

**GAO**

Report to the Chairman, Committee on  
Financial Services, House of  
Representatives

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April 2006

# TITLE INSURANCE

## Preliminary Views and Issues for Further Study





Highlights of [GAO-06-568](#), a report to the Chairman, Committee on Financial Services, House of Representatives

## Why GAO Did This Study

Title insurance is a required element of almost all real estate purchases and is not an insignificant cost for consumers. However, consumers generally do not have the knowledge needed to “shop around” for title insurance and usually rely on professionals involved in real estate—such as lenders, real estate agents, and attorneys—for advice in selecting a title insurer. Recent state and federal investigations into title insurance sales have identified practices that may have benefited these professionals and title insurance providers at the expense of consumers.

At your request, GAO currently has work under way studying the title insurance industry, including pricing, competition, the size of the market, the roles of the various participants in the market, and how they are regulated. You asked GAO to identify and report on preliminary issues for further study. In so doing, this report focuses on: (1) the reasonableness of cost structures and agent practices common to the title insurance market that are not typical of other insurance markets; (2) the implications of activities identified in recent state and federal investigations that may have benefited real estate professionals rather than consumers; and (3) the potential need for regulatory changes that would affect the way that title insurance is sold.

[www.gao.gov/cgi-bin/getrpt?GAO-06-568](http://www.gao.gov/cgi-bin/getrpt?GAO-06-568).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Orice M. Williams at (202) 512-8678 or [williamso@gao.gov](mailto:williamso@gao.gov).

## TITLE INSURANCE

### Preliminary Views and Issues for Further Study

#### What GAO Found

Some cost structures and agent practices that are common to the title insurance market are not typical of other lines of insurance and merit further study. First, the extent to which premium rates reflect underlying costs is not always clear. For example, most states do not consider title search and examination costs—insurers’ largest expense—to be part of the premium, and do not review them. Second, while title agents play a key role in the underwriting process, the extent to which state insurance regulators review them is not clear. Few states regularly collect information on agents, and three states do not license them. Third, the extent to which a competitive environment exists within the title insurance market that benefits consumers is also not clear. Consumers generally lack the knowledge necessary to “shop around” for a title insurer and therefore often rely on the advice of real estate and mortgage professionals. As a result, title agents normally market their business to these professionals, creating a form of competition from which the benefit to consumers is not always clear. Fourth, real estate brokers and lenders are increasingly becoming full or part owners of title agencies, which may benefit consumers by allowing one-stop shopping, but may also create conflicts of interest. Finally, multiple regulators oversee the different entities involved in the title insurance industry, but the extent of involvement and coordination among these entities is not clear.

Recent state and federal investigations have identified potentially illegal activities—mainly involving alleged kickbacks—that also merit further study. The investigations alleged instances of real estate agents, mortgage brokers, and lenders receiving referral fees or other inducements in return for steering business to title insurers or agents, activities that may have violated federal or state anti-kickback laws. Participants allegedly used several methods to convey the inducements, including captive reinsurance agreements, fraudulent business arrangements, and discounted business services. For example, investigators identified several “shell” title agencies created by a title agent and a real estate or mortgage broker that had no physical location or employees and did not perform any title business, allegedly serving only to obscure referral payments. Insurers and industry associations with whom we spoke said that they had begun to address such alleged activities but also said that current regulations needed clarification.

In the past several years, regulators, industry groups, and others have suggested changes to the way title insurance is sold, and further study of these suggestions could be beneficial. For example, the Department of Housing and Urban Development announced in June 2005 that it was considering revisions to the regulations implementing the Real Estate Settlement Procedures Act. In addition, the National Association of Insurance Commissioners is considering changes to model laws for title insurers and title agents. Finally, at least one consumer advocate has suggested that requiring lenders to pay for the title policies from which they benefit might increase competition and ultimately lower consumers’ costs.

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## Abbreviations

ALTA	American Land Title Association
HUD	Department of Housing and Urban Development
NAIC	National Association of Insurance Commissioners
RESPA	Real Estate Settlement Procedures Act

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United States Government Accountability Office  
Washington, DC 20548

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April 24, 2006

The Honorable Michael G. Oxley  
Chairman  
Committee on Financial Services  
House of Representatives

Dear Mr. Chairman:

Title insurance guarantees clear ownership of a property that is being sold and protects both buyers and lenders. Typically it is required in real estate purchases and is not an insignificant cost for consumers, who may pay not only for their own policies but also for the lenders'. However, consumers are generally not knowledgeable of the costs and benefits of particular title insurance services and usually rely on professionals involved in real estate, such as lenders, real estate agents, or attorneys, for advice in selecting a title insurer.<sup>1</sup> Recent state and federal investigations into title insurance sales have identified practices that may have benefited these professionals and title insurance providers at the expense of consumers. Similarly, a recent study on the competitiveness of the California title insurance market concluded that the market was not competitive and that consumers were being overcharged, provoking a strong and critical response from various market participants.<sup>2</sup>

In response to these concerns we have work under way, at your request, on the title insurance market, including pricing, competition, the size of the market, and the roles of the various participants in the market and how they are regulated. You requested that we report on the preliminary results of our work to date and identify issues for further study. This report focuses on issues related to: (1) the reasonableness of cost structures and agent practices common to the title insurance market that

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<sup>1</sup>Individual states regulate real estate brokerage, establishing licensing and other requirements for brokers and agents. Of the two categories of state-licensed real estate practitioners, brokers generally manage their own offices, and agents (or salespeople) must work for licensed brokers. States generally require brokers to meet more educational requirements than agents, have more experience, or both.

