
Report to the California Insurance Commissioner

**AN ANALYSIS OF COMPETITION
IN THE CALIFORNIA
TITLE INSURANCE
AND ESCROW INDUSTRY**

December 2005

Birny Birnbaum
Consulting Economist
1701 A South Second Street
Austin, Texas 78704

1	<i>Executive Summary</i>	1
2	<i>Purpose of Study</i>	5
3	<i>Definition of Competition</i>	6
3.1	Operational Definition of Competition for Study	8
4	<i>Description of Products and Product Markets</i>	9
4.1	Description of Title Insurance	9
4.1.1	Title Insurance Policy	9
4.1.2	Types of Title Insurance Policies	10
4.1.3	Title Insurance Companies and Underwritten Title Companies	12
4.1.4	The Preliminary Report	13
4.1.5	The Price of Title Insurance	15
4.1.6	Title Insurance Premium Split	17
4.2	Description of Escrow Services	20
4.2.1	Escrow Activities	20
4.2.2	Controlled Escrow Companies and Independent Escrow Companies	21
4.2.3	The Price of Escrow Services	22
4.3	Descriptions of Other Services	23
4.4	Phases of the Business of Title Insurance in California	24
4.5	Geographic Scope of Title Insurance and Escrow Markets	24
5	<i>Market Structure: Reverse Competition</i>	27
5.1	Reverse Competition in Title Insurance Markets	27
5.1.1	1977 Department of Justice Report	28
5.1.2	1979 American Land Title Association Report on Controlled Businesses	31
5.1.3	1980 Peat Marwick Study for the Dept. of Housing and Urban Development	32
5.1.4	1980 California Department of Insurance Bulletin 80-12	34
5.1.5	1986 Texas Department of Insurance Staff Study	34
5.1.6	Nelson Lipshutz's <i>The Regulatory Economics of Title Insurance</i>	37
5.1.7	2005 Fidelity Mercury Lawsuit	38
5.1.8	United Capital Group	39
5.1.9	Gateway Title Company vs. Mercury Companies	42
5.2	Effects of Reverse Competition	43
5.2.1	Illegal Rebates and Kickbacks	43
5.2.1.1	California Department of Insurance Enforcement Actions	45
5.2.1.2	Department of Housing and Urban Development RESPA Enforcement Actions	49
5.2.2	Controlled Business Arrangements	53
5.2.2.1	Producer-Owned Title Agencies	56
5.2.2.2	Buying Market Share	57
5.2.3	Expenses in Excess of Efficient Production	57
5.2.3.1	Free Services to Referrers of Title and Escrow Businesses	58
5.2.3.2	Multiple Commitments	58

6	<i>Other Dimensions of Competitive Market Structure</i>	61
6.1	Concentration by State and County over Time	61
6.1.1	Title Insurer Concentration at the State Level	61
6.1.2	Title Insurer Concentration at the County Level	64
6.2	Barriers to Entry	65
6.2.1	Monoline Product	65
6.2.2	Title Plant	66
6.2.3	Skilled Underwriters / Established Salespeople / Real Estate Settlement Personnel	68
6.3	Product Substitutes	69
6.4	Price Elasticity of Demand	69
6.5	Entries and Exits over Time	72
6.5.1	Title Insurance Company Entries and Exits	72
6.5.2	Underwritten Title Company Entries and Exits	74
6.6	Profitability	75
6.6.1	Title Insurer Profitability	76
6.7	Price Competition and Response to Changes in Costs of Production	83
7	<i>Findings and Conclusions</i>	92
	<i>Appendix 1</i>	<i>96</i>
	<i>Appendix 2</i>	<i>98</i>
	<i>Appendix 3</i>	<i>100</i>
	<i>Appendix 4</i>	<i>108</i>
	<i>Appendix 5</i>	<i>110</i>

Executive Summary

California Insurance Commissioner John Garamendi has requested this report by Birny Birnbaum, Consulting Economist, to determine whether a reasonable degree of competition exists in California title insurance and escrow markets.

Based upon a review of California statutes, we determined that the scope of our analysis of competition should include business activities related to title insurance, escrow services and other activities related to the provision of title insurance. We also determined that the type of competition at issue is price competition:

Do market forces in California title insurance and escrow markets drive rates and charges down to a level consistent with the expenses, efficiency, service and profit that would occur in a workably competitive market?

Do providers of title insurance and escrow products and services compete with one another on the basis of price to obtain buyers' business?

We identified the relevant product and geographic markets as title insurance and escrow services within a county or regional group of counties in California.

Findings

Based on an analysis of market structure, market conduct and market performance, we find that a reasonable degree of competition does not exist in the markets for title insurance and escrow services in California, where competition is understood as price competition that drives the price of the title insurance and escrow services to levels consistent with efficient production, service levels desired by consumers and reasonable profits. More specifically, we find that a reasonable degree of competition does not exist in the four phases of the business of title insurance in California:

1. Title Search, Examination and Commitment
2. Issuance and Servicing of Title Insurance Policy
3. Escrow and Closing
4. Other Services

Title Insurance

In the markets for title search, examination and commitment and for policy issuance and service, we found the following:

Reverse Competition

Title insurance and escrow markets are characterized by reverse competition where the marketing of the products is directed at the real estate agents, mortgage brokers and lenders who steer and direct the home purchaser or borrower – the consumer who actually pays for title and escrow services – to particular title insurers, underwritten title companies and escrow companies. Residential consumers have little, if any, market power because title insurance and escrow services are required for the closing of a real estate transaction, resulting in inelastic demand. In a reverse competitive market, expenses are inflated as title insurers compete for the producers of title business – the real estate agents, mortgage brokers and lenders and others involved in real estate settlements.

High Market Concentration

We found title insurance markets highly concentrated – a few title insurers account for the vast majority of title insurance sales – at both the statewide level and at the county level in California. For example, three title insurer groups account for 77.4% of the market at a statewide level. At the county level, each individual market was highly concentrated.

Excess Profits

In a competitive market, sellers earn a reasonable profit. In the California title insurance and escrow services markets, both the title insurers and the underwritten title companies realized excessive profits over an extended period of time. In 2003 and 2004, underwritten title companies in California earned after-tax profits of 49.0% and 32.3%, respectively – excessive by any reasonable measure.

Barriers to Entry

We found that access to title plants was generally not a barrier to entry, but we found a large barrier to entry to be established relationships between the entities that can steer the consumer's title and escrow business and the entities who sell title insurance and escrow services. We found intense competition among title insurers and underwritten title companies for senior title officers, senior escrow managers and senior sales people who have established relationships with real estate brokers, lenders, homebuilders or mortgage brokers. We found all new entrants – title insurers or underwritten title companies – were entities who had such a relationship.

Few Entries into the Market

We found few title insurer entrants over the period from 1995 through 2005 and found the number of title insurer groups declining as title insurers acquired other title insurers. We found few underwritten title company entrants over the 2000 to 2005 period and found that new entrants were controlled business arrangements whose addition to the market did not result in greater price competition.

Illegal Rebating and Kickbacks

We found numerous examples in California of illegal rebates and kickbacks where the title insurer or the underwritten title company provides money, free services or other things of value to a real estate agent, a lender or homebuilder in exchange for business referrals. These illegal rebates and kickbacks – a consequence of reverse competition – show that title insurance and escrow charges are excessive and that some portion of the overcharge is passed from the underwritten title company or title insurer to the referrer of business.

No Price Movement in Response to Changing Costs

We found a remarkable absence of rate changes by title insurers over the past five years, despite declining costs of production, increased number of transactions and increased revenue per transaction. During a period when costs per unit of production declined significantly, underwritten title companies and title insurers maintained excessive rates. The prices charged by title insurers and underwritten title companies were not and are not responsive to the changing costs of production or increasing revenue per transaction at a given set of rates.

Escrow and Closing

We found that the markets for escrow and closing services suffer from the same problems as those for title insurance. In Northern California, escrow and closing are performed by the same entities providing title insurance services and the same market dynamics exist for escrow and closing services as for title insurance products. In Southern California, escrow is performed by both independent escrow companies and the controlled escrow companies that are also underwritten title companies. Despite the greater number of businesses offering escrow services, the cost of escrow services are higher in Southern California than in Northern California. The presence of independent escrow companies in Southern California adds another layer of cost for the consumer instead of driving down prices because of greater supply of services. In a competitive market, the consumers paying for the service could exert market power to reject – and cause sellers to eliminate – unnecessary or unwanted services. Consumers do not have that market power in California escrow and closing services markets.

