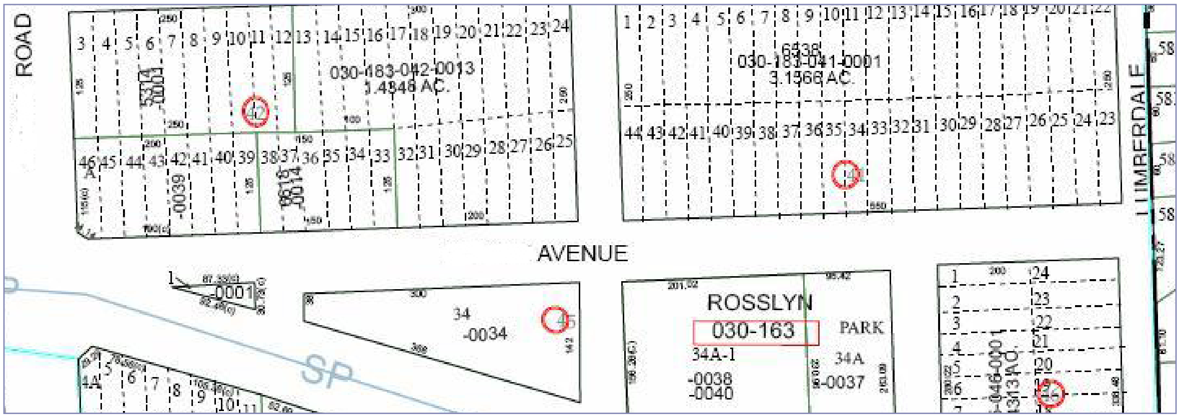

Guarantee of Clear Title:
A Revenue Opportunity for New York State

A Discussion Paper Prepared by the Partnership for New York City

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Partnership for New York City

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With a mission to maintain the city's position as a global center of commerce, culture and innovation, the Partnership for New York City is an organization of the leaders of New York City's top corporate, investment, and entrepreneurial firms. They work in partnership with city and state government officials, labor groups, and the nonprofit sector to promote the interest of the city and its neighborhoods. The Partnership carries out research, policy formulation, and issue advocacy at the city, state, and federal levels, leveraging the resources and expertise of its CEO and Corporate partners. Through its affiliate, the New York City Investment Fund, the Partnership directly invests in economic development projects in all five boroughs of the city.

One Battery Park Plaza, 5th Floor
New York, NY 10004-1479
telephone: 212.493.7400
fax: 212.344.3344
www.pfnyc.org

In the face of the worst fiscal crisis in its history, New York State is seeking creative ways to leverage its assets and increase its revenues — preferably, without raising taxes. In response, the Partnership for New York City has solicited ideas from its members for how to maximize state assets. Over the past few months, the Partnership has received some "out of the box" suggestions that deserve exploration.

One proposal that could generate as much as $1 billion a year in new revenues involves expanding the state's role in the real estate title insurance industry. Historically, the title insurance industry has been criticized as monopolistic, inefficient, overpriced and lacking in transparency.[1] The state of Iowa has self-insured title representations for many years. Other states are considering doing the same. After examining the industry business model, it is clear that — at a minimum — New York State and its localities could charge more than the nominal fees currently imposed on this state-regulated industry. Another possibility would be to dramatically reduce the cost of title insurance to consumers, especially those involved in the state's affordable housing and economic development initiatives.

The most interesting possibility, however, is for the state to take over providing guarantee of clear title and generate revenues to maintain jobs and help close the structural budget gap. In 2007, the national title insurance industry generated $1.2 billion in revenue from the policies it wrote on New York State transactions. In that same year, the industry assumed responsibility for just $48.7 million in paid losses in New York, equivalent to 4% of the revenue produced. The standard ratio of claims payments to revenues in the insurance industry typically exceeds 70%. Regulated by the State Department of Insurance, the industry has been found to have suspect practices. Despite a low level of claims, title insurance rates in New York are among the highest in the nation.

