Title Insurance: Overview and Key Regulatory Concerns

By David Keleher, ARM, CPCU, CIC, AIM, NAIC Senior Property and Casualty Insurance Specialist

◆ Introduction

It is important for state insurance regulators to understand how title insurance works and, more important, how title insurance *differs* from other regulated products. Irrespective of the title insurance regulations that a state legislature has put in place, consumers will likely turn to insurance regulators for answers to their questions about title insurance. The goal of this article is to acquaint the regulator with the basics of title insurance coverage and explain how title insurance differs from coverage provided by other policies. The article will also examine the state of the title insurance market and explore some of the key regulatory concerns spawned recently by a number of title insurance company insolvencies and title agent defalcations[1].

◆ Title Insurance – How is it Different?

What Does Title Insurance Do?

Title insurance protects real estate purchasers and/or lenders from losses that arise after a real estate settlement as a result of unknown liens, encumbrances or other defects upon the title that existed prior to settlement. Examples of title defects include outstanding property taxes not paid by a previous owner, fraud or forgery of a prior deed or transfer, or a spouse or unknown heir who steps forward to make a claim against the title. If a claim were made, defending the claim could cost thousands of dollars in attorney fees and, if the claim were valid, could even cause the buyer to lose the property itself. A title insurance policy provides coverage for legal defense, as well as the coverage amount listed in the policy, which usually equals the purchase price of the real property.

Who Is Covered By Title Insurance?

For most Americans, purchasing real estate represents the largest single investment they will make. Given the cost of real estate, very few consumers can purchase home, vacation or investment properties by paying cash. Instead, we borrow the funds from banks, savings and loans, mortgage companies, or other lenders, granting them a secured interest in the property.

One of the conditions that lenders place on the buyer is that a lender's title insurance policy must be purchased in an amount equal to the mortgage loan. However, a *lender's policy* only protects the financial institution in the event that a valid title claim arises. In a worst-case scenario, a buyer could make mortgage payments for 20 or 30 years when an unknown title defect comes to light, creating a valid claim that causes the buyer to lose the title. The lender would be covered, to the extent of the outstanding mortgage, and the owner could lose the property and all equity acquired over the 20 years that he "owned" the property.

To avoid this scenario, an option available to the buyer is the purchase an *owner's title insurance policy*. This would protect the buyer's interest in the real property. If the decision is made to purchase an owner's policy and a lender's policy at the same time, there may be considerable premium savings. In the title insurance business, this is known as a "simultaneous issue," and the premium rates charged for the owner's policy will be calculated on the difference between the amount of coverage provided to the lender (amount borrowed) and the amount of coverage provided to the owner (purchase price).

◆ How Is Title Insurance Different From Other Types of Insurance?

Before real property is transferred from the seller to the buyer, a title search must be conducted. Title searches are usually conducted by an attorney who researches the land records in the county court house and documents the chain of ownership of the property. The purpose of a title search is to identify all prior owners and any outstanding liens, encumbrances, encroachments, rights of way, easements and the like associated with the real property, so that the buyer is aware of them prior to settling on the property. As such, the title search can eliminate most of the risk from the transaction.

Anything that is identified during the search is generally excluded from coverage under the title insurance policy, since these liens, encumbrances, etc., are now known and should be satisfied at the time of settlement so a legal title can be transferred. However, something may be missed during the search process, which could result in a claim being presented at a later date. Since the defect was not known at the time the title was transferred, coverage would be provided by the title insurance policy.

In this respect, title insurance is different from all other types of insurance coverage. It protects you against events that occurred *before the policy was purchased* as long as

(Continued on page 20)

[1] Defalcation happens when an agent with fiduciary duties misappropriates money. The term is commonly used in the title insurance industry when funds that have been placed in escrow to close an insurance transaction have been misused by a title agent.

the title defect was not discovered at the time of the title search, whereas property, casualty, life and health insurance policies protect you against *events that occur afte*r you purchase the policy.

In addition, unlike other forms of insurance—such as life, medical or homeowners—that require an annual premium, title insurance has a one-time premium charge when the title policy is purchased, which is in effect until the property is resold or refinanced.

◆ TITLE INSURANCE COMPANY AND AGENT REGULATION

In most states, insurance companies must possess a certificate of authority from the state insurance department to conduct insurance business lawfully in the state. Title insurance companies are subject to all capital and surplus requirements, as well as laws that require them to submit their policy forms and rates for approval by the department of insurance prior to issuing a policy in the state. Most title insurance companies appoint producers (agents) to underwrite the risks, collect the premiums and issue the title insurance policies.

A significant difference between title insurance company agents and regular property/casualty agents is that title agents also conduct the settlements or closings, as well as the escrow funds for mortgage payoffs, taxes, closing costs, realtor commissions, etc. Since these transactions sometimes involve hundreds of thousands of dollars, this is exactly the area where title defalcations take place. Dishonest agents can be tempted to misuse funds (i.e., escrow theft) and fail to pay off loans.

◆ STATE OF THE TITLE INSURANCE MARKET

The title insurance market is dominated by four major insurance groups: Fidelity National, First American, Stewart Title and Old Republic. These four insurance groups represent close to 90% of the available market (Figure 1); the remainder of the market is made up of smaller companies with much smaller market shares.