Other Services

We found that the markets for other services are similar to the markets for title insurance and escrow and closing services. The demand for other services comes from parties in the title insurance or escrow transactions other than the consumer who pays for the other service. The consumer does not have the market power to either affect the services required or the price charged for those services. The consumer who objects to the requirement for other services or the price charged puts the larger real estate or borrowing transaction at risk.

Purpose of Study

California Insurance Commissioner John Garamendi requested this report by Birny Birnbaum, Consulting Economist,¹ to assess whether a reasonable degree of competition exists for title insurance and escrow services for residential properties in California.

California Insurance Code § 12401.3 specifies standards that “shall apply to the making and use of rates pertaining to all the business of title insurance to which the provisions of this article are applicable” and references the degree of competition in evaluating whether rates are excessive:

(a) Rates shall not be excessive or inadequate, as herein defined, nor shall they be unfairly discriminatory. No rate shall be held excessive unless

(1) the rate is unreasonably high for the insurance or other services provided, and

(2) a reasonable degree of competition does not exist in the particular phase of the business of title insurance to which the rate is applicable.

California Insurance Code § 12340.3 defines the “business of title insurance” to include, among other things:

- Issuing, or proposing to issue, a title policy;
- Transacting, or proposing to transact, any phase of title insurance; and
- Any service performed in conjunction with the issuance of a title policy, including, but not limited to, the handling of any escrow, settlement or closing in connection therewith.

In the article containing the rate standards, California Insurance Code §§ 12401.1 and 12401.2 describe rate and form filing requirements of title insurers, underwritten title companies and controlled escrow companies. Consequently, the scope of our analysis of competition is limited to the various business activities of title insurance “to which the article applies,” namely, title insurance, escrow services and other activities related to the provision of title insurance.

¹ The qualifications of Birny Birnbaum are presented in Appendix 1. We would also like to thank the staff of the Department of Insurance for tremendous assistance in obtaining and reviewing a number of documents, reports and data necessary for our analysis.

Definition of Competition

In markets characterized by pure, or perfect, competition, market forces compel suppliers to provide the product or service at a price consistent with the most efficient and lowest cost of production, where the cost of production includes a reasonable return on capital, or profit. In a perfectly competitive market, the following characteristics exist:²

1. The product being sold is homogenous or undifferentiated among suppliers.
2. There are numerous independent buyers and sellers such that no one buyer or seller is able to influence market prices.
3. There are no barriers to entry or exit from the market.
4. Buyers and sellers have perfect information about the product and prices.

The result of a perfectly competitive market is that sellers are forced to sell their product at prices that reflect the lowest cost of production and to compete for buyers' business on the basis of price. In practice, perfect competition never exists. When perfect competition does not exist, but the characteristics of perfect competition exist to such a degree that market outcomes approximate those that would occur in a perfectly competitive market or that produce price competition, a situation called "workable competition" exists.³

In a perfectly competitive market, outcomes are both efficient and produce maximum public welfare. Efficient outcomes are those in which production is organized in the manner that produces the maximum consumer satisfaction or utility.⁴ Through Adam Smith's famous invisible hand, sellers and buyers pursuing their own self-interest produce the maximum public welfare.

In a competitive market, consumers or buyers exert market pressure on sellers through a downward-sloping demand curve – consumers demand greater quantities of a product at lower prices and smaller quantities of a product at higher prices. This typically occurs because as the price of a product increases, consumers turn to substitutes for a product. In addition, as the price of the product increases, the consumer has effectively less income and is able to purchase less of the product.

² This section cites standard economic theory and references three sources: Samuelson and Nordhaus, *Economics, 15th Edition*, McGraw Hill, New York, 1995; Byrns and Stone, *Economics, 5th Edition*, HarperCollins, New York, 1993; and "Chapter XII The Title Assurance and Conveyance Industries" of "Real Estate Closing Costs, RESPA, Section 14a, Volume II Settlement Performance Evaluation" prepared by Peat, Marwick, Mitchell and Co. for the Department of Housing and Urban Development, October 1980, hereafter, the "*Peat Marwick's Study*."

³ *Peat Marwick's Study*, page XII.2.

⁴ Samuelson and Nordhaus, pages 136-141.

Price elasticity of demand is the change in the quantity of a product demanded versus the change in the product's price. A product is price-elastic if the amount purchased by consumers changes significantly in response to a change in price.⁵ In a purely competitive market, price determines the amount of product offered by sellers and the amount of product purchased by consumers. Consumer demand is price-elastic, meaning that changes in prices result in changes in amounts purchased by consumers.⁶ If there is little or no change to the quantity of a product demanded by consumers in response to a change in price, the product is price-inelastic.⁷ Price inelasticity implies that consumers as a group may be unable to discipline sellers with lower amounts purchased in response to higher prices charged.

In a perfectly competitive market, sellers offer the same product and are unable to affect the price. Price is forced to the seller's marginal cost of production, which includes a reasonable profit or return on capital.⁸ Inefficient suppliers – those with less-than-efficient costs of production or otherwise higher costs of production – are forced out of the market because they cannot make a profit at the prevailing market price.

When individual sellers have some ability to influence the price of the product sold, imperfect competition arises. The most extreme case of influencing price is a monopoly, when there is only one seller. A market in which there are few sellers is called an oligopoly, and, in an oligopoly, sellers can also affect the market price.⁹

When sellers can raise the market price above the level that would occur in a competitive market, the cost to buyers is called “deadweight loss.”¹⁰ The deadweight loss consists of reduced output and higher prices when there is a downward-sloping demand curve. That is, when prices are higher than would occur in a competitive market, buyers purchase fewer items. The combination of sellers' ability to affect market price and inelastic demand for the product will result in consumers paying higher prices for the product and purchasing the product in the same amounts as if the price were lower, at a level consistent with workable competition. Sellers in such a market will realize excess or monopoly profits.

When departures from the competitive ideal allow individual sellers to exert influence over prices, imperfect competition occurs with the result of higher prices than would occur in a competitive market, less efficient output, excess profits and prices rising above the marginal cost of production.¹¹

⁵ Samuelson and Nordhaus, page 58.

⁶ Samuelson and Nordhaus, page 39.

⁷ Samuelson and Nordhaus, page 58.

⁸ Samuelson and Nordhaus, pages 128-130.

⁹ Byrns and Stone, page 508.

¹⁰ Samuelson and Nordhaus, pages 174-175.

¹¹ Samuelson and Nordhaus, pages 164-168.

There are other forms of competition besides price competition, such as competition based upon product quality or service. Economists differentiate competition from rivalry. Purely competitive suppliers compete in one dimension – efficient production at a market-determined price. Suppliers engage in rivalry when they compete on other product dimensions besides price, such as advertising and marketing.¹²

3.1 Operational Definition of Competition for Study

In evaluating the degree of competition in the business of title insurance in California, we must have an operational definition. Given the placement of the competition requirement in a statute on rate regulation, generally, and as part of a definition of excessive rates, specifically, we conclude that the type of competition at issue is price competition. Consequently, this report will answer the following questions:

Do market forces drive rates and charges down to a level consistent with the expenses, efficiency, service and profit that would occur in a workably competitive market?

Are California title insurance and escrow product markets structured in such a way that consumers, as a group, exert market power on service providers to drive prices down to the levels expected in a workably competitive market?

Do providers of title insurance and escrow products and services compete with one another on the basis of price to obtain buyers' business?

¹² Byrns and Stone, page 511.

Description of Products and Product Markets

An analysis of competition for any particular product requires a definition of the product market – the product for which buyers and sellers engage in market transactions – and the geographic scope of market transaction.

4.1 Description of Title Insurance

When a buyer purchases real property, or when a lender loans money for the purchase of real property, they typically demand a guarantee that the seller or borrower actually has clear ownership of the property being sold or offered as loan collateral. Title insurance is the most common method of providing that guaranty.

