



Fix the Title Insurance Industry: Prohibit Affiliated Business Arrangements

**Submitted Written Testimony
of
Anthony L. Affatati
President, NAILTA**

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On behalf of the National Association of Independent Land Title Agents (NAILTA), I am privileged to address the NAIC and its member representatives. My name is Anthony Affatati. I am the President of Applied Title in Freehold, NJ and the current President of NAILTA. I am proud to call myself an independent real estate settlement services professional and I am here today to describe a problem that will prevent any meaningful regulatory reform from helping to improve the title insurance industry for the long haul: i.e., affiliated business arrangements. NAILTA's goal is to help NAIC and your respective states understand the basic problems associated with affiliated business arrangements (AfBAs) and why their promise of consumer benefit is nothing more than a myth.

The emergence of AfBAs has created an environment within the title insurance and real estate industries that threatens free market competition, increases closing costs for consumers while simultaneously reducing service levels, undermines the solvency of national and regional title underwriters, and erodes the accuracy of the land record system -- the lynchpin of the entire American economy.

Loss of Competition:

You may already understand the theory that goes hand-in-hand with the AfBA proposition: real estate transactions move faster and more efficiently when only one party (i.e. the realtor, lender, mortgage broker or homebuilder) is in control of the entire real estate process and that, in turn, is good for consumers and results in lower prices.

The one-stop shopping concept of purchasing real estate, mortgage and title insurance through affiliated companies may superficially seem like a good way to improve services to consumers and reduce costs, but it is not. Organizations such as RESPRO, NAR, MBA and the ALTA, directly and indirectly support a belief that such practices are actually preferred by consumers. This is just part of the ruse the referral source lobby has used to push pro-AfBA legislation across the United States.

You have no doubt heard testimony before today from proponents of the AfBA business model that attempts to, once again, revive the well-known myth that consumers "prefer" these settlement service providers, but this testimony is unsupported by credible data and is fraught with logical inconsistencies. The simple truth is that there is no reliable data that says consumers actually prefer AfBAs over independent title agencies. Likewise, there is no data that concludes that AfBAs reduce the cost of real estate settlements for consumers. There are three recent government studies that looked at the issue of costs in the title insurance industry and not one of them concluded that AfBAs help to reduce the costs for consumers. Not one.

Those studies are:

- *"What Explains Variation in Title Charges? A Study of Five Large Markets"* U.S. Housing and Urban Development (HUD), Office of Policy Development and Research, June 2012.

- “*Comparing Home Closing Costs: Title Charges Vary Widely in Five Metro Housing Markets.*” The Urban Institute, Feinberg, Robert; Kuehn, Daniel, et al., September 2012.
- Woodward, Susan. “*A Study of Closing Costs for FHA Mortgages,*” U.S. Department of Housing and Urban Development, Office of Policy Development and Research, May 2008.

Upon a closer review of the AfBA practice, it is clear that there is **no direct benefit to consumers** who remain completely unaware that their settlement business is being traded as part of a *quid pro quo* to compensate unlicensed referral sources for steering their consumers to closely-held title insurance agencies. Much like many of you who have closed on the purchase of home or refinanced your home mortgage know, the real estate transaction is often times confusing, cumbersome and calculated to give advantage to those other than the consumer.

The root of this problem rests in the fact that the American real estate consumer does not truly “shop” for real estate settlement services. The consumer generally relies on the realtor, lender, mortgage broker or homebuilder to make the decisions as to where title insurance is purchased, and those decisions are based on the advantages for the realtor, lender, mortgage broker or homebuilder, not the consumer.

Once consumers are truly aware that their business has been referred to affiliated service providers based on the quantity of the referral fee as opposed to the expected quality of service they prefer independent providers by a healthy majority. Survey data aside, the question must be asked: In what other industry would consumers allow this type of business model to exist?

What if it was customary for personal physicians to refer patients to specialists based on his or her kickback as opposed to the quality of treatment that he or she would expect the patient to receive. Legislators would and, in fact have, passed laws to prevent this type of activity. While decisions on title insurance certainly are not life and death, it is this business model that persists in our industry and it is largely ignored.

As a result of the AfBA referral system and the highlighted problems of reverse competition in the title insurance industry, independent competition is effectively locked out from helping to lower consumer prices because real estate firms, lenders, mortgage companies and homebuilders “control” such a large percentage of business and their joint venture partners, which include many of the national and larger regional title insurance underwriters, continue to push the referral sources to isolate business away from true and healthy competition.

