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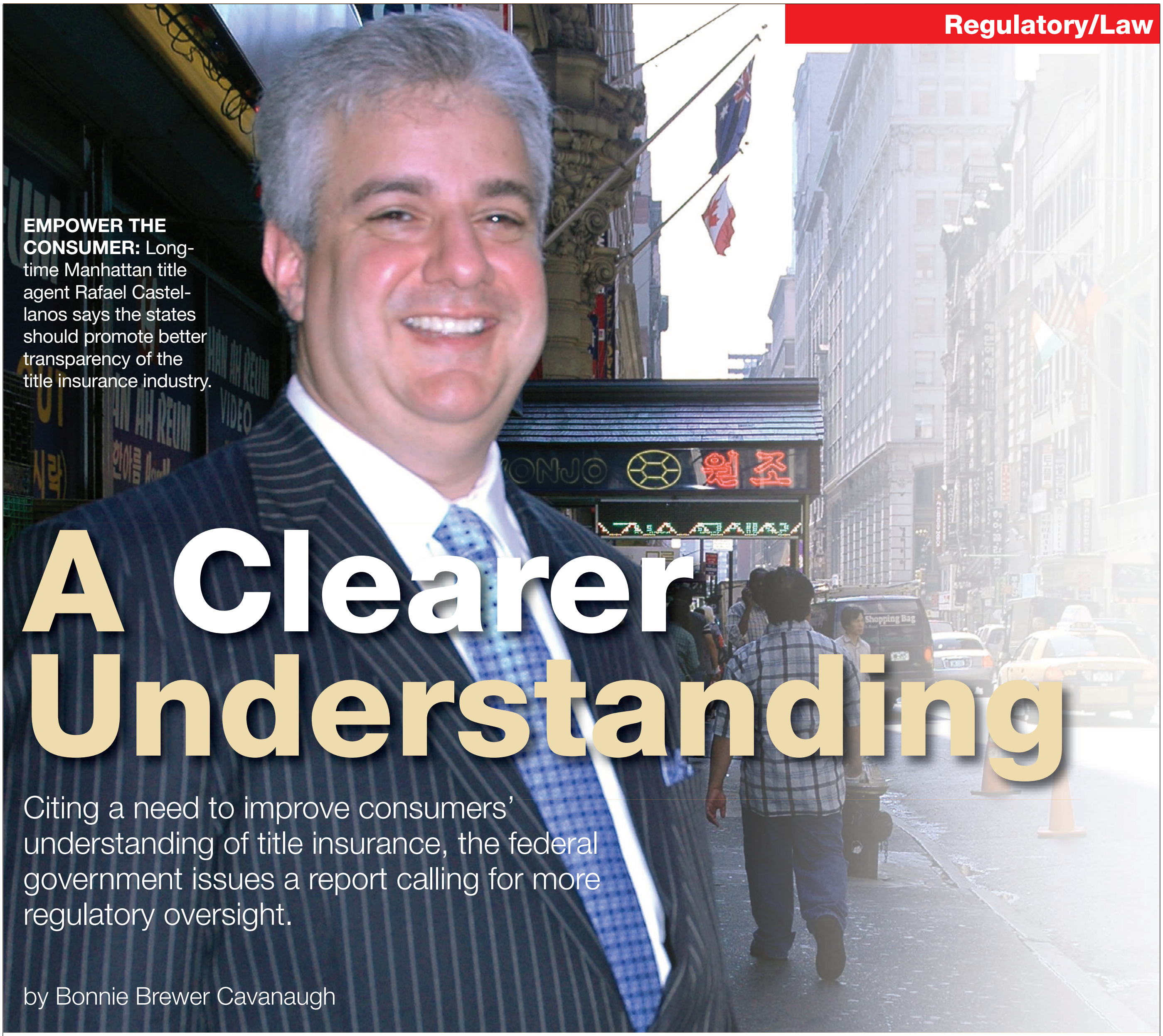
September 2007

BEST'S REVIEW

Monthly Insurance News Magazine

Insurers • Agents & Brokers • Reinsurers



EMPOWER THE CONSUMER: Longtime Manhattan title agent Rafael Castellanos says the states should promote better transparency of the title insurance industry.

