

A Synopsis of

*Title Insurance: A Historical Perspective*

Lauren Zimmer\*

May 10, 2009

\*Lauren Zimmer is a junior at SMU and double majoring in Real Estate Finance and Markets and Culture. She is from Kansas City and after graduations hopes to work in commercial real estate.

---

## **Title Insurance: A Historical Perspective**

The title insurance industry is interesting to examine because of the recent scrutiny it has come under and because it is so different from other types of insurance that is offered today. G. Stacy Sirmans and Randy E. Dumm explore this phenomenon in their article, Title Insurance: A Historical Perspective.<sup>1</sup> In their study, Sirmans and Dumm present the historical perspective of title insurance and the current problems associated with the industry. The literature on title insurance essentially examines the current state of the industry by breaking it up into categories including, history, function in real estate transactions, coverage, how the industry operates, costs and payouts, and the recent problems regarding kickbacks and reinsurance.

The need for title insurance is a relatively new and only recently has seen substantial growth. The concept of title insurance was formulated in 1876 after the 1868 Pennsylvania Supreme Court case, *Watson v. Muirhead*. Here, Muirhead lost his property due to an outstanding lien on his property that was placed before he took title. At this time, owners of real estate and especially lenders realized that before they took ownership of real estate, they wanted the guarantee that it was free and clear of encumbrances. This demand resulted in the development of the title insurance industry.

The owner of real estate and the lender, if there is one, are both protected with the purchase of title insurance. Title insurance that is required in all real estate transactions provides a wide range of guarantees that are outlined in the policies. It is important to note that all of the guarantees provided under a title insurance policy cover unknown events that have occurred in the past. First and foremost, title insurance provides protection from unknown liens, defects in public records,

---

<sup>1</sup> Sirmans, G. Stacy, and Randy E. Dumm. "Title Insurance: A Historical Perspective." Journal of Real Estate Literature 14 (2006): 293-320.

forgeries, and improperly delivered deeds. In addition, title insurance insures that the seller of real estate is the lawful owner.

While title insurance provides a wide range of coverage, there are elements of property ownership excluded under title insurance policies. Included are errors and omissions in conveyance, hidden defects, and defects known to the buyer. In addition, zoning and environmental changes are not protected by title companies. Lastly, eminent domain is something that is also not covered with a title insurance policy. The government is always allowed to seize one's property for fair market value.

Title insurance has a critical function in the real estate industry and is mandated by law to provide liquidity in property ownership and to smooth ownership transfer. Essentially the two industries are intertwined. If the uncertainty surrounding property ownership and the history of the real estate was uninsurable, very few people would be confident about investing in real estate. Title insurance is so reliant on the housing market, they too follow the same cyclical patterns that surround the real estate industry as evidenced by a decrease in premiums written when there is a slump in the housing market.

In the insurance sector, hundreds of different types of insurance exist; however, title insurance is differentiated from other types of insurance for a variety of reasons. Most types of insurance require that a premium be paid monthly, quarterly, bi-yearly, or yearly. With title insurance, there is a single premium paid by the purchaser of a piece of real estate. In this, the buyer and the lender, if the buyer obtains a mortgage, is covered indefinitely on that property. Secondly, of the premiums paid, most of these payments are used to cover fixed costs, such as the cost of maintaining a database with containing title information, as opposed to settling claims. Thirdly, as stated previously, title insurance focuses more on loss prevention for events that occurred in the past rather than on reimbursement for unknown events that may occur in the future.

The pricing on title insurance is based on the rate of the investment whereas in other forms of insurance the price is based on the amount of the expected future loss. Finally, title insurance is different from other types of insurance because there a great deal of reverse competition involved. Insurers offer rebates to real estate brokers, mortgage brokers, attorneys, and developers who refer clients to them. The real customers are the buyers of real estate and most often know very little if anything about the title insurance they are required to purchase. Thus, buyers will take the advice of their agent as to which title company to use. The real estate agents then become the target customers of the title companies and they are not the ones who will ultimately purchase the coverage. Each year, title companies pay millions in referral fees and rebates to professionals who refer clients to them. Herein lies the most watched issue regarding the title insurance industry and will be discussed later.

When a buyer obtains a title insurance policy there are two different types of policies that are delivered and three different methods that they are distributed. Just as in other types of insurance, policies can be written by a variety of parties and still be legitimate. Some are written by the title company and their exclusive agents, while others are written by agents who simply affiliate with certain title companies. Sometimes, there will even be policies written by non-affiliated agents. The utilization of such non-affiliated agents in underwriting has been credited with expanding the title insurance market over the last ten years. Of these policies written by all types of agents, there are two types that buyers may obtain. If a buyer utilizes financing from a lender, then a lender's policy is required in addition to the buyer's policy. A lender's policy covers the purchaser of a loan and is mandatory if the mortgage is to be resold in the secondary mortgage market. Unlike the owner's policy which covers the owner for the entire amount of the property, the lender's policy only covers the amount of the mortgage.

