Cracking Down on Illegal Practices in the Title Insurance Industry

By Catherine A. Asaro

I. Introduction

In 2004, the title insurance industry was estimated at $15.6 billion for premiums and related services up from $11 billion in 2003.\(^1\) It is an industry that pays out far fewer claims than most other insurances. Most title problems are discovered and corrected at the time of sale. According to credit-rating firm Fitch, title insurers average 5¢ in claims for every $1 collected in premiums, compared to property and casualty insurers which pay out 87¢ for every $1 collected.

Currently, the title insurance industry is under heavy scrutiny by both state and federal regulators for illegal kickback practices potentially costing home buyers nationwide hundreds of millions, if not, billions of dollars. Many believe that these rapidly spreading illegal practices infecting the industry are continuing to drive up the cost of premiums affecting the average consumer’s ability to finance a home. In an effort to end these illegal practices, several state insurance departments have already launched expansive industry-wide investigations with other states on the verge of joining in. According to Brian E. Sullivan, spokesman for the U.S. Department of Housing and Urban Development (HUD), at the present time HUD has 60 active investigations across the country into alleged violations of Real Estate Settlement Procedures Act’s (RESPA) anti-kickback provisions. RESPA, passed in 1974 as a consumer protection statute, was enacted to help consumers become better shoppers for settlement services and to eliminate kickbacks and referral fees that unnecessarily increase the costs of certain settlement services.

Additionally, the National Association of Insurance Commissioners (NAIC) is working in conjunction with HUD into illegal industry practices. According to NAIC’s spokesman, Woody Girion, they are conducting a nationwide investigation involving several millions. Mr. Girion also heads the insurance commissioner association group that in March of 2005 launched an interstate probe into industry abuses. NAIC believes the problems in the industry are so rampant that it is encouraging insurance commissioners nationwide to commence investigations into these practices.

II. Background

Title insurance is a contractual obligation that protects against claims on a specific portion of real property from former owners by identifying encumbrances on the title and alerting buyers to possible losses caused by defects. Both lenders and buyers need title insurance but for different reasons.

\(^1\) Fitch Inc.
Lenders require buyers to procure the insurance when financing to cover the amount of the loan. Buyers, on the other hand, are encouraged to obtain separate title insurance policies covering the full purchase price of the property as protection from the costs of legal proceedings and any settlement amounts.2

For the most part buyers have the freedom to shop around for the best rates, however, some states, Virginia for instance, set the cost of non-negotiable premiums. The premiums associated with title insurance can fluctuate depending on location and the value of the home. Typically, the total cost of both a lender's and an owner's policy could range between $400 and $1,400, the majority of which goes towards risk elimination. In order to minimize risk exposure, in addition to examining title via public records, title companies also maintain and search title "plats" which contain information on transfers and liens. Buyers purchasing property sold only a few years earlier may benefit from a discounted “reissue” rate from the title company currently covering the property.

III. Current Issues

Since approximately 1997, insurance regulators allege that title insurers began engaging in the illegal practice of rebating by forming captive reinsurance companies that in turn draw rebates from the title insurance companies. These sophisticated schemes are designed so that insurance companies split premiums with home builders, real-estate brokers and others who then steer business in their direction. The practice of rebating has been referred to as a form of “commercial bribery” and is illegal under federal law.3

A. Major Investigations

a. California

In 2003 and 2004, settlements reached with leading California title insurance companies totaled $50 million in restitution to California consumers and brought about the restructuring of the practice of providing escrow services in real estate closings. A major allegation pled in these lawsuits was that the title companies received interest payments on customer escrow funds that were never reimbursed to their customers.

In the fall of 2004, California’s Insurance Commissioner, John Garamendi, commenced an investigation into alleged kickback schemes that violated state law involving title insurers as well as certain lenders.4 It was alleged that these schemes gave up as much as half of the premium on the title insurance policies to sham captive

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2 In many states, including California, both the buyer and the lender may be covered under one policy.

3 § 8 of RESPA prohibits giving or accepting any thing of value for referrals of settlement service business related to a federally related mortgage loan and prohibits giving or accepting any part of a charge for services that are not performed. § 9 of RESPA prohibits home sellers from requiring home buyers to purchase title insurance from a particular company.

4 California State insurance code provides that title insurers cannot "pay, directly or indirectly, any commission, compensation or other consideration to any person as an inducement for the placement or referral of business."
reinsurance companies. In return, the parent companies of those captives would refer business to the title insurer. Commissioner Garamendi contends that reinsurance is unnecessary and argues that this practice harms consumers by potentially forcing up title insurance rates.

On April 4, 2005, Commissioner Garamendi held a daylong investigatory hearing giving insurers and producers an opportunity to prove that the arrangement really was reinsurance, that they were receiving a real benefit, and that the amount paid was reasonable for the benefit received. At the hearing, two of the country’s largest title insurance companies implicated for their involvement in these kickback schemes testified. A third company, arguably considered to be the country’s leading title insurer controlling about 30% of the California market, opted to cooperate with investigators and was excused from testifying. The company provided documents and insight as to the origins of the practice, how it operates and its scope.

On April 19, 2005, Commissioner Garamendi completed another 2½ year investigation into alleged illegal practices of a San Diego based title insurer by issuing a fine in the amount of $590,000 and ordering payment of $160,000 in investigation costs for alleged illegal rebating activities. The investigation revealed that the inducements given to agents amounted to $594,102.67 and came in various forms including payments for business support services, gift certificates and door prizes for realtor events, making rent payments, funding special events, and sponsoring broker activities.

b. Colorado

Recently, one of the nation’s largest title insurance companies, also implicated in Commissioner Garamendi’s investigation in California, reached a multi-million dollar settlement with the Colorado State Commissioner stemming from an investigation that started in the fall of 2004. As part of the settlement, over 2,000 homeowners will be refunded a total of $103,000. The money will go to people who purchased houses from a Los Angeles based builder from December 2002 through January.