A Clearer Understanding

Citing a need to improve consumers' understanding of title insurance, the federal government issues a report calling for more regulatory oversight.

by Bonnie Brewer Cavanaugh

Arielle Baio for *Best's Review*

Rafael Castellanos never thought his career could be dangerous. A managing partner of Expert Title Insurance Agency in Manhattan, he's been in the title business for 21 years. But a simple client misunderstanding made him reconsider the inherent risks of his profession.

Key Points

- A GAO report advises increased federal and state oversight of the title insurance market.
- Consumers, the study found, need to be better informed about the title process.
- Title agents agree with most of the report's findings but are wary of further government intervention.

Title Insurance: It's Different

Title insurance stands out from other insurance segments in five distinct ways:

1. The actual amount of work performed by title agents related to title searches, examinations and issuance of the policy is significantly higher than that of agents in P/C and other insurance lines.
2. The title agent's role and responsibilities are more labor-intensive than other lines; the agent isn't just selling insurance, but doing extensive research as well.
3. Title insurance premiums are nonrecurring: no annual premiums, no rate hikes, no renewals, and the policy lasts as long as the house in question remains in the family.
4. Title insurance has a reverse coverage period from other types of insurance because it covers backward-looking events, not forward.
5. The business cycle of title insurance is tied into the health of the real estate market and interest rates, unlike other insurance types.

Source: The American Land Title Association

"I'm a peaceful type of person," Castellanos said. "I thought the worst thing that could happen to me in this industry is I'd get a paper cut."

But a former client, a seller on a real estate transaction, had numerous judgments against him that needed to be dealt with before closing could take place. Yet the client refused. Castellanos explained his options: either adjourn the closing, or hold some amount of money in escrow and let the seller take action on his own.

"Meanwhile, he wanted his money back," Castellanos said. "He didn't want to understand that he was the one responsible for conveying clear title."

As time wore on, the client's misunderstanding turned to anger, then rage and finally a death threat. "He says, 'Give me my money back or I'll throw you out the window.'" Fortunately, the seller left the confrontational message on Castellanos' answering machine, and soon was arrested.

Threats aside, the client's misunderstanding of the title insurance process is indicative of a deeper misunderstanding by the consumer-at-large, and something the title market has been instructed by the federal government to make right.

> **"Every state is different. You can't paint a federal regulation over the real estate practices of different states."**
>
> **—Rafael Castellanos**
> **Expert Title Insurance Agency**

The U.S. Government Accountability Office this past April released a report calling for federal and state oversight of the title industry and increased consumer education of the title process. The report found that consumers have no real understanding of the market, which in turn puts little pressure on title insurers to price competitively.

The report also found the title industry markets primarily to those who would likely refer title-related business—lenders, real estate professionals and home builders—rather than directly to consumers. The report was based on a year-long review of

Good for Business

There's too much mystery surrounding title insurance, said National Homestead Inc. attorney Howard Gold. So he thinks title insurers should take a page from the pharmaceutical industry's playbook, and market directly to the consumer. "The industry is ripe for it," Gold said. "You see drug companies obviously marketing to doctors, but now you see them marketing to the consumer, too. They trust the consumer with the medical information." He added, "I've been screaming about this for years."

Meanwhile, the American Land Title Association's James R. Maher said some consumers are so poorly versed in title insurance that they don't know to ask if reissue and refinance rates are available to them. Pricing, Maher said, is another area where potential consumer misunderstandings can occur. That's because in some markets, title premiums include search and examination fees, while in other places, the premium is less and doesn't include the search and exam; they are charged separately, Maher said. "So when people ask, 'How come rates in state X are so low?', the two don't cover the same subject area. One is a risk-only jurisdiction and another is an all-inclusive jurisdiction."

And to Manhattan-based title insurer Rafael Castellanos, lack of consumer knowledge about title insurance is "a huge thing." At closings, he said, attorneys often don't take the time to explain the role of title insurance in the real estate purchase process. Then the consumer is hit with a fee of hundreds of dollars in title insurance and resents it.