<sup>2</sup>B. Birnbaum, *Report to the California Insurance Commissioner: An Analysis of Competition in the California Title Insurance and Escrow Industry*, (Austin, TX: Dec. 2005).

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are not typical of other insurance markets; (2) the implications of activities identified in recent state and federal investigations that may have benefited real estate or other professionals rather than consumers; and (3) proposed regulatory changes that would affect the way in which title insurance is sold.

For this work, we reviewed available studies of the title insurance industry. These included the aforementioned study on the California title insurance market (as well as numerous criticisms of that study) and a recent study conducted on behalf of Fidelity National Title Group.<sup>3</sup> To determine what role states play in overseeing the various parties involved in the title insurance industry, we reviewed title insurance regulations in selected states and other publicly available financial information on title insurers and agents. To gain a better understanding of how title insurance premiums are shared between insurance companies and agents, we reviewed data collected by the National Association of Insurance Commissioners (NAIC) and the American Land Title Association (ALTA).<sup>4</sup> To determine how insurers account for premiums, we also looked at financial data filed with the Securities and Exchange Commission. Finally, to gain a better understanding of the dynamics of the industry and current practices and issues within the title insurance industry, we interviewed officials from a variety of national organizations whose members are involved in the marketing or sale of title insurance, or related activities; NAIC; the Department of Housing and Urban Development (HUD); several state regulators, including insurance departments and, in one state, the real estate commissioner; title insurers; title agents; and industry consultants. We performed our work primarily in Chicago, Illinois, and Washington, D.C., between February and April 2006. We performed our work in accordance with generally accepted government auditing standards.

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## Results in Brief

The reasonableness of cost structures and certain agent practices that are common to the title insurance market—but not to other lines of insurance—merit further study. First, while state regulations generally require premium rates to be supported by underlying costs, the extent to

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<sup>3</sup>G. Vistnes, *An Economic Analysis of Competition in the Title Insurance Industry*, (Washington, D.C.: Mar. 2006).

<sup>4</sup>ALTA is a national trade association for title insurers and agents, but its members may also include attorneys, builders, developers, lenders, and real estate brokers.

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which title insurance premium rates reflect such costs is not always clear. For example, according to data compiled by ALTA, the amount of premium paid to or retained by title agents, generally to pay for title search and examination costs and agents' commissions, accounted for approximately 71 percent of title insurers' total premiums written in 2004. However, most states do not appear to consider such costs to be part of the premium, and thus do not include them in their premium rate reviews. Second, although title agents appear to play a very critical role in the underwriting process, the extent to which state insurance regulators review their operations is unclear. It appears that few states regularly collect information on title agents' operations, and three states plus the District of Columbia do not even license title agents. Third, the extent to which a competitive environment that benefits consumers exists within the title insurance market is also not clear. For example, consumers generally lack the knowledge necessary to "shop around" for a title insurer and therefore often rely on the advice of professionals, such as real estate agents and lenders. As a result, title agents normally market their business to these professionals, creating a form of competition from which the benefit to consumers is not always clear. Fourth, entities such as real estate brokers, lenders, and builders are increasingly becoming full or partial owners of title agencies in what are called "affiliated business arrangements." Such arrangements may benefit consumers by facilitating "one-stop shopping" and lowering costs, but they can also create conflicts of interest and can be used in ways that do not benefit consumers. Finally, multiple regulators oversee the different entities involved in the title insurance industry, including HUD and state insurance, real estate, and mortgage regulators, but the degree of their involvement and the extent of coordination among them are also not clear. Oversight of this, and other areas, is essential to ensuring that title insurance markets are functioning fairly, and the extent of examination and oversight afforded this industry segment reportedly has varied significantly.

Recent state and federal investigations into the sale of title insurance have identified potentially illegal activities—primarily involving alleged kickbacks—that also merit further study. The investigations alleged instances of real estate agents, mortgage brokers, lenders, and attorneys receiving referral fees or other inducements in return for steering business to title insurers or agents, activities that may have violated federal or state anti-kickback laws. Participants allegedly used several methods to convey the fees or inducements, including captive reinsurance agreements, allegedly inappropriate or fraudulent business arrangements, and free or discounted business services or other things of value. For example, in one case, investigators alleged that a title agent created several "shell" title

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agencies, some of which had few or no employees and, at least in one case, no physical location. Investigators alleged that the agencies did not actually perform any business (including settlements) but were created as vehicles to provide kickbacks to mortgage brokers for referring business. The investigators also alleged that title agents mishandled or misappropriated customers' premium payments, so that customers did not get the insurance they paid for.<sup>5</sup> Insurers and industry associations with whom we spoke told us that they had taken steps to address alleged illegal activities, but also said that current regulations did not clearly address some aspects of affiliated business relationships and that they would support greater enforcement.