FIGURE 2: TITLE INSURANCE INDUSTRY – KEY RATIOS

Loss Ratio 2011	Expense Ratio 2011	Combined Ratio 2011	Combined Ratio 2010	Combined Ratio 2009
11.8%	100.9%	112.7%	113.4%	115.2%

Figure 2 shows that the composite combined ratio for all title companies for 2011 was 112.7%, reflecting slight improvement over previous years. The loss ratio for the industry was 11.8% in 2011 and the expense ratio was 100.9%. Title insurers historically have low loss ratios because title underwriters perform extensive underwriting research on subject properties before issuing a title policy. The research title insurance companies perform prior to issuing a policy is both extensive and expensive. Research costs, the need to fund long-tail loss reserves and high allocated claims expenses when a claim does occur, cause title insurance expense ratios to be higher than other property/casualty lines of insurance. This "pre-underwriting" enables the issuing company to avoid issuing coverage on any property with a "questionable" title history. Claims should be the exception.

◆ REGULATORY CONCERNS

In 2007, the U.S. Government Accountability Office (GAO) issued a report describing certain unusual and troublesome aspects of title insurance, including a lack of price transparency and conflicts of interest among sellers. The GAO called for regulators to seek to improve consumers' ability to shop for title insurance based on price and to improve oversight of title agents by deterring inappropriate practices in the marketing and sales of title insurance.

(Continued on page 21)

FIGURE 1. TITLE PREMIUM — TOP FOUR UNDERWRITERS

Group Code	Company Name	2011 Direct Premiums	2011 Market Share	2010 Direct Premiums	2010 Market Share
670	Fidelity National	$3,282,438,594	35.46%	3,631,255,012	38.43%
70	First American	$2,383,571,660	25.75%	2,423,585,049	25.65%
340	Stewart Title	$1,279,871,839	13.83%	1,302,554,047	13.79%
150	Old Republic	$1,233,001,758	13.32%	1,053,699,409	11.15%

The Title Insurance (C) Task Force and several of its working groups are looking more closely into these issues identified by the GAO. A subgroup of insurance regulators has begun work examining the feasibility of promoting effective consumer shopping for title agents and insurers without delaying real estate closing schedules. This subgroup is also working to develop best practices for the design and implementation of title cost comparison guides for consumers. The group is currently developing a checklist of items that should be included in a model guide for consumers.

The Task Force and its working groups continually review numerous regulatory concerns, including: licensing of title insurance companies and agents; title insurance company reserve adequacy; promoting competition in the title insurance market; and promotion of laws to avoid title company insolvencies.

◆ ESCROW THEFT WHITE PAPER

The Escrow Theft White Paper (C) Subgroup has been charged to examine ways to mitigate the impact of title insurer and agent insolvencies on policyholders. The Subgroup has begun work on a white paper that is intended as a tool for regulators to research methods for combating and preventing escrow theft, title insurance theft and other forms of fraud associated with title insurance and closing services transactions. The white paper may also be used by the title insurance and closing services industry when evaluating their own enterprise risk management and auditing guidelines for combating escrow and title insurance premium theft.

Areas the white paper will address include: gaps in insurance laws/regulations which lead to escrow theft; types of escrow theft and how the theft takes place (including recent cases and objective illustrations); potential tools and methods to address escrow theft; enhanced initial audits of agents/agencies by underwriters; market conduct examinations; and regulator and underwriter monitoring for warning signs of potential problems. The progress on the white paper can be followed on the Subgroup's Web page.[2]

◆ CONCLUSION

Title insurance protects consumers (insureds) and lenders from possible defects in title. Without title insurance, lenders would be unwilling to make mortgage loans for real estate transactions. The coverage continues as long as the insured has an ownership interest in the property. Title insurance policyholders depend on state insurance departments to make sure title insurance companies have the financial means to respond if and when they file claims 20 - 30 years in the future.

Regulators are under scrutiny from the GAO, which expects states to do a better job of promoting competition for title insurance consumers. As the U.S. economy slowly breaks free of the "Great Recession," regulators should expect calls from consumers asking about the financial strength of title insurance companies. Prudent regulators would be well-advised to keep current on title-insurance-related issues.

For more information about title insurance, or to sign up as an interested regulator or interested party, please contact: Bruce Ramge, Chair, Title Insurance (C) Task Force and Nebraska Director of Insurance (402-471-2201) or David Keleher (DKeleher@naic.org, 816-783-8238).

[2] www.naic.org/committees_c_title_tf_escrow_theft_white_paper_sg.htm

The Center for Insurance Policy and Research

NAIC Central Office
Center for Insurance Policy and Research
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197
Phone: 816-842-3600
Fax: 816-783-8175

http://www.naic.org http://cipr.naic.org

© Copyright 2012 National Association of Insurance Commissioners, all rights reserved.

The National Association of Insurance Commissioners (NAIC) is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight. NAIC staff supports these efforts and represents the collective views of state regulators domestically and internationally. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S. For more information, visit www.naic.org.

The views expressed in this publication do not necessarily represent the views of NAIC, its officers or members. All information contained in this document is obtained from sources believed by the NAIC to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, such information is provided "as is" without warranty of any kind. **NO WARRANTY IS MADE, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY OPINION OR INFORMATION GIVEN OR MADE IN THIS PUBLICATION.**

This publication is provided solely to subscribers and then solely in connection with and in furtherance of the regulatory purposes and objectives of the NAIC and state insurance regulation. Data or information discussed or shown may be confidential and or proprietary. Further distribution of this publication by the recipient to anyone is strictly prohibited. Anyone desiring to become a subscriber should contact the Center for Insurance Policy and Research Department directly.