4.1.1 Title Insurance Policy

Title insurance assures a purchaser of real estate (and the lender) that the seller has clear ownership – or title – to the property and can transfer it to the purchaser. The title insurer issuing the policy not only guarantees that the title to the property is sound, it promises to defend the purchaser’s title against any litigation questioning the title and pledges, in the event there is a problem with the title, to compensate the insured (purchaser and lender) up to the amount of liability on the policy.¹³ The title policy does not require that title problems be fixed, only that lenders or owners be compensated in the event of a problem that is covered under the policy.

The California Department of Insurance *Consumer Guide to Title Insurance*¹⁴ provides the following description of title insurance:

Title insurance guarantees that the title to real property is free from all defects in title that may exist in the public records for that property.

Possible title defects include:

- Errors or omissions in deeds
- Mistakes in examining records
- Forgery
- Undisclosed heirs
- Missing heirs
- Liens for unpaid taxes
- Liens by contractors

¹³ California Land Title Association, *Understanding Title Insurance*, found at: <http://www.clta.org/Publications/publications-index.htm>. See also the description of title insurance in the history of the First American Corporation at: <http://www.firstam.com/faf/company/history.html>.

¹⁴ <http://www.insurance.ca.gov/CSD/Brochure/Residential/TitleInsurance.htm>.

Before issuing a policy, title companies check for defects in your title by examining public records including deeds, mortgages, wills, divorce decrees, court judgments, tax records, liens, encumbrances, and maps. The title search determines who owns the property, what outstanding debts are against it, and the condition of the title.

Title insurance is a contractual obligation that protects against losses resulting from various types of defects (as set out in the policy) that may exist in the title of a specific parcel of real property. This protection is effective as of the issue date of the policy. Title companies issue policies on all types of real property.

Title insurance protects you and your lender if someone challenges your property title because of alleged title defects, which were unknown to you at the time you purchased the property and secured title insurance, but come to light at some future date. A title insurance policy contains provisions for the payment of legal fees in defense of a claim against your property that is covered under your title policy. It also contains provisions for payment of losses which result from a covered claim. Coverage can benefit the homeowner or the mortgage company (lender).

4.1.2 Types of Title Insurance Policies

There are two basic types of title insurance policies – the lender’s policy and the owner’s policy.¹⁵ The lender’s policy is issued to the lender and will pay the lender the remaining principal on the loan if there is a title problem that cannot be resolved. The owner’s policy is issued to the buyer of the property for the full purchase price of the property. Consequently, the maximum liability on a title insurance policy is the purchase price of the home.¹⁶

In a typical home purchase, both a lender’s policy and an owner’s policy are issued. The lender requires a lender title insurance policy whenever there is a loan involved in the real estate transaction. The standard California Association of Realtors (CAR) residential property purchase agreement¹⁷ requires the issuance of an owner’s policy for the buyer of the property.

¹⁵ See California Land Title Association, *Understanding Title Insurance*, at: <http://www.clta.org/Publications/publications-index.htm>.

¹⁶ Charles Nyce and M. Martin Boyer, “An Analysis of the Title Insurance Industry,” *Journal of Insurance Regulation*, Winter 1998, page 215.

¹⁷ CAR Form RPA-CA, Revised 10/02, Section 12 E.

The title insurance policy covers past events and continues in force until the loan is extinguished (for the lender's policy) and until the property is sold (for the owner's policy). With a refinancing transaction, the existing lender's policy is terminated and a new lender's policy is issued. The existing owner's policy remains in place.¹⁸

In most states, there is a standard owner's policy and a standard lender's policy, which are typically policies developed by the American Land Title Association (ALTA). In California, there are several owner's policies used.¹⁹ The California Land Title Association (CLTA) standard owner's policy offers the least coverage. The CLTA homeowner's title policy broadens coverage by providing, among other things, coverage for forced removal of a structure because it extends onto other land or violates an existing zoning law. The ALTA residential policy provides broader coverage, including coverage for an unrecorded lien by a homeowners' association or unrecorded easements, among other things. The typical lender's policy is the ALTA loan policy, which is the same as the CLTA loan policy.²⁰

The CAR California Residential Purchase Agreement form²¹ includes several provisions about title insurance. Section 12A requires that the buyer be provided a current preliminary title report and section 12E requires the buyer to receive a CLTA/ALTA Homeowner's Policy of Title Insurance, which provides broader coverage than the CLTA Standard Owner's Policy. The CAR form also provides, "A title company, at Buyer's request, can provide information about the availability, desirability, coverage, and cost of various title insurance coverages and endorsements. If Buyer desires title coverage other than that required by this paragraph, Buyer shall instruct Escrow Holder in writing and pay any increases in cost."

¹⁸ See California Land Title Association, *Why Lenders Require Title Insurance When Refinancing a Loan*, at: <http://www.clta.org/Publications/publications-index.htm>. See also, Charles Nyce and M. Martin Boyer, "An Analysis of the Title Insurance Industry," *Journal of Insurance Regulation*, Winter 1998, page 217. Nyce and Boyer cite data from A. M. Best that property was held an average of 14.1 years in western states and 16.8 years in eastern states for the period 1991-1996, providing a rough estimate of the average coverage provided by an owner title policy.

¹⁹ For comparison of California title insurance policy coverages, see www.fidelitytitle.net.

²⁰ Interview with Larry Green, Executive Director of California Land Title Association, June 23, 2005.

²¹ CAR Form RPA-CA, Revised October, 2002.

4.1.3 Title Insurance Companies and Underwritten Title Companies

In California, the business of title insurance is conducted by underwritten title companies, title insurance companies, controlled escrow companies and independent escrow companies. Underwritten title companies and title insurance companies are licensed by the California Department of Insurance and supervised for solvency²² and competitive behavior.²³ Rates and policy forms are subject to the provisions cited in California Insurance Code §§ 12401 through 12401.10. Independent escrow companies are licensed and supervised by the California Department of Corporations.²⁴

Title insurance policies are issued by title insurance companies, but, in California, are generally sold by underwritten title companies.²⁵ The underwritten title company – the equivalent of a title agent in other states – searches a variety of historical records to determine whether the seller of the property has clear ownership, or title, to the property as presented in the sales contract. Historically, title insurers or underwritten title companies maintained their own title plants – a physical housing of title-related documents. Over the past few decades, title plants have become, to a large extent, computerized and title insurers have merged title plants into joint title plants. These joint title plants provide access to other title insurers and underwritten title companies – non-owners – for a subscription fee.²⁶ Title plant information comes from individual counties as the title-related information – such as property sales, liens, and tax information – is filed initially within the county.

Title insurers sell title insurance in one of three ways – through affiliated underwritten title companies, through non-affiliated underwritten title companies or directly. Affiliated underwritten title companies are members of the same corporate family of the title insurer and, generally, all of that underwritten title company's activities are underwritten by the parent title insurer. A non-affiliated underwritten title company is like an independent agent for personal lines insurance – it can place the title insurance with any of multiple underwriters. Direct business refers to relationships between the title insurer and major real estate settlement entities, such as a national lender. In this situation, the title insurer performs the functions of the underwritten title company as well as those of the title insurer.

²² See California Insurance Code §§ 12350 through 12394.

²³ See California Insurance Code §§ 12396 through 12412.

²⁴ See <http://www.corpageca.gov/ole/oleqa.htm> and <http://www.corpageca.gov/pub/escrow.htm>.

²⁵ Some title policies are sold directly by title insurance companies without the intermediation of an underwritten title company. In California, this direct business represents a small percentage of overall title premium – about 3.2% in 2004. See Table 1 for a breakout of direct, affiliated UTC and non-affiliated UTC business for title insurers in California.

²⁶ Author's review of responses to California Department of Insurance request for title plant information, issued June 7, 2005, and author's tour of Data Trace Joint Plant for Los Angeles County, April 21, 2005.

4.1.4 The Preliminary Report

When a consumer starts to buy some real estate or to refinance an existing real-estate secured loan, a real estate professional involved in the transaction will contact one or more underwritten title companies to open a title order. Once the title order is opened, the underwritten title company will search, analyze and examine the title records and issue a preliminary report about the title.