In the past several years, regulators, industry groups, and others have suggested several changes to regulations that would affect the way title insurance is sold, and further study of these suggestions could be beneficial. In 2002, HUD proposed revisions to the regulations that implement the Real Estate Settlement Procedures Act (RESPA) that were designed to increase competition in the real estate settlement industry. The proposed revisions included the development of guaranteed mortgage packages and a more binding good faith estimate, both of which could affect the pricing and sale of title insurance. Such revisions proved to be controversial, and in response to considerable comment from industry (including the title industry), consumers, and others, HUD withdrew the proposal in 2004. However, HUD announced in June of 2005 that it was again considering revisions to the regulations implementing RESPA and was seeking input from the industry and others. In addition, NAIC, which among other things develops model insurance laws that states can adopt, is considering changes to the model laws for title insurers and title agents.<sup>6</sup> Finally, at least one consumer advocate has suggested that requiring lenders to pay for the title policies from which they benefit might increase competition and ultimately lower costs for consumers. Further review of the effects of such potential changes on the title industry and the feasibility of making such changes could help Congress, HUD, and state regulatory agencies in their oversight and decision-making processes.

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<sup>5</sup>Colorado Division of Insurance Order No. 0-06-089 (Nov. 15, 2005).

<sup>6</sup>NAIC is a voluntary organization of the chief insurance regulatory officials of the 50 states, the District of Columbia, and four U.S. territories. NAIC assists state insurance regulators by providing guidance, model (or recommended) laws and guidelines, and information-sharing tools.

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This is a preliminary report based on information collected to date and does not include conclusions or recommendations.

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## Background

In any real estate transaction, the buyer and lender providing the mortgage need a guarantee that the buyer will have clear ownership of the property. Title insurance is designed to provide that guarantee by agreeing to compensate the lender (through a lender's policy) or the buyer (through an owner's policy) up to the amount of the loan or the purchase price, respectively. Lenders' policies are in force for as long as the original loan is still outstanding, but end when the loan is paid off—for instance, through a refinancing transaction—while owners' policies remain in effect as long as the purchaser of the policy owns the property.

Title insurance is sold primarily through title agents. Before issuing a policy, a title agent checks the history of a title by examining public records such as deeds, mortgages, wills, divorce decrees, court judgments, and tax records. If the title search discovers a problem—such as a tax lien that has not been paid—the agent either arranges to resolve the problem, decides to provide coverage despite the problem, or excludes it from coverage. The title policy insures the policyholder against any claims that might have existed at the time of the purchase but were not identified in the public record. The title policy does not require that title problems be fixed but compensates policyholders if a covered problem arises. Except in very limited instances, title insurance does not insure against title defects that arise after the date of sale.

Title searches are generally carried out locally by title agents because the public records to be searched are usually only available locally. In addition, the variety of sources that agents must check has fostered the development of privately owned, indexed databases called “title plants.” These plants contain copies of the documents obtained through searches of public records, indexed by property address, and must be regularly updated. Title plants may be owned by insurers, title agents, or a combination of entities. In some cases, the owner of a title plant sells access to other insurers and agents, charging them to use the service.

Title insurance premiums are paid only once, at the time of sale or refinancing, to the title agent. Agents retain or are paid a portion of the premium amount as a fee for conducting the title search and related work, and for their commission. Agents have a fiduciary duty to account for premiums paid to them, and insurers generally have the right to audit the agents' relevant financial records. The party responsible for paying for the title policies varies by state and can even vary by areas within states. In



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many areas, the seller pays for the owner's policy and the buyer for the lender's policy, but the buyer may also pay for both policies or split some (or all) of the costs with the seller. In most cases, the policies are issued simultaneously by the same insurer, so that the same title search can be used for both policies. In a recent nationwide survey, the average cost for simultaneously issuing lender's and owner's policies on a \$180,000 loan, plus other associated title costs, was approximately \$925—or approximately 34 percent of the average total loan origination and closing fees.<sup>7</sup>

In almost all states, title insurance is regulated by state insurance departments; in all states, insurers selling title insurance in that state are subject to the state's regulations for their operations within that state. State regulators are responsible for enforcing these regulations, primarily through the licensing of agents, the approval of insurance rates and products, and the examination of insurers' financial solvency and conduct. State regulators typically conduct financial solvency examinations every 3 to 5 years, while examinations reviewing insurers' conduct are generally done in response to specific complaints by consumers or concerns on the part of the regulator.