According to Erin Toll, Deputy Commissioner of Compliance with the Colorado Division of Insurance who headed up the investigation, the State was prepared to impose sanctions against 9 title insurance companies accused of giving "kickbacks" dating back to 1997 to large homebuilders in the State who in turn steered business their way.

The outcome of the Colorado investigation revealed that all but one homebuilder had set up affiliated companies in Vermont, the country’s capital for captive insurance companies.5 The smoking gun in the Colorado investigation that reaffirmed the suspect nature of these feigned reinsurance companies was the fact that they did not pay a claim in 3 years and the

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5 Vermont has 530 captive insurance companies which is more than any other state or nation with the exception of the Cayman Islands and Bermuda in providing reinsurance to title insurance companies.
agreements were written with caveats preventing the companies from ever having to pay on a claim.

On February 21, 2005, a consent agreement was reached with a California based title company to refund consumers $24 million in fees they paid to reinsurance companies controlled by homebuilders, brokers, lenders, and real estate agents. According to Governor Bill Owens, this settlement marks the first time a state has forced a consumer refund in what officials say is a standard practice among large title companies nationwide.

At the present time, Colorado insurance officials are negotiating possible settlements with other major title insurers. Some insurers are reporting to have voluntarily ended these alleged illegal practices nationwide. On the other hand, another major title insurer acting as a holding company for a number of title companies remains steadfast in its refusal to settle causing the insurance division to seek a cease-and-desist order against that company.

c. Other States

On the heels of the Colorado settlement, Minnesota regulators commenced an investigation issuing subpoenas to 19 title insurance companies for information regarding reinsurance agreements and possible "illegal or undisclosed payments to a title insurer in return for steering business their way," said department spokesman Bruce Gordon.

In late February, 2005, Florida’s Attorney General, Charlie Crist, started an investigation into kickbacks and other illegal payments in title and real estate industries involving as many as 50 title insurance companies. Also, HUD announced a $6.2 million settlement with title insurers and lenders in Texas. In March, 2005, HUD announced a $450,000 settlement with title insurers and real estate companies in Oklahoma over illegal partnerships. These cases name a number of companies, big and small, publicly traded as well as private. Although the parties do not admit to any wrongdoing, they are making payouts to the government or consumers.

As recent as April 1, 2005, a similar investigation was commenced in Wisconsin based on reports that the company targeted in HUD’s investigation was involved in a fee-sharing program with lenders and realty agents. In October, 2004, as a result of 4 complaints issued against the targeted company, the Wisconsin State Insurance Commissioner's office issued an order requiring it to upgrade its new associates' duties or pay them less as their compensation was unreasonable given their services.

Furthermore, similar investigations into kickback schemes have been launched by regulators in Alaska, Massachusetts, and Washington as part of this growing nationwide scandal rocking the title insurance industry. It appears to be just a matter of time before New York’s Attorney General starts probing into statewide practices in the title insurance industry as well.

III. Proposed Alternatives

In an effort to end these illegal practices spreading throughout the
industry, a number of alternatives have been proposed. One alternative is socialization which is the policy followed in the State of Iowa. In Iowa, state agencies are allowed to sell title insurance, however, residents are permitted to buy out of state policies.

Another proposed market-based alternative would be to have whoever selects the title company pay for the policy which, in the long run, should reduce premiums. The principle being that if lenders required title insurance, the lender would pay for the policy because the costs are high and the consumer derives little direct benefit from it. The original premise behind consumers absorbing the cost for this insurance pre-dated the introduction of the secondary mortgage markets. In these secondary markets the primary lender has the ability to bundle individual mortgages into “mortgage-backed securities” and sell them to investors thereby eliminating the default risk by the borrower.

In the event that a transaction involved a realtor, the owner’s policy would then be paid for by the realtor. Both lenders and realtors would be price-sensitive buyers because they are paying the premiums and are better-positioned in the market than the average consumer.

Another alternative, on the table in California, is regulation. On April 28, 2005, California Senate Bill 728 targeting the illegal practices in the industry passed committee. Originally introduced on February 22, 2005, this bill, sponsored by the Department of Insurance, is intended to address the use of illegal rebates by title solicitors to procure title insurance business from the real estate industry. If passed, it would create a formal registration process for title solicitors and require title insurance companies to provide regular training to title solicitors educating them on illegal rebate statutes contained in existing law. It would further require a person to obtain a valid certificate of registration as a title solicitor issued by the commissioner. The insurance commissioner would then have the power to institute disciplinary proceedings against individuals transacting title insurance using illegal rebates to get title business.

In conclusion, these widespread industry abuses have fleeced the innocent home buyer and triggered a nationwide investigation by state and federal regulators that is in full swing. By allegedly inflating premiums to finance the kickbacks to builders and lenders, regulators believe that the home buyers have gotten the short end of the stick for far too long. Given the appearance that insurers may not have acted in the best interests of their clients, regulators are calling for broad changes that could that could overhaul the industry. Title Insurance Companies, homebuilders, real estate agents, mortgage brokers, and lenders have all been targeted. The industry is under the microscope and due to the millions, if not, billions of dollars at issue many believe that retribution to the home buyer is long overdue.

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