In most situations, the title search is completely electronic, meaning that all necessary information is available over a computer network or internet connection. This result occurs because most properties have been sold or refinanced within the past 20 years. Over this period, the vast majority of all records – even in smaller counties – is now electronic.²⁷ In some cases, a question about title may arise and the title officer must search older paper records – the so-called “back title plant” – to identify and review older documents. In rare instances, the title officer may need to go back to original title documents from the 1800s.

In most residential transactions today, the title search will look to find the most recent real estate transaction and concentrate on the period from the last transaction forward because the period up to the most recent transaction will be covered by the title search associated with that previous transaction. In some instances, the new title search will review title-related activity prior to the previous transaction, particularly in instances where the previous title search was performed by another underwritten title company or title insurer.

The initial work product is a preliminary title report that assesses the seller’s title, identifies any problems with the title, specifies any problems that will be excluded from coverage unless fixed (such as debts that must be paid off by the seller) and states if there is a commitment to issue a title policy and, if so, on what terms.²⁸

²⁷ Author’s review of responses to California Department of Insurance request for title plant information from title insurers and underwritten title companies, issued June 7, 2005.

²⁸ United Title Company, *Preliminary Reports 101*, page 5, found at: <http://www.unitedtitle.com/libraryofdocs.aspx?id=3&showAd=1>. See also CLTA preliminary report form at: http://ulj.firstam.com/ul/transform.do?link=/db/UL/vol2/NonStateSpecificForms/0046_clta-prel-95.xml.

Preliminary Reports 101, published by United Title Company,²⁹ describes the preliminary report process and product:

After a title order is opened, copies of recorded documents that affect any part of the subject property are assembled in the search package and examined by a skilled technician. The result of this examination is the Preliminary Report that is prepared and sent to the customer.

The report reflects the exceptions to title (matters over which no insurance coverage is provided) that UNITED TITLE COMPANY expects to show in the contemplated policy.

The report is issued before any policy of title insurance, thus the name Preliminary Report.

Those matters shown in the report are as follow:

SCHEDULE "A" IS:

1. The estate or interest covered.
2. The vested owner of the estate or interest.
3. A description of the land involved.

SCHEDULE "B" IS:

1. Exceptions, liens, and encumbrances which affect the land at the date and time of the report.

The Preliminary Report explained on the following pages is a standard form used by all members of the California Land Title Association. The investigation of title include matters contained in the public records and, depending upon the type of final policy that is issued, certain off-record items that may be disclosed by an inspection of the subject property. There may be other matters which may affect title, but may not be identified in the Preliminary Report.

The preliminary report is essentially a commitment to issue a title insurance policy and will include any problems identified with the title, title problems that will not be covered under the policy – liens and encumbrances – and any actions required by the seller or owner to fix problems with the title.³⁰ For example, if the title search finds that there is a lien on the property because of an unpaid bill, the underwritten title company will require that the lien be removed or eliminated before the title policy can be issued, or will exclude coverage for that item.³¹

²⁹ The publication can be found at:

http://www.unitedtitle.com/libraryofdocs.aspx?file=librarydoc/PRELIM_101.pdf.

³⁰ See California Land Title Association, *Understanding Preliminary Reports*, at:

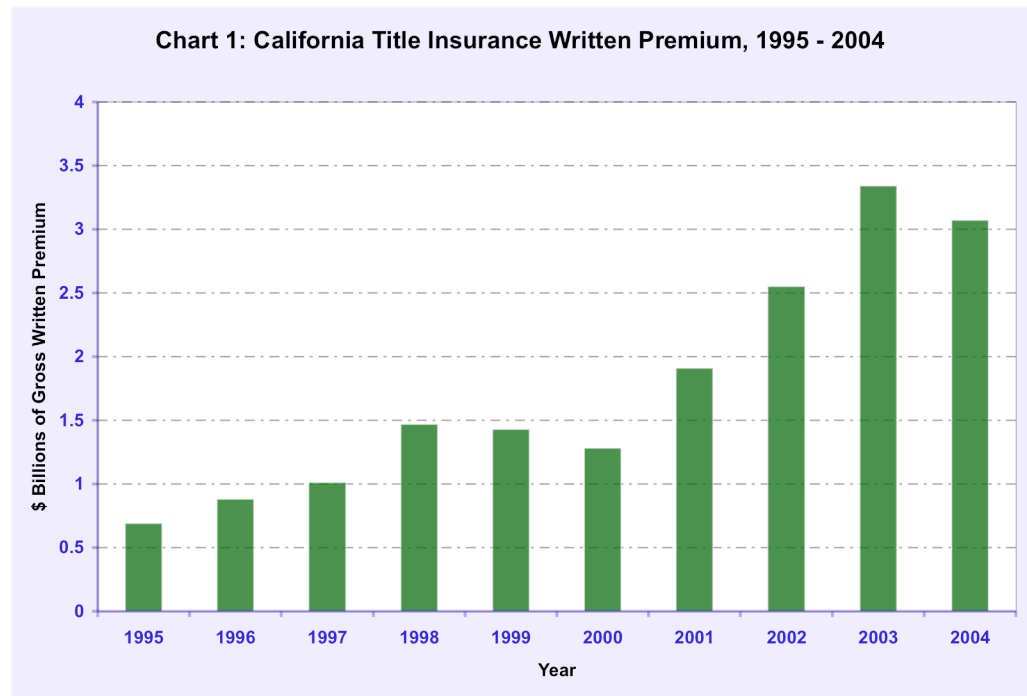
<http://www.clta.org/Publications/publications-index.htm>.

³¹ See also California Insurance Code § 12340.11.

If the title commitment is accepted, the title insurer (or the underwritten title company on behalf of the title insurer) issues the title policies to the lender and new owner and services those policies. The title insurer is responsible for defending the title and settling claims.

4.1.5 The Price of Title Insurance

Californians paid about \$3.1 billion for title insurance in 2004, down from about \$3.4 billion in 2003. Chart 1 shows dramatic growth in the amount of California title insurance premium over time, particularly since 2000.



The price a consumer pays for title insurance is based on rates filed by title insurers with the California Department of Insurance. Rates for title insurance are typically a function of the amount of liability. The liability is the amount of coverage, which is the amount of the loan for the lender's policy and the purchase price of the house for the owner's policy. The filed title insurance rates typically do not vary within the state. However, because title rates are a function of sales price or loan amount, the average title premium varies considerably by county.

When both the lender's and the owner's policies are issued in a real estate transaction, the cost of both policies is not twice the cost of one policy. For example, a recent filing by LandAmerica's Commonwealth Land Title Insurance Company states a premium of \$1,683 for an owner's policy with \$500,000 of coverage, which, for example, equals the purchase price.³² The cost of a concurrently-issued lender's policy is \$100.³³ If we assume a loan of \$400,000 was involved in this real estate purchase, the premium for a lender's policy with no concurrently-issued owner's policy would be \$1,423.80.³⁴ It should be noted that the issuance of a lender's policy with no concurrently-issued owner's policy would likely only occur in a refinance transaction and there is typically a discount of at least 20% from the basic rate on a refinance lender's policy.

For another example, Fidelity National Title Insurance Company has filed rates producing a premium of \$1,695 for the \$500,000 owner's policy, \$75 for a concurrently-issued lender's policy and \$1,445 for a \$400,000 lender's policy not issued concurrently with an owner's policy.³⁵

Depending on the particular county where the real estate transaction occurs, the title insurance and escrow may be paid for by the buyer, the seller or both, typically based on historical and customary practice.³⁶ The lender does not pay for its title insurance policy. Who pays can also be a point of negotiation between the buyer and seller in a real estate transaction. In a refinance transaction, the owner pays for the title insurance.³⁷

³² The filing has an effective date of July 11, 2005. The policy priced in the example is the California Land Title Association Standard Coverage Policy. See Basic Insurance Rate Table "A," Rates, page i and Owner's Insurance Section, Part II, Page 1, Section 2.1 A.

³³ Part III, Page 1 of Commonwealth Filing, Section 3.1 A 2.

³⁴ Part III, Page 1 of Commonwealth Filing, Section 3.1.A.2 and Basic Insurance Rate Table "A," page i.