Insurance regulations can vary across states, creating differences in the way insurers are regulated. For example, most states require insurers to submit proposed premium rates to the state regulator, and then perform some level of review of those rates. In several states, however, the state regulator sets the premium rate which all insurers must charge, and in at least one state the regulator does not review rates at all. In addition, while most states license title insurance agents, several do not. At the federal level, HUD is responsible for enforcing RESPA, which regulates real estate settlement practices. Among other things, RESPA requires that borrowers receive certain information regarding closing costs, including title insurance fees. RESPA also generally prohibits giving or accepting any thing of value for the referral of settlement services, such as the referral of business to a particular title agent. RESPA also allows state insurance commissioners to take enforcement actions, under RESPA, against these prohibited activities.

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<sup>7</sup>The survey was conducted by Bankrate.com in 2005 by obtaining information online where available, and contacting title agents as necessary. We did not assess the validity of the data collected in the survey.

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## Certain Aspects of the Title Insurance Market Merit Further Study

Some aspects of the title insurance market that set it apart from other lines of insurance merit further study, including:

- the importance of title search costs, rather than losses, in setting premium rates;
- the fact that title insurance agents play a more important role than agents for other lines of insurance;
- the fact that title insurance is generally marketed not to consumers but to professionals such as real estate agents or mortgage brokers;
- the proliferation of affiliated business arrangements between title agents and these professionals; and
- the involvement and coordination among the regulators of multiple types of entities involved in the marketing and sale of title insurance.

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## Extent to Which Premium Rates Reflect Underlying Costs Not Always Clear

The extent to which title insurance premium rates reflect insurers' underlying costs is not always clear. Insurance rate regulation, among other things, aims to protect consumers by ensuring that premium rates accurately reflect insurers' expected and actual costs, and that they are not excessive. However, most state regulators do not appear to consider title search expenses to be part of the premium. As a result, these expenses are not included in regulatory reviews that seek to determine whether premium rates accurately reflect insurers' costs. To complicate matters, it also appears that few state regulators collect financial data from title agents, who generally conduct the title search and examination work, so that examining such expenses would be difficult. Further, unlike other lines of insurance, the largest costs for title insurers are expenses related to title searches and agent commissions, not losses on policy claims. In 2004, according to data compiled by ALTA, losses and loss adjustment expenses incurred by title insurers as a whole were approximately 5 percent of total premiums written, while the amount paid to or retained by agents (primarily for work related to title searches and examinations, and for agents' commissions) was approximately 71 percent of premiums written. In contrast, property casualty insurers' losses and

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loss adjustment expenses accounted for approximately 73 percent of total premiums in 2004.<sup>8</sup>

A related area worthy of further review is premium rate regulation for mortgage refinance transactions. In these cases, a title search most likely has been performed relatively recently, and the property is not changing hands. If the same title insurer was conducting another title search for the refinancing, that search would presumably need to cover a shorter period of time. Because title search and examination costs are the largest component of premium rates for title insurance, the premium rates for refinance transactions could reasonably be expected to be lower than for home purchases. While it appears that many insurers do provide discounted premiums on refinance transactions, the extent of such discounts and how widely they are used—that is, whether consumers know about them and know how to take advantage of them—is unclear.

Finally, the extent to which premium rates increase as loan amounts or purchase prices increase could also usefully be examined. Costs for title search and examination work do not appear to rise as loan or purchase amounts increase, and the portion of premiums that covers potential losses is only about 5 percent of total premiums. If premium rates reflected the underlying costs, premium rates could reasonably be expected to increase at a relatively slow rate as loan or purchase amounts increase. However, this does not always appear to be the case. For example, using premium rates posted on the Internet by two state regulators with whom we spoke, we found that when the purchase price or loan amount doubled from \$150,000 to \$300,000, the increase in total premium for an owner's policy for selected insurers in the same county ranged from approximately 27 to 57 percent. According to an industry expert and officials from an industry association, allowing such pricing reflects a policy decision by state regulators to have higher-income purchasers subsidize the title insurance costs of lower-income purchasers.

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<sup>8</sup>According to industry consultants and analysts, the different loss and expense structure of the title insurance industry reflects the fact that title insurance is primarily focused on preventing losses through title searches and examinations; meanwhile, most property casualty insurance is focused on compensating policyholders for losses.

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**Preliminary Questions**

- How do title insurers determine premium rates, and how have these rates changed in recent years?
- How does the current rate review structure in most states examine the costs that determine title insurance premium rates?
- What data are collected that could be used to assess the extent to which title insurance premium rates reflect the associated costs?
- To what extent do title insurers offer discounted premium rates on mortgage refinance transactions?

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**Extent of Regulatory Focus on Title Agents Merits Further Review**

Title agents play a more significant role in the title insurance industry than most other types of insurance agents. For most lines of insurance, an agent's role is primarily a marketing role. Title insurance agents not only perform this task, but also carry out most underwriting tasks, including title search and examination work. In many cases, title agents retain the actual insurance policy and, after deducting expenses, remit the title insurer's portion of the premium. As we have seen, amounts paid to or retained by title agents for this work in 2004 were around 71 percent of total premiums written.

