Title insurance is a scam and it’s time for a government takeover

Iowa’s state-run system is by far the cheapest in the nation—and the most effective

By Jeff Andrews Feb 26, 2018, 4:35pm EST

Of all the paperwork and hassle that goes into closing on a new home purchase, one of the most overlooked is also one of the most costly—title insurance.

A lot of homebuyers don't even know they need title insurance until the end of the homebuying process, a time when most people just want to get the process over with. The price tag, which can run north of $2,000 in some states, doesn't seem like a lot in the context of a six- or seven-figure transaction, so a lot of homebuyers just go along with it.

But title insurance doesn't need to be nearly as expensive as it is. Given the availability of online records, providing a title guarantee is as easy and cheap as it's ever been. The exorbitant cost is the result of a title insurance cartel that sets its own prices, doesn't give consumers choice, and gives kickbacks through a web of affiliated companies.

Meanwhile, Iowa's state-run title insurance agency, Iowa Title Guaranty, provides the same service for a flat rate of $110 for mortgages up to $500,000 in a market where the median home price is $131,600, according to Zillow. Iowa also has the lowest claim rate of any state, in some years falling below 1 percent.

"There is no point [to title insurance]," said Robert Hunter of Consumer Federation of America. "What keeps it going is the vested interests who are ripping off people in the process. You got a lot of powerful players who like the status quo."

For decades, conservative dogma has preached that private enterprise is both cheaper and more efficient than a government entity. With title insurance, nothing could be further from the truth, as a handful of companies are forcing people to buy a largely unnecessary product for 20 times the cost.

It's time for a change. It's time for a government takeover of title insurance.

Title insurance is a scam

Title insurance began in the mid-19th century as a way to certify that the person selling you land did in fact own the land.

Today, title insurance protects against errors in public records, unknown liens or easements, or missing heirs. Homebuyers can buy title insurance to protect themselves, but mostly, they're buying title insurance to protect their mortgage lender. Most lenders don't buy their own title insurance; they force borrowers to buy it for them.

Unlike health insurance or car insurance, title insurance protects against an event that happened in the past, so thanks to modern-day digital record-keeping, these issues can be found and corrected with routine (and low-cost) due diligence.

The ease with which companies can guard against a claim shows in the claim rates. While home insurance and car insurance companies can pay upwards of 80 percent of their premium dollars on claims, title insurers only pay around 3 or 4 percent of their premium dollars on claims.

That means 95 percent of their revenue goes toward operating expenses, which are minimal at least as they relate to insuring a title and paying claims, but end up rising and falling in lockstep with revenue.

The title insurance market has proven hard to change because it is dominated by four companies: First American Title, Fidelity, Stewart, and Old Republic account for somewhere between 85 and 90 percent of the industry.

These companies control most of the pricing mechanisms related to title insurance. Title insurance rates, which are generally structured as dollars per $1,000 worth of mortgage debt, differ state-to-state. Twenty state use a "file and use" system, where title insurers choose their own rate, and the state holds the authority to reject it, although they don't. Sixteen states have title insurers seek prior approval for the rates they charge. Ten states don't regulate title insurance rates at all.

Some states have "rating bureaus" that influence rates, but the big four title insurers are often members of these rating bureaus. In other states, those companies control rates just by the sheer force of their market dominance. This keeps rates artificially inflated.

Title insurers also don't market their services to homebuyers, but to real estate professionals—real estate agents, mortgage lenders and brokers, attorneys. Title insurers woo real estate middlemen with lavish parties, tickets to sporting events, and in some cases direct kickbacks from title insurance agents for guiding homebuyers to their company. In fact, much of the premium from title insurance goes to kickbacks.

Kickbacks take a number of forms in the industry, but one example is "reinsurance." A mortgage lender might have a homebuyer purchase title insurance from a particular title insurer. That title insurer will then buy "reinsurance" on that title from a company affiliated with the the mortgage lender, as if more insurance was needed on a policy that pays out only 5 percent of premiums on claims.

"Affiliated business entities continue to grow, and they find better and better ways of hiding those agreements and arrangements," said Tara Lawrence, Director of Iowa Title Guaranty. "You might hear them referred to as marketing service agreements, MSAs. It's a way to shelter and hide kickbacks, essentially."