³⁵ The Fidelity rate filing has an effective date of October 4, 2002. See Insurance Rate Table "R" on pages 16-17, Owner's Insurance, Part 2.1 A on page 19 and Lender's Insurance, Parts 3.1 A 1 and A2 on page 31.

³⁶ See California Land Title Association, *Why Lenders Require Title Insurance When Refinancing a Loan*, at <http://www.clta.org/Publications/publications-index.htm>.

³⁷ California Department of Insurance *Consumer Guide to Title Insurance*, Interview with Larry Green, Executive Director of California Land Title Association, June 23, 2005. See also Section 4D of the CAR California Residential Purchase Agreement.

The bulk of the title insurance premium goes to expenses as opposed to claim payments. A.M. Best reports that title insurers paid an average of 4.6% of premium for claims and claim settlement expenses from 1995 to 2004 compared to around 80% for the property casualty industry.³⁸ Title insurers pay a relatively small portion of the premium dollar in claims because they are, essentially, guaranteeing the quality of their work. According to the California Land Title Association, “Title insurers work to identify and eliminate risk before issuing a title insurance policy.”³⁹ While some claims may arise because of fraudulent documents or undisclosed information, for the overwhelming majority of properties, title insurers can effectively ensure clean title through careful search and examination.

4.1.6 Title Insurance Premium Split

The title insurance premium is split between the title insurance company and the underwritten title company, when an underwritten title company is involved in the title transaction. The typical premium split in California is 8% to 12% for the title insurer and 92% to 88% for the underwritten title company.⁴⁰ The percentage of gross title premium retained by title insurers in California – a bit less than 10% on average – is much less than the percentage retained by the same title insurers in other states. For each of the top four title insurer groups, which wrote a combined 85.1% of total California title insurance premium in 2004, the countrywide agent retentions – a term comparable to the underwritten title companies’ share of title premium – was much lower than the 90% found in California:

<u>Title Insurer Group</u>	<u>Countrywide Agent Retention</u>
First American:	81.3% ⁴¹
Fidelity:	77.7% ⁴²
LandAmerica:	80.1% ⁴³
Stewart:	81.7% ⁴⁴

³⁸ A.M. Best Special Report, *Title Industry Running on All Cylinders*, October 4, 2004, page 9.

³⁹ California Land Title Association, *Understanding Title Insurance*, at:

<http://www.clta.org/Publications/publications-index.htm>.

⁴⁰ Author’s review of numerous underwriting agreements between title insurers and underwritten title companies. See also Table 7, below, which shows that underwritten title companies remit, on average, about 10% of gross title insurance premium to title insurers. Appendix 2 summarizes the key provisions of several underwriting agreements.

⁴¹ First American Corporation 2004 Annual Report to Stockholders, page 17.

⁴² Fidelity National Financial 2004 Annual Report to Stockholders, page 27.

⁴³ LandAmerica Corporation 2004 Annual Report to Stockholders, page 15.

⁴⁴ Stewart Information Services Corporation 2004 Annual Report to Stockholders, page 27, author’s calculation.

The difference in agent retention (underwritten title company share of gross title premium) in California versus the countrywide figures may be a result of the typical underwriting agreement in California that specifies that the underwritten title company reimburse the title insurance company up to \$5,000 for any title insurance claim paid by the title insurance company on a policy underwritten by the underwritten title company.⁴⁵ A general explanation for the differences in agent retentions across companies and across states comes from Dr. Nelson Lipshutz:

A change in commission rates may reflect any number of factors. It might reflect simply a shift in the relative costs faced by insurers compared to agents. Reasons for such a shift might include differing rates of title product expense inflation faced by insurers and agents, or a change in the intensity of marketing effort required in the marketplace. On the other hand, a change in the commission rate might reflect an exercise of market power related to the ability of agents to “control” the placement of business.⁴⁶

Table 1 shows the amount of California title insurance premiums generated from underwritten title companies affiliated with title insurers, from underwritten title companies not affiliated with title insurers and from direct business by title insurers without the intermediation of an underwritten title company from 1995 through 2004. The table shows that the share of direct business dropped from about 27.5% in 1995 to almost zero in 2000. Direct business grew to 3.2% in California in 2004, a far lower percentage of title insurance premiums than the 16.2% found in the remainder of the country in 2004.

⁴⁵ Author’s review of underwriting agreements between underwritten title companies and title insurers in California. See Appendix 2 for a description of specific underwriting agreements. The \$5,000 reimbursement is limited to claims for which the underwritten title company performed the title examination and policy issuance according to the directions of the title insurer. The typical underwriting agreement also specifies that the underwritten title company must reimburse the title insurer for the entire amount of a claim resulting from the underwritten title company not following specified procedures.

⁴⁶ Nelson R. Lipshutz, *The Regulatory Economics of Title Insurance*, Praeger Press, Westport, CT, 1994, page 37.

Table 1⁴⁷
Percentage of Total Title Insurance Premiums from
Affiliated and Non-Affiliated Underwritten Title Companies and from
Direct Sales, California and Remainder of the Country

California

<u>Year</u>	<u>Direct</u>	<u>Non-Affiliated</u>	<u>Affiliated</u>
1995	27.5%	18.1%	54.4%
1996	12.9%	22.4%	64.6%
1997	6.7%	26.1%	67.2%
1998	1.2%	24.4%	74.5%
1999	1.0%	25.6%	73.4%
2000	0.4%	21.2%	78.4%
2001	0.4%	21.2%	78.4%
2002	2.0%	23.3%	74.7%
2003	3.3%	24.3%	72.4%
2004	3.2%	22.1%	74.8%

Remainder of Country

<u>Year</u>	<u>Direct</u>	<u>Non-Affiliated</u>	<u>Affiliated</u>
2004	16.2%	26.8%	57.0%

⁴⁷ California figures are author's calculations based upon Annual Statement Schedule T data for California, 1995 through 2004. Remainder of Country figures are author's calculations based upon Market Share Report for 2004 published by the American Land Title Association at www.alta.org.

4.2 Description of Escrow Services

In a real estate transaction, money changes hands. A neutral third party – not the buyer or seller – typically handles the money and the instructions for transferring the money from one party to another. This set of activities is called escrow. In California, escrow services consist of both the transfer of funds among buyer, seller and lender and the closing of the real estate transaction.

4.2.1 Escrow Activities

United Title Company provides consumers with a guide entitled “What is Escrow?”⁴⁸ which describes escrow as follows:

A buyer, seller and lender have certain biased interests in any real estate transaction. Escrow is a nonbiased entity that protects all parties. This is why escrow was developed. As a buyer, seller, or lender, you want to be certain all conditions of sale have been met before property and money change hands. Escrow is defined as a procedure in which a third party acts as a stakeholder for both the buyer and the seller, carrying out both parties’ instructions and assuming responsibility for handling all the paperwork and distribution of funds.

Escrow does:

- Serve as the liaison to all parties in the transaction;
- Act as a neutral “stake-holder”
- Prepare escrow instructions; requests a preliminary title search or title commitment to determine the present condition of title to the property
- Comply [sic] with the lender’s requirements as specified in the escrow agreement
- Receive purchase funds from the buyer
- Prepare or secures [sic] the deed or other documents related to escrow; prorates taxes, interest, insurance and rents according to instructions
- Secure releases of all contingencies or other conditions required;
- Records deeds and any other documents as instructed
- Close escrow when all instructions from buyer and seller have been carried out
- Disburse authorized funds
- Prepare final statement

⁴⁸ The publication can be found at:
<http://www.unitedtitle.com/libraryofdocs.aspx?file=librarydoc/WhatIsEscrow.pdf>

4.2.2 Controlled Escrow Companies and Independent Escrow Companies

In Northern California, all escrow activity is generally conducted by controlled escrow companies, which are affiliates of the underwritten title companies or title insurers.⁴⁹ In Southern California, escrow activity is generally conducted by independent escrow companies and by controlled escrow companies performing a “sub-escrow” function.⁵⁰ Sub-escrow is typically the portion of escrow activity associated with disbursement of funds by the lender, who prefers to do business with the underwritten title company than with an independent escrow company.⁵¹

A recent Commonwealth Land Title Insurance Company filing describes sub-escrow as a charge for “the receipt of funds from a lender whose deed of trust is to be insured and from the escrow holder, the payoff of an existing loan secured by the subject property and the disbursement of the balance of funds received, if any, to the escrow holder.”⁵² The current Chicago Title Insurance Company rate filing describes limited or sub-escrow as services “performed by the Company only in support of a primary escrow agent in connection with the issuance of a policy of title insurance. The services are limited to the acceptance of documents and funds to pay off or release a particular encumbrance or charge against the land, or to transfer funds from one party to a designated payee upon instructions limited to such items by the lender, lienholder or payor.”⁵³

The difference in escrow market structure in Northern and Southern California is a result of historical and customary practice and does not appear to be a response to underlying economic conditions or costs to provide the service. Because lenders were reluctant to do business with independent escrow companies in Southern California, the underwritten title companies established sub-escrow functions to handle disbursement of funds from the lender.⁵⁴

⁴⁹ California Insurance Code § 12340.6(a).