Title insurance is a business that largely depends on the accuracy and completeness of public records and the performance of the public employees who keep them. As the state embarks on downsizing its public sector workforce to reduce expenditures, this appears to be an area where state and local government could fairly expect increased payment for their work. The Partnership proposes that New York should take a close look at this publicly regulated industry as an example of where historic and customary practice may be at odds with the immediate interests of the state. This policy paper is intended to begin that discussion.

The Title Insurance Process — Generally[2]

The purpose of title insurance is to ensure that a buyer has clear ownership of a property so that a lender can make a mortgage loan to the buyer for the sale or refinance of a home or business. Lenders also use the certifications and standards employed by the title insurance industry to strengthen the quality of securities offered on the secondary market.

Title agents and insurers primarily sell title insurance. Prior to policy issuance, title agents must check the history of a title through public records, such as deeds, mortgages, wills, divorce decrees, court judgments and tax records. If any defects appear on the title, the agent works to resolve them prior to closing. The policy insures against any claims that might exist, but are not known, at the

1 Eaton, Joseph, W., and Eaton, David, *The American Title Insurance Industry,* New York University Press, 2007.

2 This general summary of the title process is taken largely from the United States General Accounting Office, *Title Insurance: Actions Needed to Improve Oversight of the Title Industry and Better Protect Consumers*, GAO Report 07-401, April 2007.

time of purchase. Title insurance generally does not cover title defects if they arise after the date of sale.

Title searches are generally conducted by local title agents or their employees. The variety of documents that must be reviewed has given rise to the development of privately owned indexes. Part of the industry involves insurers, title agents and others building these databases and then selling access to others in the business as a way to streamline searches. In Iowa, where the title business is run by state government, data search software programs are in the public domain.

In New York State these searches can take between 90 and 120 days for a purchase and 30 to 45 days for a refinancing.[3] While there are no published industry standards regarding turnaround time, New York State's practice appears to reflect industry experience.[4] Iowa state law requires that a certification be granted within 30 days of receipt of payment to the state.

Title insurance premiums are paid once, at the time of sale or refinancing, to the title agent. These premiums are split between the agents and the insurers. Agents have a fiduciary duty to account for premiums paid to them and insurers have the right to audit the agents' books and records. The price that a consumer pays for title insurance is determined by the underwriter applying a rate to the loan value for a "lender's policy", (issued to mortgage lenders) or to the purchase price for an "owner's policy" (issued directly to the property purchaser).

There are several differences between title insurance and other forms of insurance. First, most premiums paid on property insurance are used to reimburse claims. This is not the case for title insurance. Nationally, only 5 percent of total premiums paid are used to cover losses while over 70 percent is paid to, or retained by, agents.[5] Second, a title agent's job differs from standard insurance professionals. Insurance agents in lines of business other than title work act as salespeople. Title agents are researchers. Third, unlike life and property insurance premiums, title premiums do not recur. Fourth, the title insurance business follows the market cycles of the real estate market very closely.

Title insurance programs and regulation are the responsibility of state governments. In New York State, title insurance rates are established by the industry-sponsored Title Insurance Rate Service Association, Inc. (TIRSA) under the supervision of the New York State Superintendent of Insurance. TIRSA developed and updates the Title Insurance Rate Manual for New York. The Superintendent must approve any amendments to the Manual.[6] There are two rate zones in the State — Albany and counties to the south are in one zone, with the remainder of the state in the other zone.[7]

Industry Weaknesses

Title insurance represents the weakest link in an industry that has been subject to several regulatory challenges to its basic business models over the past few years. Many of the investigations of other areas of the industry have resulted in agreements to improve business practices and transparency. The title industry, according to its critics, does not release financial information based on General Accepted Accounting Principles.

2001 Congressional Hearing

In December 2001, former Senator Phil Gramm (R) Texas, a strong business advocate, and ranking member of the Senate Committee on Banking,

3 GAO, Op Cit, page 17.

4 Iowa mandates a 30 day turnaround time for mortgage releases. See: Iowa Bar Association, *Iowa Title Guarantee versus Title Insurance*, 2003.

5 GAO, Op Cit, page 9.

6 Title Insurance Rate Services Association (TIRSA), *Title Insurance Rate Manual: New York State,* Fourth Reprint, May 1, 2007.