Despite title agents' critical role, the amount of attention they receive from state regulators is not clear. For example, according to data compiled by ALTA, while most states require title agents to be licensed, three states plus the District of Columbia do not.<sup>9</sup> In addition, also according to the same source, 18 states and the District of Columbia do not require agents to pass a test to become licensed, and only 20 states require some form of continuing education as a prerequisite for title agents. At least one state does not regulate title agents. While NAIC has produced model legislation that states can use as a basis for their own regulation of title agents, according to NAIC, as of October 2005, only 3 states had passed the model act or similar legislation.<sup>10</sup>

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<sup>9</sup>The District of Columbia does not require title agents based there to be licensed, but title agents based in Maryland or Virginia who conduct business in the District must be licensed by their respective states.

<sup>10</sup>NAIC, among other things, develops model insurance laws that states can adopt, and has developed such laws for both title insurers and agents. NAIC also manages the accreditation process for state insurance regulators, requiring them to adopt certain key laws in order to take advantage of reciprocity arrangements between states. However, states do not need to adopt the model laws in order to be accredited.

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The level of oversight of title agents by the state regulators that we spoke with for this report varied. For example, one state regulator told us that examiners conduct regular but informal visits to the title agents in their state but do not track such contacts. Another regulator told us that the agency’s review of title agents’ operations focused primarily on financial condition, not on compliance with state laws. This regulator also collected financial data from title agents, but had only recently begun systematically analyzing that data and questioned its quality. Another regulator told us that the agency had recently begun an intense examination of title agents’ activities and had taken a number of related enforcement actions.

The state insurance regulators with whom we spoke expected or required insurers to oversee the operations of the title agents writing policies for them. One regulator said that the state did not have specific regulations requiring insurers to monitor title agents’ operations, but expected such monitoring as a matter of course. This regulator also expected insurers to resolve any problems the regulator might find with agents’ operations. Another state regulator told us that, in light of activities identified in recent investigations, their office recently revised its regulations to require title insurers to monitor the activities of their agents and hold insurers responsible for their agents’ actions.

**Preliminary Questions**

- To what extent do state insurance regulators review and collect information from title agents operating in their state?
- To what extent are title insurers required to oversee the agents who write insurance for them? To what extent have state insurers adopted model title insurance and agent laws?

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**Extent of Competition in the Industry That Could Benefit Consumers Is Not Clear**

For several reasons, the competitiveness of the title insurance market merits further study. First, because the purchase of title insurance is an infrequent and unfamiliar transaction for most people, consumers often rely on the advice of a real estate or mortgage professional in choosing a title insurer. As a result, title insurers and agents normally market their product to such professionals rather than to consumers. Thus, while consumers are the ones paying for title insurance, they generally do not know how to “shop around” for the best deal, and may not even know that they can. Meanwhile, the potential exists for real estate or mortgage professionals to recommend—not the least expensive or most reputable title insurer or agent—but the one that is most closely aligned with the

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professional's best interests. While RESPA generally prohibits the payment of fees for such business referrals, as discussed later in this report, recent federal and state investigations have alleged such arrangements. Some industry officials pointed out that cost was not the only basis for selecting a title insurer because service and speed were also important.

Second, concentration in the industry has raised further questions about its competitiveness. In 2004, according to data compiled by ALTA, the five largest title insurers and their subsidiary companies accounted for over 90 percent of the total premiums written. However, according to the annual reports of several of these companies, a large number of local agents are used to conduct their business—for example, one company noted in its annual report that more than 9,500 agents sold the company's insurance nationwide. And while a recent analysis of competition in the California title insurance market concluded that the market was overly concentrated, some experts disagree with the study's methodology and its conclusions.<sup>11</sup>

Finally, certain aspects of the financial performance of title insurers and agents have also caused some to question the competitiveness of the title insurance market. For example, as previously discussed, losses on title insurance claims accounted for only about 5 percent of total premiums written in 2004—a very low percentage compared with most other lines. In addition, according to data collected by ALTA, total operating revenue for the industry as a whole rose approximately 68 percent between 2001 and 2004, from approximately \$9.8 to \$16.4 billion. Such conditions could create the impression of excessive profits. The same study of competition in the California market analyzed the profitability of insurers and agents in that market and concluded that they were earning large profits at consumers' expense.

**Preliminary Questions**

- To what extent do aspects of competition beneficial to the consumer appear to exist in the current title insurance market?
- What has been the short- and long-term financial performance of title insurers and agents, and what accounts for the dramatic increase in total operating revenue?

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<sup>11</sup>Birbaum, *Report to the California Insurance Commissioner*.