⁵⁰ Although “sub-escrow” is a standard term in the California title insurance and escrow service industry and included as a service separate from “full escrow” in title insurer rate filings, “sub-escrow” is not specifically mentioned in the California Insurance Code.

⁵¹ Interview with Larry Green, Executive Director of the California Land Title Association, June 23, 2005.

⁵² Commonwealth Land Title Insurance Company rate filing, effective date of July 11, 2005, Part IX, page 4.

⁵³ Chicago Title Insurance Company, California Schedule of Fees, effective July 1, 1996, General Rules, F3, page 7.

⁵⁴ Interview with Larry Green, Executive Director of the California Land Title Association, June 23, 2005.

4.2.3 The Price of Escrow Services

Rates are filed with the Commissioner for escrow services. Like title insurance rates, escrow fees vary by the size of the transaction. Unlike title insurance rates, escrow fees also vary by county. Table 2 shows escrow fees for a sales transaction for various transaction amounts in five counties filed by three title insurance companies. The prices for escrow services in Southern California are significantly higher than in Northern California.

Data on total escrow fees paid by Californians is not available. Californians paid about \$1.1 billion in escrow fees in 2004 to controlled escrow companies, down from about \$1.2 billion in 2003.⁵⁵ The amount paid to independent escrow companies, who operate in Southern California, is unknown.

Table 2
Escrow Fees Filed for Selected Counties and Transaction Amounts

First American Title Insurance Company

<u>Amount</u>	<u>Fresno</u>	<u>Sacramento</u>	<u>San Francisco</u>	<u>Los Angeles</u>	<u>San Diego</u>
\$250,000	\$725	\$655	\$590	\$1,400	\$900
\$350,000	\$875	\$760	\$740	\$1,600	\$1,100
\$500,000	\$1,025	\$875	\$920	\$1,800	\$1,400
\$1,000,000	\$1,025	\$950	\$930	\$2,500	\$1,900

Fidelity National Title Insurance Company

<u>Amount</u>	<u>Fresno</u>	<u>Sacramento</u>	<u>San Francisco</u>	<u>Los Angeles</u>	<u>San Diego</u>
\$250,000	\$450	\$650	\$530	\$800	\$800
\$350,000	\$550	\$750	\$635	\$1,000	\$1,000
\$500,000	\$700	\$1,000	\$800	\$1,500	\$1,500
\$1,000,000	\$700	\$1,375	\$800	\$1,500	\$1,500

Commonwealth Land Title Insurance Company

<u>Amount</u>	<u>Fresno</u>	<u>Sacramento</u>	<u>San Francisco</u>	<u>Los Angeles</u>	<u>San Diego</u>
\$250,000	\$588	\$588	\$538	\$1,125	\$1,125
\$350,000	\$700	\$700	\$663	\$1,300	\$1,300
\$500,000	\$700	\$700	\$850	\$1,300	\$1,300
\$1,000,000	\$700	\$700	\$850	\$1,300	\$1,300

⁵⁵ Compilation of Income Statement Line 2 of the 2004 Underwritten Title Company reports. See Appendix 5.

4.3 Descriptions of Other Services

Title insurance companies and underwritten title companies may provide, and charge consumers for, other services. The other services are typically activities related to, but not included in, standard title insurance and escrow services. For example, Chicago Title Insurance Company's rate filing includes additional charges for the preparation of the following "instruments:"

- Affidavit of Death of Joint Tenant
- Affidavit of Death of Community Property
- Agreement of Sale (Land Contract)
- All Inclusive Note and Deed of Trust
- Assignment of Lease
- Assignment of Note and Deed of Trust
- Assignment of Oil and Gas Lease
- Assumption
- Beneficiary Statements
- Bill of Sale
- Collateral Assignment
- Deeds (Grant)
- Deeds (Quitclaim)
- Note (Unsecured)
- Notice of Completion
- Power of Attorney (Limited)
- Request for Notice
- Request for Full Conveyance
- Request for Partial Conveyance
- Subordinations
- Substitution of Trustee

Commerce Title Company filed the following additional service:

- Loan Tie-In Fee: \$75-150 per loan, depending upon the service requirements of the lender. This is the charge made when a new loan escrow is handled concurrently with the sale escrow; or where a second loan escrow is handled concurrently with a new first loan escrow.

LandSafe Title of California has filed the following additional services:

- Loan Tie In (sales only)
- Drawing Documents
- Processing Subordination
- Making Disbursements After 5th Disbursement
- Interest Bearing Account Set Up

Southland Title Corporation has filed charges in addition to the escrow fee for the following services:

- Loan Tie-In Fee (Purchase/Sale Only)
- Subordination
- E Doc Fee
- Document Preparation
- Demand Fee
- Interest Bearing/Setup/Closing

The Insurance Commissioner has oversight of other services and the charges for those services with the exception of “miscellaneous charges.” California Insurance Code 12340.7 defines miscellaneous charges as “conveyancing fees, notary fees, inspection fees, tax service contract fees and such other fees as the commissioner by regulation may prescribe.” Miscellaneous charges are excluded from the definition of rate.

4.4 Phases of the Business of Title Insurance in California

Based upon our review, described above, we conclude that the phases of the business of title insurance in California consist of the following:

1. Title Search, Examination and Commitment
2. Issuance and Servicing of Title Insurance Policy
3. Escrow and Closing
4. Other Services

4.5 Geographic Scope of Title Insurance and Escrow Markets

Title insurers are licensed to transact business by the Department of Insurance and such license authorizes the insurer to conduct business in any county in California. Underwritten title companies and controlled escrow companies are also licensed to transact business by the Department of Insurance, but these licenses are county-specific. An underwritten title company may only conduct business in those counties for which it has made application and received approval. In theory, an underwritten title company could obtain authorization to conduct business in every county. A few underwritten title companies operate in many counties, but the majority of underwritten title companies operate in only a few counties.

It is common for underwritten title companies to work on title and escrow in counties for which they do not have a license through fee-splitting arrangements with underwritten title companies who are licensed in those counties. The Department of Insurance has not collected much information on this practice and, consequently, the nature of the fee-splitting arrangements, the type of work performed by each underwritten title company and the extent of such fee-splitting arrangements is not known.

The data upon which title search, examination and commitment are based is collected at the county level. However, county-based title plants have given way to regional title plants that maintain title-related information in two or more counties. As more and more title information becomes electronic – through the passage of time with all new additions being electronic and through conversion of historical paper documents to electronic documents – the scale of the title plant is not limited by county or even state. A national title insurer can operate a national data center which maintains title plant information for a number of states. Some of the larger underwritten title companies and title insurers in California have consolidated title search, examination and policy issuance into centralized locations that serve two or more counties.

In recent years, the Federal Trade Commission has taken three anti-trust actions against title insurers because of anti-competitive actions related to title plants.⁵⁶ The FTC analyses describe the markets for title plants as follows:

Because of the county-specific way in which title information is generated and collected and the highly local character of the real estate markets in which the title plant services are used, geographic markets for title plant services are highly localized, consisting of the county or local jurisdiction embraced by the real property information contained in the title plant.

Consumers obtain title and escrow services from local service providers and these title and escrow services are affected by local custom and history – from who pays for what services to whether a controlled escrow company or independent escrow company is involved in the escrow and closing.