Maher said consumers have become much more sophisticated in recent years and need more information. "Twenty years ago, people didn't talk at cocktail parties about what their mortgage cost; rather they just got it. It's become part of cocktail chatter," he said. With that in mind, ALTA is launching its own consumer Web site. "We have a lot of consumer information on our basic Web site, but a lot of our users are our members," Maher said. "A number of our state affiliates are doing much the same thing—putting up a Web site to help consumers."

In any event, "Consumers should care a little bit more" about title insurance, Gold said. "Title insurance is possibly the only industry wherein a company does not market to the person who's paying the bill. There's no connection between the insurer and the borrower. It's a step removed."

Very Little in Common

Key elements of title insurance distinguish it from personal-lines classes of property/casualty insurance.

Features	Title Insurance	P/C Insurance
Protects Against	Past Events	Future Events
Scope of Coverage	Specific	Broad
Actuarially Defined Rates	Evolving	Yes
Administrative/ Acquisition Costs	High	Low
Loss Costs	Low	High
Policy Term	Potentially Unlimited	Finite
Premium (GAAP)	Fully Earned at Issuance	Earned Over Policy Term
Rate Regulation	Varies	High
Rate Activity	Varies	Tied to Inflation and Underwriting Business Cycles
Loss Frequency	Low to Moderate	High
Loss Severity	Low	Moderate
Distribution	Agents/Direct	Agents/Direct/Mass Market
Marketing Success	Based on Service	Based on Rates
Competition	Semi-Concentrated Market	Fragmented Market

Source: A.M. Best Special Report, *Strong Housing Market Drives Title Insurance Growth in 2005*

title practices in California, Colorado, Illinois, Iowa, New York and Texas.

The GAO report found 92% of the nation's title insurance market is controlled by just five insurers: Fidelity National Title Insurance Co.; The First American Corp.; Land America Financial Group Inc.; Stewart Title Insurance Co.; and Old Republic National Title Insurance Co.

It also found inconsistencies among the state markets studied, such as the use of local versus regional title agents; affiliated versus independent agents; title search and examination procedures; the scope of activities performed by agents; and premium costs due to cost/market variations.

"In New York state, for example, title insurance is not mandatory, not when you purchase a home," Castellanos said. "However, most attorneys will not represent you unless you have title insurance."

Further, the GAO report recommended that the U.S. Department of Housing and Urban Development strengthen its protection of consumers and improve their ability to comparison-shop; further evaluate affiliated business arrangements, or ABAs; and strengthen its relationships with state regulators.

"Given consumers' weak position in the title insurance market, regulatory efforts to ensure reasonable prices and deter illegal marketing activities are critical," the GAO report stated. "State regulators have not collected the data needed on title agents' costs and operations needed to analyze premium prices and underlying costs," it said.

In addition, the report said, HUD and state insurance regulators have faced obstacles in trying to identify improper marketing and sales activi-

Clearing Up the Past

Title insurance is different from all other insurance sectors. It's backward-looking; rather than projecting future risks, title insurers look into the past to ensure there are no liens or judgments against the title. They also do the bulk of their work before a claim is made.

Title insurance is more like a warranty, said James R. Maher, executive vice president of the American Land Title Association. ALTA has some 2,500 agency members nationwide.


James R. Maher

"In theory, we should have zero claims," Maher said. Yet on the regulatory front, "we have had a perennial problem in trying to demonstrate our societal value. Everyone focuses on the insurance component, more so than the things that lead up to it."

Title insurance is probably the least-automated sector of the industry, and consumers often don't realize the lengthy title research that must be done—all without a computer.

"There are 3,600 reporting jurisdictions in this country—townships, counties, cities and so on—and only a handful are automated," Maher said. Many jurisdictions have online files dating from the later years of the 20th century, but they're of limited help since in many cases title agents need to go back much earlier, he said.

The title search starts with a trip to the hall of records. Depending on the jurisdiction, these records could be spread out among various municipal authorities and buildings, including the county courthouse, the county clerk's office, the surrogate court, or various state and local offices. The title agent also examines the property itself and identifies current and former owners, and scours public records for judgment liens and unpaid real estate taxes.

"This search extends back 40 to 50 years or more," said Rafael Castellanos, a managing partner of Expert Title Insurance Agency in Manhattan. Then the title agent, in cooperation with attorneys and the lender, clears any defects found in the title before settling. Only then is the title transferred. "That's a huge amount of work," he said.