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## Further Study of the Effect of Affiliated Business Arrangements Could Be Beneficial

The use of affiliated business arrangements involving title agents and others such as lenders, real estate brokers, and builders, appears to have grown over the past several years, and further study of their effect could be beneficial. Within the title insurance industry, the term “affiliated business arrangements” generally refers to some level of joint ownership among title insurers, title agents, real estate brokers, mortgage brokers, lenders, and builders. For example, a mortgage lender and a title agent might form a new jointly owned title agency, or a lender might buy a portion of a title agency. According to some industry groups, consumers can benefit from such arrangements, which may provide convenient, one-stop shopping and lower costs. But some consumer groups and state insurance regulators point out that such arrangements can also be abused and could present conflicts of interest. For example, a real estate broker that is part owner of a title agency might be seen as unable to provide objective advice on which title insurer a consumer should use. In addition, some see such arrangements as a way to hide referral fees by allowing title insurers or agents to mask such fees as a return on ownership interest. As detailed later in this report, a number of recent investigations have alleged improper use of affiliated business arrangements.

State regulation of affiliated business arrangements appears to vary. For example, according to one industry association, a number of states limit the amount of business title insurers and agents can receive from an affiliate. In addition, among the state regulators with whom we spoke for this review, one did not normally examine such arrangements, but the others were beginning to conduct more extensive reviews. RESPA regulations require disclosure of affiliated arrangements whenever a settlement service provider refers a consumer to a business with which the provider has an ownership or other beneficial interest. In addition, while owners of affiliated business may be compensated for their ownership interest in, for example, a title agent, RESPA regulations prohibit compensation beyond that interest.

As noted above, the extent of information collected regarding the activities of title agents appears to be limited. As a result, the extent of information collected on affiliated business arrangements involving title agents is likely similarly limited. The use of affiliated business arrangements, and the potential benefits and concerns regarding their use, make this an issue on which further study could be beneficial.

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## Extent of Involvement and Coordination among Regulators of the Multiple Entities Involved in the Sale of Title Insurance Is Worthy of Further Study

Several types of entities (besides the insurers and their agents) are involved in the sale of title insurance, and the degree of involvement and the extent of coordination among the regulators of these entities appears to vary, making this an area meriting further review. Multiple types of entities are involved in the marketing of title insurance, including real estate brokers and agents, mortgage brokers, lenders, and builders who refer clients to the insurers and agents. These entities are generally overseen at the state level by different regulators, and the extent of regulation related to title insurance sales practices tends to vary across states. One state insurance regulator with whom we spoke told us that they informally coordinate with the state real estate commission as well as HUD. Another regulator said that, while they have tried to coordinate their efforts with the state regulators of real estate and mortgage brokers, those regulators have generally not been interested in such coordination. The apparent growth of affiliated business arrangements, which give some of these entities an ownership interest in others, makes examining the strengths of—and need for—such coordination even more important. However, some coordinated regulatory efforts have taken place. At the federal level, HUD, which is responsible for implementing RESPA, has conducted some investigations with state insurance regulators. As we will see, some of these investigations of the marketing of title insurance by title insurers and agents, real estate brokers, and builders have turned up allegedly illegal activities in the market. Oversight of this, and other areas, is critical to ensure that title insurance markets are functioning fairly.

### Preliminary Questions

- To what extent do regulatory differences among those involved in the sale of title insurance create concerns, and to what extent is there regulatory coordination?
- To what extent do current regulations address the potential concerns about affiliated business arrangements?
- What could state and federal regulators do to improve coordination?

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### Preliminary Questions

- To what extent is information available on the growth and use of affiliated business arrangements in the title insurance industry?
- What are the potential benefits and concerns associated with the use of affiliated business arrangements?
- To what extent do state insurance and other regulators review affiliated business arrangements?
- How are RESPA disclosure requirements of affiliated business arrangements, and the related prohibitions on referral fees, enforced?



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## Further Study of the Implications of Recent State and Federal Investigations Could Be Beneficial

Federal and state investigators have identified two primary types of potentially illegal activities associated with the sale of title insurance. The first involves providing home-builders, real estate agents, real estate brokers, and lenders with potentially unlawful referral fees through captive reinsurer agreements, allegedly inappropriate or fraudulent business arrangements, and free or discounted business services and other items of value. The second involves potential fraud committed by title agents who allegedly misappropriate or mishandle customers' premiums. Industry representatives told us that title insurers have begun to address these problems but that clearer regulations and more enforcement are needed.