⁵⁶ See *In the Matter of LandAmerica Financial Group, Inc.*, Docket No. C-3803 at: <http://www.ftc.gov/os/caselist/c3808.htm>; *In the Matter of Fidelity National Financial, Incorporated*, Docket C-3929 at: <http://www.ftc.gov/os/caselist/c3929.htm>; and *In the matter of Commonwealth Land Title Insurance Company*, Docket No. C-3835, at : <http://www.ftc.gov/os/1998/11/9810127cmpagehtm>.

Although some title insurers have developed statewide and national relationships with some lenders, real estate agencies or homebuilders, the vast majority of title insurance and escrow business is generated by local referrals. We found, as described below, significant competition for the referrers of title insurance and escrow business – as opposed to competition for the consumers who actually pay for the services.

In his primer on title insurance, Nelson Lipshutz describes the title insurance markets:

Title insurance underwriting is an inherently distributed function, because the data on which the underwriting decision is based are located in county-level courts and registries. Further, the title insurer often fulfills the role of closer of the real estate transaction, and in those instances is also responsible for filing deeds, mortgages, and similar documents in those same locations.⁵⁷

We found that the key point of competition among underwritten title companies and title insurers is for referrals from the real estate professionals who can steer the ultimate consumer – the buyer or seller of a property or the consumer borrowing money secured by real estate – to the escrow company, the underwritten title company and the title insurer. In most cases, this competition for referrals is quite local and focuses on escrow and title sales staffs who have established relationships with the real estate professionals who are able to steer title and escrow business. In other cases, the competition is at a national level, characterized by the largest title insurers seeking a countrywide relationship with lenders or others who are able to steer business on a nationwide basis. The largest title insurers and underwritten title companies in California typically have organizations and staff devoted to both national sales as well as having local sales offices devoted to local sales.

Based on all of the above, we conclude that a county or regional group of counties is the appropriate geographic measure of the title insurance and escrow markets in California.

⁵⁷ Nelson Lipshutz, *The Regulatory Economics of Title Insurance*, Praeger Press, Westport, CT, 1994, page 5.

Market Structure: Reverse Competition

In evaluating the structure of title insurance and real estate markets, the dominant characteristic of these markets is reverse competition.

5.1 Reverse Competition in Title Insurance Markets

Reverse competition refers to the situation where a third party is necessary for the seller to sell the product to the consumer. In the case of title insurance, title insurers do not market their services directly to the consumers who actually pay for the title insurance and escrow. Rather, they market their services to entities involved in the real estate transaction who are able to refer or steer the consumer to a particular underwritten title company or title insurer. The title insurer and underwritten title company compete for business by providing a variety of considerations to the producers of business – real estate brokers, mortgage brokers, lenders, and developers – to secure the referrals. This competition is called reverse competition because market forces cause title insurers and escrow companies to spend money to obtain business – costs that are passed on to consumers. Competition for business raises the costs of production and raises the price to consumers.

Professor Jack Guttentag succinctly describes the phenomena of reverse competition:

Why third-party settlement service charges are too high:

Third parties involved in the lending process include title insurance companies, mortgage insurance companies, appraisers, credit-reporting agencies, flood insurance companies and escrow companies. Their costs are generally higher than they would be if they were purchased in a normally competitive market.

The reason is that third-party service providers compete not for the favor of borrowers, who pay their fees, but for the favor of the lenders who select them. This type of competition is perverse because it drives up the costs of the service providers. This in turn raises prices to borrowers or prevents prices from falling in response to improvements in technology.⁵⁸

Numerous studies and reports have described the reverse-competitive structure of title insurance markets.

⁵⁸ Jack Guttentag, “Real Estate Settlement Services Take Bite Out of Borrowers,” *Inman News*, September 6, 2005. Dr. Guttentag is Professor Finance Emeritus from the Wharton School at the University of Pennsylvania. See <http://www.mtgprofessor.com>.

5.1.1 1977 Department of Justice Report

A 1977 report by the Department of Justice⁵⁹ identified three principal participants in the title insurance transaction – the real estate settlement producer, the title company (which performs the title search and issues the title policy on behalf of the title insurer), and the title insurer or underwriter whose policy is issued.

The report describes the real estate settlement producer as “a person whose knowledge, experience and business relationships give him a potential to control, through domination of the closing process, the placement of orders for a whole array of ancillary services such as title insurance.”⁶⁰

The report is one of the first descriptions of reverse competition:

The market demand in the title insurance industry also differs from that of most other forms of insurance. Title insurance is ancillary to the principal transaction, which is the purchase of an interest in land. As part of the process of acquiring an interest in land, the buyer either desires or is required to obtain evidence that his interest is as represented by the seller.

Under these circumstances, the demand for title insurance is highly inelastic. That is, within reasonable limits the number of policies demanded will not change significantly with changes in policy prices or changes in the income of consumers. Title proof is simply part of the procedure for transferring interests in land and, as a result, title insurance has become an ancillary service of the real estate market.

The effects of the phenomenon are described as follows:

Perhaps nowhere in the economy is there such a maldistribution of economic knowledge and power than in the finance and real estate markets.

Sellers in particular and those choosing the source of title insurance for the ultimate buyer are generally quite well informed as to what is offered in the market. Those who actually pay for policies are as a rule notoriously uninformed as to the sellers and the services they provide.

⁵⁹ *The Pricing and Marketing of Insurance: A Report of the Department of Justice to the Task Group on Antitrust Immunities*, January 1977, pages 250-274, hereafter *1977 DOJ Study*.

⁶⁰ *1977 DOJ Study*, pages 251-252.

Due to lack of knowledge, lack of time, and lack of interest, the purchaser of a title insurance policy frequently exerts little, if any, influence on the selection of sellers. Although the person who pays for the title insurance policy could determine the seller, he usually does not, relying, instead, on his real estate broker, mortgage banker or attorney to direct the business to the most suitable insurer.

In other words, competition in the title insurance business is directed at the producer of the business rather than the consumer. A title company wishing to increase its market share would not necessarily try to reduce prices or improve coverages in order to attract retail purchasers of title insurance. Rather, the company would seek to influence those brokers, bankers and attorneys who are in a position to direct the title insurance business to it. The most direct manner of influencing this is to grant the producer of the business a fee, commission, rebate, or kickback – to the detriment of the title insurance purchaser. This is the phenomenon of reverse competition.

The presence of reverse competition in the title insurance industry has resulted in “a long history of such anti-competitive practices as fixed fees, forced (tied) sales and kickbacks.” Reverse competition as the effect of raising the cost of title insurance, for the higher the cost of the insurance, the larger the referral commission or kickback to the business producer and the more business a title insurer is likely to have.

....

In conclusion, the title insurance industry suffers from a number of competitive problems. Chief among those is reverse competition brought about by an imbalance of knowledge on the part of real property purchasers. Reverse competition presently overwhelms most forms of competitive pressure in its tendency to drive title rates up. Unless this problem can be solved, or unless title insurance is marketed in new ways, direct ways which eliminate reverse competition, competitive controls cannot be relied upon to prevent excessive rates.⁶¹

⁶¹ 1977 DOJ Study, pages 254-257, 274.

Neither of the necessary measures prescribed by the Department of Justice have come to pass. Reverse competition continues to be the dominant characteristic of title insurance markets. The DOJ's specific proposal to create direct marketing of title insurance to consumers was to require lenders to purchase the title insurance and be prohibited from passing the cost through to the buyer or seller of the property. The DOJ reasoned that, by requiring lenders to purchase the title insurance would create a class of consumers – the lenders – who regularly purchase the product and who would be able to interact directly and routinely with title insurers. This market dynamic would allow lenders to place pressure on title insurers to lower prices.⁶²

The DOJ study concluded that the primary reason for rate regulation of title insurance is:

to control the price inflating tendency of reverse competition. As indicated at the outset, lack of purchaser knowledge causes competition in the title insurance industry to focus on market outlets. Instead of price competition to reduce costs and attract ultimate consumers, reverse competition drives up title costs as insurers strive to pay higher commissions and kickbacks to real estate settlement producers.⁶³

The DOJ study also discussed controlled business arrangements as a “loophole” in the federal prohibition (through the Real Estate Settlement Practices Act) of giving or receiving “anything of value for the mere referral of business of a federally-related real estate mortgage settlement service, such as title insurance.”⁶⁴

The DOJ study concluded that controlled business arrangements – where a real estate settlement producer was also an owner of the title company and directs business to the affiliated title company – formalizes kickbacks as dividends or profits to the real estate settlement producer.

