

The Title Insurance Toll

By Scott Wilson

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You buy car insurance in case of an accident. Health insurance covers you if you get sick. Homeowners insurance helps you rebuild after a fire. But what do you get when you buy title insurance?

Americans spend more than \$16 billion annually for title insurance when buying, selling or refinancing their homes. But few people question the expense; even though they're probably paying too much, say consumer advocates and government regulators. What's more, title insurers have been fined repeatedly for illegally giving concert tickets, trips and even cash kickbacks to real estate agencies, lenders and builders. Consumers typically go with a recommendation from one of those sources, experts say, and may not even realize that they have a choice. **"Consumers of title insurance often tend not to get the best deal because they're not the ones who end up selecting which title insurance policy they will end up buying,"** California Insurance Commissioner Steve Poizner said in an interview. "Unfortunately, what's happened in this industry is there's been a lot of illegal kickbacks and incentives that have been paid by the title industry to others to steer business in a particular direction," Poizner said.

Title insurance is part of virtually every real estate transaction. It covers claims and legal fees for home buyers and lenders if problems arise – even years later – over ownership of a property's title. Defects in title include errors or omissions in deeds, mistakes in examining records, forgery, liens for unpaid taxes or contractor's bills, conflicting wills related to the home and missing heirs who suddenly appear and claim to own the property. Typically there are two title policies for each property: one to protect the home buyer; the other to protect the mortgage lender.

In California, coverage that protects the buyer would probably cost about \$1,200 to nearly \$2,000 for a \$500,000 home. In Southern California, the policy is customarily paid for by the seller, but practices vary by region. In the San Francisco Bay Area, for example, the buyer usually pays. In

Los Angeles Times

most places, the buyer must pay for the policy that protects the lender. For a house with a \$400,000 mortgage, the policy would usually cost \$500 to \$600.

Such policies can offer peace of mind even though there's little chance a homeowner will ever encounter a title-related problem. While auto and homeowner insurers return about 70% of their premiums to customers in claims, title insurers pay out just 5%. Title insurers say that's not a fair comparison, since a portion of the premium is devoted to preventing problems. First American Corp., the Santa Ana-based company that is the nation's leading title insurer, says that for 30% of applications it does "curative" work, including fixing errors, before issuing a policy.

Such insurers market their product not to the consumers who pay for it, but to real estate agents, lenders and builders because they have the most influence over what title company is used. These marketing efforts sometimes take the form of cash rewards and gifts, although federal and state laws forbid giving anything of value in exchange for referrals in a real estate transaction.

A 2007 report by the U.S. Government Accountability Office found 58 federal and state investigations into illegal payments by the title industry, resulting in more than \$100 million in fines and penalties during the previous four years. In the last three years, California's four largest title insurers have been ordered to pay about \$49 million in penalties and refunds to consumers for illegally giving cash and gifts to reward real estate agencies, lenders and builders who brought in title customers, according to Department of Insurance records. In 2005, state investigators found that First American had given tickets to sporting events, the Teen Choice Awards and concerts featuring Gwen Stefani, U2, Elton John, Velvet Revolver, the Eagles and Paul McCartney. The company spent thousands of dollars more on food and beverages for real estate agents' events and paid for chartered fishing trips, riverboat dinner cruises and trips to the Del Mar racetrack.

First American and its chief competitors – Fidelity National Financial Inc., LandAmerica Financial Group Inc. and Stewart Title Guaranty Co. – have also been sanctioned for funneling millions of dollars to realty agencies, builders and lenders through sham "reinsurance" arrangements. The real estate intermediaries were purportedly being paid to share the title

Los Angeles Times

insurance risk, but state investigators found they never had to pay out a single penny in claims. In agreeing to pay fines and give refunds to consumers, the four title insurers neither admitted nor denied wrongdoing. Industry leaders say they do not condone unlawful practices. "They are the exception in the title business, but when they do occur they should be addressed by regulators," said Kurt Pfothauer, chief executive of the American Land Title Assn. Industry representatives say that real estate agents, loan officers and builders work with title insurance companies every day and are best able to recommend the most reliable and service-oriented firms.

Still, at least half of what Americans pay for title insurance can be attributed to illegal referral payments, said J. Robert Hunter, insurance director for the Consumer Federation of America. "Title insurance is vastly overpriced," Hunter said. "It should be a few hundred dollars." As evidence, Hunter and other consumer advocates point to Iowa, the only state with a government-run title insurance program. There, coverage for a \$500,000 home costs just \$110, with lawyer fees and other costs bringing the total to about \$500. That price includes the owner and lender policies. "The Iowa people have effectively a more efficient system," said Peter Rousmaniere, a Vermont-based insurance consultant. The title insurance industry argues that it takes longer to close a home deal under Iowa's system, causing lenders to charge consumers a slightly higher interest rate.

Cliff Morgan, vice president of underwriting at First American, bristles at suggestions that title insurance is overpriced. "Title insurance is a bargain for the work involved and the risk involved," Morgan said. "The groups that are making these statements are doing so out of ignorance of the process." Morgan said title companies put a lot of time and effort into building and maintaining databases of public records that are used to conduct a title search. Even though automation has helped speed up title searches, he said, workers still have to look over documents turned up in a title search and decide what actions to take. "It's not just pushing a button and whoa, you have a completed search," Morgan said. "There's a lot of human intervention."

Title companies, like real estate brokers and appraisers, prospered during the housing boom. The industry posted \$16.6 billion in revenue nationwide in 2006, up from \$5.1 billion in 1996. Now title

Los Angeles Times

insurers are seeing revenues decline with falling housing sales and their costs rise as increases in foreclosures and defaults lead to more title claims and disputes. First American said last month that it expected to post a loss of as much as \$50 million for the fourth quarter of 2007, compared with net income of \$104 million for the same period in 2006. The company reported net income of \$46.6 million for third quarter ended Sept. 30.

From time to time, title insurers have come under fire for not providing coverage in those rare occasions when people need to file claims. Bob Ford, a Villa Park-based real estate investor, said in 40 years of buying and selling real estate he has made three title insurance claims – and each time he had to sue the title company to get it to pay. “They are very reluctant to pay claims,” Ford said. “I succeeded in each case, but I didn’t get my attorney’s fees back, so I probably lost money.” Morgan said such situations are infrequent. “I’m not saying that disagreements don’t arise over whether a loss is covered, but by and large that’s a very, very rare instance,” he said.

Consumers who do try to shop for title insurance will find their choices considerably limited. Because of consolidation, First American, Fidelity National, LandAmerica and Stewart Title now control 92% of the California title insurance market, up from 72% for the top four companies in 1998. Poizner said he is trying to remove red tape to allow new title insurance companies to move into the market and create competition. Critics say the only thing title insurers compete for now is the intermediaries – real estate agents and others – who bring them paying customers. The consumer ends up paying for this added expense, said Hunter, Rousmaniere and others.

“Competition by sellers of title insurance does not benefit consumers the way it is supposed to,” said Jack Guttentag, professor emeritus of finance at the University of Pennsylvania’s Wharton School. *“When title companies compete, you lose.”*