7 TIRSA Manual, Op Cit, p. 8.

Housing, and Urban Development outlined a fundamental problem with the title insurance industry.

> Now I am not saying that title insurance does not add value. But I am saying that it doesn't equal the value it costs. And what happened is, and I don't know if it is the power of the lobby or inertia, but it seems to me that a lot of government programs, as well as Fannie Mae and Freddie Mac, change their policy of title insurance, that risk involved in not having title insurance is miniscule compared to the cost. I urge you to get your staff to speak to somebody who is getting federal assistance and to look at their closing statements and see the big chunk of money they have to pay for title insurance. This cries out for something to be done about it.
>
> We could probably do more to promote home ownership by fixing this than by any increase in appropriations for housing that will be made in the next eight years combined…It needs to be fixed…If people want to buy it, great, but your programs are making them buy it. My guess is that the social cost of not having it wouldn't be one-tenth, maybe not one-hundredth of the cost of purchasing those policies. I plead with the Department of Housing and Urban Development to do this.[8]

The 2006 Attorney General settlement

On May 23, 2006 the New York State Attorney General announced a settlement with Fidelity National Title Group and First American Title Insurance Company — two of the three largest companies in the New York State title market. The agreement stemmed from an investigation conducted by the Attorney General and State Insurance Commissioner.

> The new probe revealed evidence of an illegal scheme by which real estate developers would receive free or discounted title insurance in other states in exchange for giving their New York business to the settling insurance companies. These discounts were not available to home purchasers and small businesses, who in effect subsidized the illegal rebates by paying the "full freight" of New York's high title insurance rates. The investigation also found that the insurance companies paid illegal referral fees to their customers' representatives who did not perform any substantial services.[9]

According to the agreement, both companies reduced rates by 15% for all types of transactions. The New York State Attorney General called New York's title insurance rates "the highest in the nation".

2007 GAO Audit

In April 2007 the General Accounting Office[10] released a report that highlighted many of the concerns that were addressed in the AG/Insurance settlements. The report also went beyond the scope of the settlement to address other more structural aspects of industry practices. The GAO concluded that there is minimum state and federal regulation of the industry, particularly regarding how industry costs are evaluated in rate approval actions. The GAO's report also included many specific findings, including reports of kickbacks, supporting the conclusion that more transparency is needed in the

8 Gramm Quote taken from Eaton, OpCit, p. 2004-05.

9 New York State Insurance Department and New York State Office of the Attorney General, *Title Insurers Agree to Sweeping Reforms; First American and Fidelity to change Practices and Reduce Rates*, May 23, 2006.

10 GAO. Op Cit, April 2007.

industry as a whole. In addition, increased auditing and enforcement of relevant regulations were cited as critical to developing a more consumer-friendly industry. Limited competition within the industry appeared to be a factor in keeping premiums high.

The GAO report identified various statutory and regulatory efforts underway, including observations on the Iowa state-run program. Sale of title insurance was banned in Iowa after homeowners were left with worthless policies by the 1947 collapse of Sioux City title insurance companies. By the time the prohibition was challenged in Iowa's Supreme Court 30 years later, the court upheld the ban. The court ruled on the basis that the plaintiff in the case — Chicago Title — had collected $370,000 in title insurance premiums over the previous five years without paying out a dime on those policies.

The Iowa program has not resulted in a higher percentage of claims than in "traditional," industry-driven states, but the costs to consumers is much lower. On average the total cost in Iowa is $400: $110 state fee ($40 of which goes to the state's title insurance company) and $300 for attorney fees and the title filing amount. Since 1986, program revenues have gone to fund title insurance operations, pay claims, maintain a reserve and surpluses have been transferred to Iowa's affordable housing program. One-half of all revenue collected from the program during this period has been transferred to affordable housing.

Lenders have criticized the Iowa program for high standards that sometimes interfere with completing a transaction. To address these concerns, the Iowa Title Guarantee Program is working on improving the process for lenders without compromising state and consumer protections.

Partnership for New York City
One Battery Park Plaza New York, New York 10004-1479
T 212.493.7400 **F** 212.344.3344 www.pfnyc.org