The cost structure of the title industry is another unique aspect of the industry. As stated previously, most of the premium payments are used to pay fixed costs. Relative to the entire insurance industry, there is very little loss payout. The text cites that while property and casualty insurers pay out 87 cents on the dollar of premium, title insurers only pay around 5 cents per dollar of premium.<sup>2</sup> Most of the payouts cover title searches, examinations, settlement services, and document preparation. The loss ratios, direct losses paid divided by the direct premiums earned, of a title insurance company are generally very low. For example, in Texas, in 2004, the loss ratio was only 2.5%. For the entire United States, loss ratios for title insurance are mostly less than 10%.

The title insurance industry too has unique characteristics in comparisons to other types of insurance. As noted earlier, the title insurance business follows cyclical patterns similar to that of the larger economy. Thus, following the Second World War, the title insurance industry saw great expansion with the housing boom. More recently, prior to the collapse of housing market, the title insurance industry expanded greatly. The expansion of the industry is concentrated in the hands of six major title companies. The chart below depicts the premiums by the top six title insurance groups for 2004.

<b>Group</b>	<b>Percentage of Direct Premium Written</b>
Land America	34.67%
Fidelity National Financial	24.33%
First American Title	20.61%
Stewart Title	8.92%
Old Republic	4.82%
Attorney Title Inc.	2.16%

With regards to the entire insurance sector of the economy, title insurance holds a relatively large market share for the coverage that it provides. Falling under the property and casualty category

---

<sup>2</sup> Sirmans, G. Stacy, and Randy E. Dumm. "Title Insurance: A Historical Perspective." Journal of Real Estate Literature 14 (2006): 293-320.

of insurance, title insurance accounts for 3.6% of all those property and casualty insurance premiums written in the U.S. The chart below depicts various types of property and casualty insurance available and the dollar amount of premiums earned along with the percentage share of the property and casualty sector each assume.

	<b>U.S. 2004 Premiums</b>	<b>Share of the Title Insurance to Property and Casualty Insurance</b>
Private Passenger Auto	\$156,734,038	36.8%
Homeowner Multiple Peril	\$49,988,887	11.7%
Other Liability	\$40,720,856	9.6%
Workers Compensation	\$36,760,327	8.6%
Commercial Multiple Peril	\$29,134,347	6.8%
Commercial Auto	\$26,722,522	6.3%
Title Insurance	\$15,488,147	3.6%
Accident and Health	\$9,955,816	2.3%
Medical Malpractice	\$9,191,530	2.2%
Fire	\$8,316,595	2.0%

The structure of the title insurance industry has created many profitable opportunities for knowledgeable participants in the field. The main problems that have surfaced regard the pricing of the policies, referral payouts, and the way in which title companies reinsure their policies. The pricing strategy and referral payouts employed in insuring title are problematic because often the consumer's best interest is disregarded and it is easy to take advantage of the customers. The customer is whoever purchases the real estate, but the policy and policy holder are most often selected with the consumer playing little role in the selection process. Real estate brokers and title companies often have prearranged agreements involving referrals that may not be the best arrangement for the customer. Because the customer usually knows little about the title insurance process, they can easily be taken advantage of. The reinsurance of title insurance policies is also problematic. Recently, home builders and other professionals in the real estate or mortgage industries have formed their own reinsurance agencies. They also have prearranged agreements where they will send buyers of real estate to a certain title companies for a referral fee. Then they,

with their reinsurance companies, will reinsure those same policies and pay a kickback to the original insurer. All of these practices increase competition between title companies and then drive the price of title insurance up when it is unnecessary. The customer ends up paying much more for the policy than needed to cover the cost of referrals and kickbacks. Because title insurance is regulated by state, there are many questions that arise because of the differences in the ways the states regulate referrals, kickbacks, and pricing. The ambiguity that lies herein is concerning. Recently, governmental agencies such as HUD and RESPA are examining the issues surrounding payouts and pricing. The title companies are coming under intense scrutiny and it is likely that in the future the federal government will take on the role of regulating the industry to eliminate the cross state differences.

Sirmans and Dumm highlight the characteristics of title insurance and then comment on the current issues surrounding the industry. They explain that title insurance is needed to close most real estate transactions and that having quality title is increasingly important. The coverage that the buyer of real estate receives includes protection from unknown liens, defects in public records, forgeries, and improperly delivered deeds. Currently, the major concern regarding the industry involves the kickbacks and referral fees arranged between title insurers and a party in the real estate transaction such as a broker or mortgage lender. The buyer of the title insurance is usually unfamiliar with title insurance and has little influence on the one time premium they pay. Consequently, the price a customer pays is not always the lowest possible fee, and thus there is a perception that title insurance is overpriced and not really necessary. The authors feel that in order to keep the price of title insurance down, the relationships between title companies and real estate brokers, mortgage lenders, attorneys, and home builders, must be closely monitored and regulated by the federal government so that there is not as much variability in state regulations.