Increase in Costs:

While most title insurance premiums are set by laws which require licensed companies to file rates for use and/or approval, the non-title insurance premium fees, such as settlement fees, search fees, closing fees, and other ancillary costs related to closing continue to rise. Even in

those states where “soft-cost” fees are part of the title insurance risk premium, the upward trend of premiums illustrates that consumers are paying more for title insurance, not less.

Since the title agency typically rewards referral sources such as realtors, lenders, mortgage brokers and homebuilders anywhere from 25% to 50% of total revenue, agencies look to both increase revenue and decrease costs in order to maintain profitability. Once a title insurance business is in position to give away nearly half of its revenue to insure a flow of referrals, the argument for increasing title insurance premiums will grow ever louder.

In addition, there are certain fees that title agents have some latitude in charging. For example, in Pennsylvania, agents can only charge a settlement fee if the settlement is outside either the office or normal business hours. An agent that is giving away 50% of her premium will be much more likely to charge this fee to a consumer when given the opportunity to do so. In essence, AfBAs create upward pricing pressures, not downward pricing pressures that might actually help reduce settlement costs.

One has to ask if a title agent can afford to give up to 50% of their premium to a referral source that adds no value to the examination of the title or the issuance of the policy, whether risk premiums are too high already. Members of Congress are already considering such issues as part of the debate to reform the financial services sector. NAILTA has met with members of the House Financial Services Committee and CFPB to discuss these important policy issues and recommends that more study of costs be done to determine whether AfBAs truly do offer their consumers a benefit on price.

Due to the reverse competition in our market and the AfBA business model there is no downward pressure on pricing whatsoever. In a free market, sellers always want prices to be high in order to increase profits. Consumers balance that upward pressure with their ability to competitively shop for the best prices and quality of service. In the title insurance industry however, services are not marketed directly to consumers, they are marketed to the referral sources who also benefit from increased prices as they share in the revenue stream. It is telling that in 15 years of being a Title Insurance Agent I have never once marketed my services to any consumer or referral source based on having lower costs than my competition. Not once. This is not a healthy environment for the consumer.

Decrease in Service:

Similarly to the potential for increase in costs, paying referral fees of up to 50% of revenue forces agents to reduce costs beyond the normal improvements in efficiency that all business aim towards. Industry research shows that 29% of all title insurance sold in the United States is through an AfBA. 49% of the revenue in those transactions goes to the referral source who adds no value to the examination of title or the issuance of the policy. That equates to 14.21% of all revenue in the Title Insurance Industry. These numbers are all trending up. This reduced revenue in the industry, without any off-setting gain in productivity, can only cause harm to service.

Consider the typical AfBA business model. Unlike an independent service provider who actually pays money to market for business, the AfBA simply provides 50% of its profits to its

referral sources to secure a steady source of captive business. Incentives for service are not done at the service level; they are done at the management level. Thus, unlike an independent service provider who has the challenge of mixing service with marketing, the AfBA only has to make its operating account available to its referral sources to maintain business. Whether it performs its job on a service level is secondary to the referral itself. Actually, declaring that service is secondary is an over-statement, the fact is that it is almost irrelevant.

When service suffers, the consumer suffers. If a business has to give away half of its profits to maintain a captive referral base, it must compensate for that loss somewhere. Typically, the compensation comes from one of two sources. The title agent will overcharge consumers for non-premium related fees and other “soft” costs or they will strive to reduce costs in ways that are detrimental to performance. This includes hiring fewer and less knowledgeable professionals, leading to potentially catastrophic consequences for the industry and the fundamental stability of the economy.

Long Term Health of Underwriters is Diminished:

While national title insurance underwriters pursue their short term interests of increased market share by encouraging agents to participate in AfBAs, the long term health of those companies and the industry as a whole is in jeopardy. As agencies give away more and more revenue to referral sources they turn to the title underwriters and demand higher and higher premium splits to maintain profitability. The results are inadequate capital reserves for the underwriters, the effects of which are being fully realized in the current market. Claims and loss ratios are at historically high levels due to the combination of market forces and poor performance of agencies for the reasons listed above and underwriters continue to receive less and less of every premium dollar collected.