"The value we have is in the proceeds," Maher said. "That's the thing [we] can never get people to focus on. The GAO recognizes that in the report."

ties under RESPA, the Real Estate Settlement Procedures Act of 1974, such as "the increasing number of ABAs."

That's where Castellanos has concerns. At a real estate closing in New York state, the buyer, seller and bank each has its own attorney, as does the title insurance company. "Everyone has their own interest and they need to be protected in that respect," he said. "Then you have these ABAs, where it's one-stop shopping."

The ABA Dilemma

An ABA will provide its own attorney; a title insurance company affiliated with the real estate broker; and a mortgage broker that's affiliated with the real estate broker, Castellanos said. "In a way, it's nice for the consumer—they don't have to do anything—but there is an obvious conflict of interest there. There's money going back and forth."

The presence of ABAs "immensely" cuts down on independent competition, "and not in a good way—a bad way, because there are clear conflicts," he said.

The GAO report also recommended that state regulators work harder to prevent illegal marketing practices by tightening the regulation and oversight of title agents; increasing the transparency of title premiums to consumers; and working to increase cooperation with real estate entities and other regulators.

It also advised Congress to amend RESPA, adding greater enforcement authority to HUD through the authorized use of civil monetary penalties for violations.

Castellanos called the GAO report "a great step in the right direction."

"I've got to commend these folks for at least trying to get behind some of the inconsistencies the consumer is seeing," he said. "There are injustices at times that are dealt to the consumer. But we need to go a little bit further. In a way, you really have to go on a state-by-state basis. Every state is different. You can't paint a federal regulation over the real estate practices of different states."

Title insurance is "the single largest closing cost" in a real estate transaction, but also "the one where the consumer has the least information," said Howard Gold, an attorney with title insurer National Homestead Inc. of Wellesley Hills, Mass.

"Five percent of every premium dollar goes to pay losses, while 70% of the premium dollar goes to the agent as commission," he said. He termed it a "value-neutral" issue.

"Title insurance, as a general rule, rises and falls with the fortunes of the housing industry," Gold said. "If you see a higher interest rate, eventually you're going to see fewer refinances, and as most of the country is in a housing slump, you're obviously going to see fewer purchases in the area of title income."

Changing Times

James R. Maher, executive vice president of the American Land Title Association, said that comparing title insurance to the property/casualty market is a lot like comparing golf scores to basketball scores.

"The fewer points you score, so to speak, the better," Maher said. "Really, we're trying to eliminate as many of the risks as we can up front. Believe me, if we had an 85% claims rate, you'd be searching for a different kind of title insurer. The real thrust of that report by the GAO is that the consumer is being left out of the process," he said.

But he sees a "mismatch" in the GAO's plan to use civil monetary penalties to augment regulatory enforcement.

"We're not saying it's wrong. We're saying it's not completely effective," Maher said. "Civil money penalties may act as a deterrent to the big guys. They may step one step further from the line, if you will. But it's not going to affect the local actors. They know Washington is not going to come down and squash them. They're just too small-fry."

Besides, civil penalties go straight into the general revenue fund of the U.S. Treasury and would not be available to boost investigatory resources. "They don't come back to HUD in terms of hiring 30 or 40 more investigators," said Maher, who worked at HUD for 10 years.

He'd rather see a local real estate broker, title agent or mortgage lender, who was injured because of the conduct of competitors, bring legal action for injunctive relief, which is "a superior deterrent and resource for results or answers," Maher said.

Gold said "the title insurance industry is ripe for change," either by government regulation or by innovators in the industry, "but the status quo is unacceptable because title insurance is an absolute necessity."

Yet if tighter enforcement and oversight lead to the need to collect data on title agents, ALTA wants to make sure the government uses a light touch.

"GAO is right—in order to enforce regulation you need to have more information. But make sure the information is what you need, and make sure it's not a fishing expedition," Maher said.

"More information needs to be gathered before we run off and regulate in some manner that might be an inappropriate."

"Oversight of title insurance is probably a good thing," Castellanos said. "There are those unscrupulous title insurance agents out there, the less-than-one-percent (who) should be taken out immediately. The only way to do that is to monitor them constantly." BR