The entire title insurance market—save for in Iowa—is an example of reverse competition, where a product is marketed to intermediaries instead of to the people actually buying it. The kickback to real estate professionals is the way they secure sales. If a title insurance company tries to compete by offering a lower price, that's less money they have to kick back to real estate professionals and secure sales. Some title insurance startups have found that they actually have to *raise* their rates to be competitive.

In 2012, homebuyers paid more than $10 billion in title insurance premiums. Given how lucrative a hustle it is, it's no secret why title insurance persists.

State-run title insurance: a better way

Most of the developed world uses a land registration system called Torrens title, in which the state keeps a definitive record of land ownership. There's no need for title "insurance," because the state provides a guarantee of title through its exhaustive and well maintained public record.

But the United States has never been prone to adopting the policies of its international counterparts, even when they're demonstrably better. While it's certainly unlikely any state would actually kill a private industry to form a state-run agency in the United States in the year 2018, it's worth highlighting how much better Iowa's state-run system is.

In 1947, Iowa outlawed title insurance in its entirety, but because secondary mortgage market players like Fannie Mae and Freddie Mac require it, Iowa acquiesced in 1987 by creating Iowa Title Guaranty, the only title insurance entity authorized to do business in Iowa.

If an Iowa lender wants to force a borrower to buy title insurance for them, the only option is Iowa Title Guaranty. If you're a homebuyer in Iowa, you're more than likely using an Iowan mortgage lender, and thus Iowa Title Guaranty.

And if you're in Iowa, there's no reason to use anything other than Iowa Title Guaranty because of the incredible value it provides. The agency started charging a flat fee of $110 in the mid-2000s instead of the graduated rate title insurance companies use. It also provides a free owners policy to protect homebuyers; you'd have to buy that separately in another state.

Here's how the process works in Iowa, in its most basic case: Instead of having title insurance agents, Iowa certifies an abstractor to perform the records search. A private practice attorney reviews it and issues an opinion. The abstract—the chronicle of all transactions related to the property—is updated and the loan is completed. Sometimes the abstractor and the attorney are the same person.

Another key difference in Iowa is that Iowa Title Guaranty requires that any issues with the title be resolved before closing. That's partly why their claim rates are lower than title insurance companies in other states. Those companies perform searches and issue opinions, but ultimately may issue the insurance and just hope any outstanding issues don't land in court.

Iowa Title Guaranty passes $60 of the $110 to the attorneys and abstractors, but no money goes back to the lender, eliminating the kickback problem seen in other states. Any excess revenue beyond operating expenses is given to affordable housing initiatives in Iowa, such as helping first-time homebuyers with a down payment or paying down interest on a loan. Between $1 million and $2 million of their revenue annually ends up going to these causes, and $58 million total since the agency's inception.

Despite the state's strict regulation, Iowa Title Guaranty doesn't have a complete monopoly. If an Iowa homebuyer uses an out-of-state lender, that lender might use a title insurance company from that state. That state isn't going to enforce Iowa's laws, particularly when it likely benefits a local business to let it go.

The reason Iowa can charge a cheap flat rate for title insurance is because costs are minimal, predictable, and steady from year-to-year. Charging a graduated rate like insurance companies do isn't necessary, but it provides excess revenue to those companies at times when home prices are up, like right now.

Given how ridiculous and expensive title insurance is in other states and how well things run in Iowa, how has nothing changed? The short answer: Money talks. When states have attempted to pass reforms, title insurance lobbyists get in the way.

The New York Times reported last month on a bro-down between the New York Mets and real estate professionals at Citi Field hosted by AmTrust Title—yet another lavish event meant to woo real estate professionals. Title insurance companies write these events off as business expenses, meaning taxpayers are picking up part of the tab.

New York's legislature considered a ban on "expenses" like these events, and even something as small as buying a cup of coffee for a potential client. Given these events are such a small part of the kickback scheme, the ban hardly qualifies as a reform measure. But before the ban was to take effect, a measure to delay the ban passed unanimously after a fierce lobbying effort.

The lobbying effort even imperils Iowa Title Guaranty. Iowa is an untapped market for title insurance companies, and the agency has to regularly fend off challenges to their system.

"But we're on the side of consumer protection," said Matt Rousseau of Iowa Title Guaranty. "We're advocating for lower closing costs. It's hard to argue with that."