NAILTA is proud of its association with title insurance underwriters, both regional and national. In conjunction with those partners, NAILTA has researched and recommends the adoption of important objective criteria that regulators can use to broadly assist the title insurance marketplace avoid reserve shortcomings and, at the same time, maintain the solvency and stability of the title insurers. It is NAILTA’s belief that these risks are related concepts. One such objective criterion is the “Premium-to-Surplus Rule,” which is part of NAILTA’s Blue Ribbon Title Insurance Underwriter Certification criteria.

The Premium-to-Surplus Rule is an objective measure of the health and solvency of a title insurance underwriter based upon a simple ratio of the insurer’s annual gross title insurance premiums versus the insurer’s policyholder surplus. Those title insurers with ratios greater than 5:1 are at a heightened and predicable risk of financial distress due to a material financial event, such as defalcations or high claims.

NAILTA has authored a White Paper on the subject of helping NAIC and its members to better regulate the title insurance industry concerning escrow fraud and the related solvency issues surrounding title insurance underwriters. A copy of our White Paper is available upon request.

Erosion of Accuracy in the Public Records:

Perhaps the most alarming aspect of this business practice is that Title Agents are supposed to be the guardians of the public land records, the underlying foundation of the entire economy of the United States. Poor performance by Agents and their less and less experienced staff, among other factors, is eroding the legitimacy of those records. If we do not clearly understand who owns what and the condition of the titles in question, the American economy may again be in jeopardy.

What Can You Do To Prevent Reverse Competition From Harming Your State?:

The problem of reverse competition is not a problem without a remedy. Instead, it is a problem that can be easily addressed with simple changes to administrative philosophies – for those states who already have anti-kickback legislation on their books – and with attention to the basic fundamentals of business economics – for those regulators with the foresight to see affiliated business arrangements for what they are (i.e. a kickback patronage system). In essence, when a business model is failing and cannot sustain revenues for itself, it should not be allowed to siphon off revenues from another business model in order to sustain itself. Corporate cannibalism is a threat to public policy and consumer protection. It is not a business model to be celebrated and protected through more pro-AfBA public action.

NAILTA recognizes that states have tools at their disposal to address these issues. In many cases, it is a question of developing the will to use those tools that will make the biggest impact on the problem. There is no single AfBA that would go out of business if AfBAs were forced to compete on price and service. Instead, those referral sources who were once paid for their referrals would likely continue sending their business to those service providers known to them for their service and their pricing. Proponents of AfBAs like to scare legislators and regulators with the false depiction that says a world without AfBAs would be a world we cannot live with.

In truth, if AfBAs were prohibited think of the potential consequences:

1. Lenders would be forced to find service providers who competed on price and service, not the value of their kickbacks and referral payments.
2. Consumers would be allowed to make service provider selections based upon the best performer in the price and service category. Any such referrals would be based upon what matters to a consumer – price and service – not whether the referring party would be paid to refer.
3. Market participants would have a downward pricing pressure to lower costs and improve service.

Currently, none of these advantages exist. Instead, proponents of AfBAs push unproven and unsupported myths that mask the truth – that AfBAs are nothing more than shell companies designed to disguise referral payments.

Conclusion:

In light of these problems, NAILTA recommends the following actions:

- Adopt laws that reinforce the fact that referral sources may not sell or solicit title insurance and may not get things of value, including stock dividends or ownership units, in exchange for the referral of settlement business.
- Promulgate laws that encourage market participation by local and regional title insurance underwriters.
- Seek input from their local independent land title association when considering the impacts of bills concerning market inducements, controlled business arrangements and their effects on small business.
- Create laws that protect consumers against substandard market practices by requiring minimum title search periods under Marketable Title Act or state customs (i.e. Ohio, 42 year title search; Louisiana, 30 year title search, etc.).
- Ensure that all title insurance agents maintain professional licenses and ethics training.
- Encourage the development of a separate escrow agent license program.

About NAILTA:

The National Association of Independent Land Title Agents (NAILTA) is a non-profit trade association that represents the interests of independent title insurance agents and independent real estate settlement professionals from across the United States. It was created by independent real estate settlement professionals to further the agenda of small business owners from within the title insurance, abstracting, surveying, and real estate community who lack representation at local, state and national levels.

To contact NAILTA, please visit our website at www.nailta.org.