurance was news last month that the state of Colorado is poised to impose sanctions against nine title insurance companies. The firms were accused of giving "kickbacks" to large homebuilders in the state in return for the homebuilders' steering business their way, according to Erin Toll, deputy commissioner of compliance with the Colorado Division of Insurance in Denver. Lorri Lee Ragan, spokeswoman for the American Land Title Association, an industry trade group in Washington, D.C., declined to comment.

It wasn't the charge of backdoor dealing that surprised me, it was the size of the alleged kickbacks: 50% of the premium in return for a guarantee that homebuilders would refer a certain amount of business their way. The investigation is one of nearly a dozen state inquiries into questionable practices by title insurers launched over the last five years.

If some title insurers are able to give up half of their premiums in return for future business, how overpriced are these policies?

The housing boom and subsequent wave of refinancing has sent title insurance soaring to a record rate of \$15.6 billion for premiums and related services in 2004, up from \$11 billion a year earlier, according to the credit-rating firm Fitch Inc. The bulk of those premiums come from residential transactions.

Here's how it works:

Title insurance policies guarantee lenders that if the title search fails to turn up outstanding liens or claims on the property before the transfer to a new owner, the insurer will make good on the loan. For example, the insurer's search through land-title records may fail to uncover that a previous owner owed back taxes, or borrowed against the property by forging the name of a spouse.

Consumers pay approximately \$3.50 per \$1,000 of the mortgage amount for a lender's policy, or roughly \$700 for a \$200,000 mortgage and \$1,400 for a \$400,000 mortgage. You may pay more or less depending on your state, says Ms. Ragan of the title insurers association.

There are two flavors of title insurance – lenders' policies, which protect the lender, and owners' policies, which protect the homeowner. If you purchased lender title insurance, and not owner's insurance, the equity you have built up in your home may be at risk in the event the title company missed a prior claim on the property. It's mandatory to buy lender policies; owner policies generally are optional, though they're more common in some states than others.

"If the homeowner has an owner's policy they would be covered, but if they don't have owner's insurance they would have to hire their own real estate attorney [and pay to] resolve the problem themselves," Ms. Ragan says.

Depending on your state law, the buyer or the seller may be responsible for paying title insurance costs on closing day. Consumers have the option of finding their own title insurer, but in practice they rarely do. Usually, the first and last contact with the insurer is if there's something wrong. (Quick, can you name your title insurance provider? I know I can't.)

The upshot: Title insurance for lenders costs a lot of money but provides consumers little direct benefit. This is why I say it's time for lawmakers to shift the burden of paying for title insurance to its main beneficiary: the lenders.

The argument for consumers' footing the bill for title insurance once did make sense. Decades ago, primary mortgage lenders shouldered most of the risk of making loans; if the borrower ended up defaulting on a loan because a previously unknown prior claim existed, the lender was out of luck. Title insurance took

away some of that risk for lenders, making it more likely that a greater number of consumers would be able to obtain loans.

But the early 1970s saw the Government National Mortgage Association, or Ginnie Mae, introduce the so-called secondary mortgage markets, which allow mortgage lenders to bundle individual mortgages into investments called mortgage-backed securities, and then sell them to investors. Today, most individual mortgages are quickly sold in this fashion on the secondary markets, so the borrower default risk to the original lender is virtually eliminated.

Still, lenders need title insurance to sell loans in the secondary market. "Mortgage companies must make representations and warranties to the secondary market, and one of those representations and warranties is that there is a title insurance policy on the property," says Tim Doyle, a director in the government affairs department of the Mortgage Bankers Association in Washington D.C.

It's precisely because the title insurance is for the secondary markets that it shouldn't be the homeowner's responsibility to provide it, says Jim Carney, legislative counsel to the Iowa Bar Association in Des Moines, Iowa.

Premiums "ought to be considered a cost of business that the lender assumes and pays for," he says.

And lenders would probably get a better deal than consumers do. While consumers lack leverage, you can be sure the lending industry wouldn't stand for being overcharged for these policies, and premiums would become more fairly priced.

The Colorado investigation – and numerous other state lawsuits and legal settlements in the industry over the past decade – suggest there's fat to be cut.

"We're looking at whether the price that they're charging for the insurance is commensurate with the level of risk that the insurer is taking," says Erin Toll, deputy commissioner of compliance with the Colorado Division of Insurance in Denver, "We think it's not, that it grossly exceeds the risk."

The industry pays out far fewer claims than most other types of insurance. Title insurers average five cents in claims for every \$1 they collect in premiums, according to credit-rating firm Fitch. Compare that with property and casualty insurers, which pay out roughly 87 cents for every \$1 they collect.

The title insurers say they can't be compared with other types of insurers because the risks – of fraud, among other things – aren't as calculable as, say, individuals' longevity. Plus, they cite the high costs of digging through public records for each sale.

And yes, you could argue that were lenders forced to pay for title insurance, they might simply turn around and pass the cost back onto consumers in the form of higher origination costs or interest rates.

But Wharton's Mr. Guttentag doesn't believe that would happen. Premiums are artificially high, he says, because the industry is so inefficient.

"Because insurers must compete for lenders, realtors and the like to get business referrals, there are heavy marketing expenses to pay and unfortunately the kind of side deals that you see in cases like we're seeing in Colorado," he says. "Remove the back-door element, sell directly to the lender, and there would be legitimate price competition and the price would go down."

Ms. Ragan of the title insurers association says the nature of title insurance makes it unlikely that costs could be significantly reduced, regardless of who pays the premiums. "Loss prevention, and clearing the problem before the house goes to settlement, that's where the money goes," she says "This is the way it's always been done and I don't see things changing anytime soon."

The Department of Housing and Urban Development currently is taking another stab at reforming the federal Real Estate Settlement Procedures Act, which is designed to protect consumers from excessive charges at closings. As I wrote in this [column](#)⁴ last year, the Bush administration, under pressure from title insurers, mortgage brokers and others who collect those fees, [backed down](#)⁵ from proposed changes to Respa that would give lenders an incentive to guarantee total closing costs in advance. The changes would have made it easier for homebuyers to shop around for the best deals on interest rates, appraisal costs and title insurance.

A new set of Respa proposals is expected sometime this year, but given last year's punt, the outlook for real reform is dubious. Still, now that the election has come and gone, here's hoping the administration will champion the effort to lower closing costs for homebuyers -- with title insurance at the top of the list.



¹ SAVE ON TITLE INSURANCE

As [this article](#)² explains, lenders generally won't issue a mortgage without a guarantee the property doesn't have any other hidden owners or liens. So across the nation, title insurers sift through records, charging borrowers anywhere from a few hundred dollars to several thousand. But there are ways to cut the cost of title insurance, if you know what questions to ask. [Click here](#)³ for more by Terri Cullen.