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GAO Takes Aim at Title Insurance Industry

In response to an increasing number of state and federal investigations into the title insurance industry, the House Committee on Financial Services Chairman Michael Oxley recently requested the General Accounting Office, Congress' non-partisan auditor and think tank, to conduct a comprehensive study of the title insurance industry. In requesting the study, the Committee cited the recent rash of investigations that found many title companies were making payments to lenders and builders in violation of the Real Estate Settlement Procedures Act and their having engaged in other anti-competitive practices. The Committee requested that the GAO: (1) Analyze factors that impact the price of title insurance; (2) determine how the product is marketed and to what extent consumers would benefit from a more competitive marketplace; and (3) examine the relationship between title insurers, realtors, builders and lenders to determine whether such relationships promote anti-competitive practices.

The GAO has issued its initial findings, highlighting the following as meriting further study and attention.

Premium Rates as a Reflection of the Insurers' Underlying Cost

The GAO found that the extent to which premium rates reflect actual costs or risks is unclear because: (1) Many state regulators do not determine whether premium rates accurately reflect the insurers' costs; (2) insurers may provide discounted premiums in refinance transactions to reflect the short period of time the title search covers but it is not clear the extent such discounts are applied; and (3) the correlation between premium rate increases and higher loan amounts is unclear as costs for title search and examination do not appear to rise as loan or purchase amounts increase.

Regulatory Focus on Title Agents

In the title insurance industry, agents play a more significant role than agents involved in selling other types of insurance because title agents perform most of the underwriting tasks, title search and examination work. Despite this significant role, the GAO found that it is unclear how much scrutiny title agents receive from state regulators. Three states plus the District of Columbia do not require licensing of title agents and 18 states and the District of Columbia do not require title agents to pass licensing examinations. Therefore, the extent to which states review the activities of title insurance agents and the extent to which such review is necessary merit further study.

Extent of Beneficial Market Competition

The GAO questioned the competitiveness of the title insurance industry because: (1) Consumers generally are not knowledgeable enough to shop around for title insurance but rely on the advice of real estate professionals, such as lenders, real estate agents and attorneys; (2) since title agents get referrals from these real estate professionals, title agents generally market their products exclusively to these professionals and the professionals generally recommend the title insurer who represents their best interests and not necessarily the least expensive or most reputable; (3) the five largest title insurers and their subsidiaries accounted for over 90% of the insurance premiums written in 2004; and (4) those insurers suffered low levels of losses while enjoying increased operating revenue, creating the impression of excessive profits and the lack of a competitive market. Interestingly, the GAO noted that consumer advocates have suggested that lenders should pay for title insurance policies from which they might benefit, which would arguably force title insurers to compete more aggressively for business.

Affiliated Business Arrangements

Affiliated business arrangements in the title insurance industry, which generally refer to some level of joint ownership between a title insurer, title agent, real estate broker, mortgage broker, mortgage lender, and/or builder, have increased over the past several years. The GAO study found that while such arrangements may provide one stop shopping and might even lower costs for the consumer, in addition to the RESPA implications of such arrangements, they may also present

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conflicts of interest when they involve kickbacks to the referring entity.

Involvement and Coordination Among State Regulators

Various state regulators are involved in title insurance, such as regulators overseeing insurance agencies, real estate brokers and agents, mortgage brokers, mortgage lenders, and builders. Yet, the GAO study found that there was little coordination among these regulatory entities in overseeing title insurance related activities.

Recent State and Federal Investigations

The report identified two primary types of illegal activities in the sale of title insurance; fees that title agents give to builders, real estate agents, brokers or lenders in return for referrals, and the mishandling of customers' title insurance premiums. Insurance regulators in several states have identified captive reinsurance arrangements used to inappropriately compensate builders or lenders for referrals. (In fact, soon after the release of the GAO report, HUD entered into substantial settlements involving alleged RESPA violations by captive title insurance agencies.) Insurance regulators and HUD have also alleged the existence of shell title agencies with no physical location, employees and/or assets that do not perform title and settlement services but exist primarily to funnel kickbacks. As for the mishandling or misappropriation of funds, GAO found that title agents often failed to remit premiums to the title insurer resulting in the title insurer failing to issue title policies to customers who have paid for the policies.

The GAO findings will likely buttress efforts already underway at (1) HUD to change RESPA regulations to address some of these concerns, (2) the National Association of Insurance Commissioners as it considers changes to model title insurance and title agent laws to address affiliated business arrangement referral fee concerns, and (3) state mortgage and insurance regulatory authorities as they increase their efforts to clamp down on sham joint ventures, captive reinsurance and similar arrangements.

Blank Rome continues to monitor these title insurance issues and enforcement activities. If you would like further information on structuring your business to avoid potential RESPA and state law violations, whether in the title insurance context or otherwise, please contact us. ■

Update on the California Fax Ban Law

As you may recall from the Consumer Lending/Retail Banking Update, Winter 2006-2 edition, the effective date of the California Fax Ban Law ("Fax Law"), which would prohibit the sending of unsolicited advertisements by fax to both prospective and existing customers without express permission from the intended recipient, was stayed pending the outcome of litigation challenging the Fax Law by the U.S. Chamber of Commerce. Recently, the U.S. District Court for the Eastern District of California held that the Fax Law did not apply to interstate faxes because it was preempted by the federal Telephone Consumer Protection Act, but that the Fax Law was valid as to intrastate faxes. This means that businesses located in California sending faxes to residents of California who are either prospective or existing customers, must get express permission before sending a fax or risk paying actual or statutory damages of $500 per violation, which may be trebled for willful violations, whichever is greater.

If you would like further information on how this law or any other state or federal fax ban laws would affect your business, please contact us. ■

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