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## Investigations Have Alleged Existence of Kickback Schemes and Fraudulent Activities in the Title Insurance Industry

In several states, state insurance regulators identified captive reinsurance arrangements that they alleged were being used by title insurers and agents to inappropriately compensate others—such as builders or lenders—for referrals.<sup>12</sup> In such arrangements, a home-builder, real estate broker, lender, title insurance company, or some combination of these entities forms a reinsurance company that works in conjunction with a title insurer. The title insurer agrees to “reinsure” all or part of its business with the reinsurer by paying the company a portion of the premium (and ostensibly transferring a portion of the risk) for each title transaction. Investigators alleged that these reinsurance companies did not actually provide reinsurance services in return for this compensation because the amount the reinsurers received exceeded the risk they assumed. The investigators considered these arrangements a way to pay for referrals, a practice that is unlawful under some state anti-kickback and anti-rebating laws as well as under RESPA. In one investigation, a reinsurer controlled by three title insurance underwriters entered into agreements with lenders, real estate brokerages, and builders to pay part of its premiums to these entities. State investigators alleged that the reinsurer was transacting reinsurance business without a required certificate from the state and that the title insurers were using unfair practices. As part of the settlement, state investigators demanded that the reinsurer cease operations in the state and that the underwriters end their captive reinsurance arrangements with unauthorized reinsurers but also reimburse affected

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<sup>12</sup>Reinsurance is a mechanism that insurance companies routinely use to spread risk associated with insurance policies. Simply put, it is insurance for insurance companies.

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consumers and pay penalties to the state.<sup>13</sup> In New York, regulators and the attorney general confirmed that they are currently investigating alleged illegal kickbacks in the title insurance industry.

State and federal investigators have also alleged the existence of inappropriate or fraudulent business arrangements among title agencies, title insurers, mortgage brokers, attorneys, and real estate brokers that were allegedly being used to convey kickbacks and referral fees. Most of the investigations we reviewed have examined activities by title agents that involve affiliated business arrangements—that is, part or full ownership of title agencies by real estate brokers, lenders, home-builders, and mortgage brokers. A typical fraudulent business arrangement involves a shell title agency that is set up by a title agent but that generally has no physical location, employees, or assets, and does not actually perform title and settlement business. In cases we examined, regulators alleged their primary purpose is to serve as a vehicle to provide kickbacks by being a pass-through for payments or preferential treatment given by the title agent to real estate agents and brokers, home-builders, attorneys, or mortgage brokers for business referrals. Investigations have alleged that the arrangements in these cases violate RESPA. For example:

- In one federal investigation, a title insurer and eight home-builders were alleged to have formed shell agencies that performed little or no title work, were not independent entities, and benefited financially from referrals.<sup>14</sup>
- In a multi-state federal investigation, a title agency and its affiliates were found to have created “preferred” attorney lists for real estate closings. Attorneys were allegedly placed on the list only if they agreed to refer their clients to the title agency’s affiliated online title company. As part of the settlement, the parties agreed to stop creating “preferred” attorney lists and pay monetary penalties to the federal government.<sup>15</sup>

State and federal investigators have also looked at other types of alleged kickbacks that title agents have given real estate agents and brokers, and attorneys involved in real estate transactions. In investigations we

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<sup>13</sup>California Department of Insurance File No. DISP05046621, Accusation, Notice of Noncompliance, Demand for Monetary Penalty, and Right to Issue Order to Show Cause (July 18, 2005); and Order Restipulation and Waiver (Feb. 21, 2006).

<sup>14</sup>HUD Settlement Agreement (Dec. 15, 2005).

<sup>15</sup>HUD Settlement Agreement (July 10, 2003).

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reviewed, these alleged kickbacks included free or discounted business services or other items of value and included gifts, entertainment, business support services, training, and printing costs. One state investigation identified items such as spa treatments, event tickets, electronics, and trips to domestic and foreign vacation locations. Investigators alleged that these inducements also violated federal and state anti-kickback and anti-rebating laws.<sup>16</sup>

Finally, federal and state investigators have alleged that some title agents have misappropriated or mishandled customers' premiums. For example, one licensed title insurance agent, who was an owner or partial owner of more than 10 title agencies, allegedly failed to remit approximately \$500,000 in premiums to the title insurer. As a result, the insurer allegedly did not issue 6,400 title policies to consumers who had paid for them. The agent also had allegedly mixed funds from premiums with business assets and allegedly misappropriated escrow funds for his personal use. The investigators, who alleged that the agent had failed to perform his fiduciary duty and had violated several state laws, subsequently suspended his license and, pending the outcome of hearings, plan to shut down the title agencies he owned or controlled.<sup>17</sup> Some employees of title agencies have also been alleged to have submitted fraudulent receipts, invoices, and expense reports and then used the reimbursement money for personal expenses or to pay for items on behalf of those who referred business to them.<sup>18</sup>

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### Some Industry Participants Say the Issues Raised by the Investigations Are Being Addressed, but Clearer Regulations Are Needed

In response to these and other investigations, insurers and industry associations say they have addressed some concerns but that clearer regulations and stronger enforcement regarding affiliated businesses are needed. One title-insurance-industry association told us that some title insurers have been motivated by recent federal and state enforcement actions to increasingly address kickbacks and rebates through, for example, increased oversight of title agents. In addition, they said that

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<sup>16</sup>California Department of Insurance, File Nos. LA 15489-A and LA 15516-A, Accusation, Notice of Noncompliance and Hearing, Demand for Monetary Penalty, and Right to Issue Order to Show Cause (Feb. 2, 2006).

<sup>17</sup>Colorado Division of Insurance Order No. 0-06-089 (Nov. 15, 2005).

<sup>18</sup>California Department of Insurance, File No. VA 1012-A, Accusation, Notice of Noncompliance and Hearing, Demand for Monetary Penalty, and Right to Issue Order to Show Cause, Statement of Charges, and Notice of Hearing (June 10, 2002); Order of Restricted License and Payment of Monetary Penalty (2003).

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companies operating legally are hurt by competition from those breaking the rules and that these businesses welcome greater enforcement efforts. Another industry association, however, told us that clearer regulations regarding referral fees and affiliated business arrangements would aid the industry's compliance efforts. Specifically, regulations need to be more transparent about what types of discounts and fees are prohibited and what types are allowed.

**Preliminary Questions**

- How widespread are cited infractions associated with the sale of title insurance?
- What are the implications of the findings of state and federal investigations for the title insurance industry and consumers?
- What actions have regulators and title industry participants taken to reduce the extent of illegal activities?

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## Potential Regulatory Changes Raise a Number of Issues

Over the past several years, regulators, industry groups, and others have suggested changes to regulations that would affect the way title insurance is sold. In 2002, in order to simplify and improve the process of obtaining home mortgages and to reduce settlement costs for consumers, HUD proposed revisions to the regulations implementing RESPA. The proposed revisions included the creation of a guaranteed mortgage package that included guaranteed prices for loan origination and settlement services and a guaranteed interest rate, as well as a revised good faith estimate that would have required additional disclosures of settlement fees and limit fee increases over the original estimates. In response to considerable comment from the title industry, consumers, and other federal agencies, HUD withdrew the proposal in 2004. Opponents argued that the revisions would have given lenders too much leverage in putting together the guaranteed mortgage packages and would have included title insurance—a product priced in part on risk—in a package that was priced based on market forces. HUD announced in June of 2005 that it was again considering revisions to the regulations, and has subsequently held a number of industry roundtables to get input from industry and others.<sup>19</sup>

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<sup>19</sup>Department of Housing and Urban Development, “Real Estate Settlement Procedures Act (RESPA); Simplifying and Improving the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers: Notice of Meetings—RESPA Reform Roundtables; Notice,” 70 Fed. Reg. 37646 (June 29, 2005).

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NAIC officials told us that NAIC is considering changes to the model title insurance act in order to address current issues such as the growth of affiliated business arrangements. The model law for title insurers, among other things, covers premium rate regulation and title insurers' oversight of title agents that write insurance for them. The model law for title agents includes, among other things, agent licensing requirements and prohibitions on referral fees. According to NAIC, they will likely change the model title insurers act to more closely mirror RESPA's provisions regarding referral fees and available sanctions against violators. In addition, they would like to revise the model title agents act by strengthening the licensing requirements for title agents, because doing so can discourage the formation of shell agencies as part of an improper affiliated business arrangement.

Finally, at least one consumer advocate has suggested that requiring lenders to pay for the title policies from which they benefit might increase competition and ultimately lower costs for consumers. Lenders could then use their market power to force title insurers to compete for lenders' business based on price. Additional regulation, these advocates said, might be necessary to require lenders to pass such cost savings on to consumers. Some title industry officials have voiced concern with such an approach because it would allow the lender to decide which title insurer the buyer must use. That is, if the buyer wanted to get the cost savings associated with simultaneously issued lender's and owner's policies, the buyer would have to use the same insurer as the lender.

**Preliminary Questions**

- What benefits and concerns might arise from the implementation of potential regulatory changes?
- What barriers to implementation exist, and how serious are they?
- What other regulatory alternatives exist?

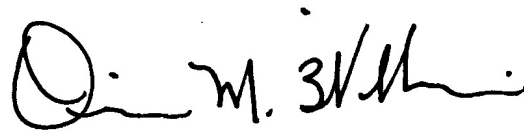
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As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the report date. At that time, we will send copies to the Senate Committee on Banking, Housing and Urban Affairs; the House Committee on Financial Services; the Secretary of Housing and Urban Development; and other interested parties. We will make copies available to others upon request. The report will also be available at no charge on our Web site at <http://www.gao.gov>.

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Please contact me at (202) 512-8678 or [williamso@gao.gov](mailto:williamso@gao.gov) if you or your staff have any questions about this report. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix I.

Sincerely Yours,

A handwritten signature in black ink that reads "Orice M. Williams". The signature is written in a cursive style with a large initial "O" and a distinct "M".

Orice M. Williams  
Director, Financial Markets  
and Community Investment

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# Appendix I: GAO Contact and Staff Acknowledgments

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## GAO Contact

Orice Williams, (202) 512-8678, [williamso@gao.gov](mailto:williamso@gao.gov)

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## Staff Acknowledgments

In addition to the contact named above, Lawrence Cluff, Assistant Director; Tania Calhoun, Emily Chalmers, Nina Horowitz, Marc Molino, Donald Porteous, Melvin Thomas, and Patrick Ward made key contributions to this report.

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