To sum up the major evils of controlled title companies, where a real estate settlement producer is able to direct the purchaser of a title insurance policy to a particular title company and at the same time that producer owns the title insurance company, the purchaser is likely to end up 1) paying unreasonably high premiums, 2) accepting unusually poor service, or 3) accepting faulty title examinations and policies from the controlled title company.⁶⁵

⁶² 1977 DOJ Study, pages 260-261.

⁶³ 1977 DOJ Study, page 266.

⁶⁴ 1977 DOJ Study, pages 268-269.

⁶⁵ 1977 DOJ Study, page 273.

5.1.2. 1979 American Land Title Association Report on Controlled Businesses

In 1979, the American Land Title Association, the national trade association and advisory organization of title insurers, published a report on the problems of controlled business arrangements in the title insurance industry.⁶⁶ The report describes the reverse competitive structure of the title insurance market and how controlled business arrangements contribute to the problem.

Because title insurance services are generally obtained only in connection with the purchase of real estate, which is an infrequent event in the lives of most people, home buyers and sellers as a rule have little familiarity with title insurance service providers and, accordingly, are willing to accept the recommendation of others regarding the selection of a title insurance service provider.

Real estate brokers, mortgage lenders, attorneys, and real estate developers play pivotal roles in the real estate settlement process, with the result that they are in a strong position to influence or control the consumer's selection of a title insurance service provider.

The economics of title insurance operations, which involve high fixed costs and require a sufficient volume of business to achieve necessary economies of scale, result in the title insurance servicing providers assigning a great deal of value to every additional transaction. Accordingly, title insurance service providers are subject to intense competitive pressures to obtain business from controllers of business.

⁶⁶ American Land Title Association, *The Controlled Business Problem in the Title Insurance Industry*, November, 1979. As an advisory organization, ALTA develops standard policy forms and endorsements that it files on behalf of member companies in individual states to enable the member title insurance companies to utilize the standard forms and endorsements.

5.1.3 1980 Peat Marwick Study for the Dept. of Housing and Urban Development

In a 1980 study for the Department of Housing and Urban Development (hereafter “Peat Marwick’s study”), Peat Marwick examined title insurance and settlement practices and pricing in eight metropolitan areas, including Los Angeles.⁶⁷ The study set out to determine if workable competition existed in the markets for title assurance and conveyance services and if consumers were well served in terms of service and product provision. The study concluded:

The major findings of the study show that the markets for title assurance and conveyance services are not characterized by workable competition. Nor do they perform well in most localities in terms of providing consumers with required settlement services at a price which approximates the cost of efficiently providing those services.⁶⁸

Peat Marwick’s Study also found that the “dominant economic characteristic of the title insurance industry is reverse competition”⁶⁹ and “reverse competition essentially is competition for referral by providers rather than competition for customers themselves.”⁷⁰

Peat Marwick’s Study found prices varied significantly among the eight locations studied, but concluded that “the practices and price structures in each area are determined more by historical chance or by local institutional factors than by an economic rationale.”⁷¹

Peat Marwick’s Study’s findings for Los Angeles included:

The total cost of title assurance and conveyance services in the Los Angeles area was the highest among the eight selected sample sites. Title insurance is used almost exclusively as the acceptable form of title assurance, but an unusual feature of the title and conveyance market in Los Angeles is the use of escrow companies to provide conveyance services. While the title companies provide the title search, examination, and insurance at rates which are not unusually high, the conveyance functions are then performed by escrow companies who charge substantial fees. Escrow companies may be independent, but often are owned by real estate brokers, lenders or title companies.

⁶⁷ “Chapter XII The Title Assurance and Conveyance Industries” of *Real Estate Closing Costs, RESPA, Section 14a, Volume II Settlement Performance Evaluation* prepared by Peat, Marwick, Mitchell and Co. for the Department of Housing and Urban Development, October 1980.

⁶⁸ *Peat Marwick’s Study*, page XII-59.

⁶⁹ *Peat Marwick’s Study*, page XII-45.

⁷⁰ *Peat Marwick’s Study*, page XII-45.

⁷¹ *Peat Marwick’s Study*, page XII-39.

Another source of variation unique to Los Angeles is the use of a California Land Title Association policy as the standard form of a lenders policy. An additional fee is charged if the bank requires, as they frequently do, lenders title insurance using the American Land Title Association (ATLA) form. The differences between the policies are apparently sufficient to prompt most secondary mortgage markets investors to request the ALTA forms.

The Los Angeles SMSA is the national model for open and unregulated competition in the markets for title assurance and conveyance services. There is effectively no regulation of rates, either for title insurance or for any of the other services covered by this chapter. While open competition may not be a cause of high prices, neither has it promoted competition and consumer savings.⁷²

Peat Marwick's Study found that "the combination of reverse competition and prices set by historical and customary practices has led to excess revenues which either are used to obtain referrals or contribute to underwriter profit."⁷³

The study also concluded that excess profits may not accrue to title insurers, but rather to the producers of the title business. The underwriter may be forced to bid away the excess profits to acquire the business from the real estate settlement entity.⁷⁴ The report also concluded that high commissions, kickbacks and referral fees inflated the cost of producing title insurance and were not legitimate marketing costs.⁷⁵

⁷² *Peat Marwick's Study*, page XII-27.

⁷³ *Peat Marwick's Study*, page XII-58.

⁷⁴ *Peat Marwick's Study*, page XII-45.

⁷⁵ *Peat Marwick's Study*, page XII-58.

5.1.4 1980 California Department of Insurance Bulletin 80-12

In an effort to address rebating problems in the California title insurance industry, the California Department of Insurance issued a bulletin in 1980 regarding unlawful rebates.⁷⁶ The bulletin specifically recognized reverse competition in title insurance markets:

It is well established that the industry operates in an environment described by economists as reverse competition. We described this phenomenon and the role of the anti-rebate laws in Bulletin 74-2 as follows:

Purchasers or sellers of residential property who must pay for the almost universally required policy of title insurance seldom make a conscious selection of cost, quality, or service. Rather, the selection is usually made by the agent or representative of the person required to pay for the title policy and, as a consequence, the title industry's competitive effort has been aimed at the agent or representative. While the representative has a fiduciary relationship to the purchaser or seller, cost or service features of the transaction of potential benefit to the purchaser or seller may be subordinated to other considerations found to be personally desirable or beneficial to the representative. As a result the opportunity for enrichment of the representative may be placed in a higher order of priority than the opportunity of securing for the person required to pay for the policy of title insurance the best product in terms of cost or service.

5.1.5 1986 Texas Department of Insurance Staff Study

In 1985, the Texas State Board of Insurance convened an advisory committee of Department of Insurance staff and industry and consumer representatives to study and make recommendations regarding title insurance rates in Texas. In September 1986, the advisory committee issued its report and findings.⁷⁷

One of the unanimous advisory committee recommendations was that, because of reverse competition in title insurance, "the State Board of Insurance should amend its rate development formula to provide a limitation on title expenses and should adjust title rates in accordance with the limitation imposed."⁷⁸

⁷⁶ State of California Department of Insurance Bulletin 80-12, December 24, 1980, Subject: Insurance Code Section 12404 – Unlawful Rebates.

⁷⁷ *Title Insurance Advisory Committee Final Report to the State Board of Insurance, September 1986.*

⁷⁸ *Title Insurance Advisory Committee Final Report to the State Board of Insurance, September 1986, Proposal V.*

In the portion of the report prepared by the staff of Texas Department of Insurance, reverse competition was identified as the “fundamental problem in the marketing and pricing of title insurance.”⁷⁹

In addition to describing how title insurers compete for the producers of business – real estate brokers, lenders and others in a position to direct the consumer to a title company or title insurer – the staff report described the lack of market pressure exerted by the consumers paying for the product.

The competitive pressure to secure business through the payments of commissions to agents or to other producers of business greatly exceeds the competitive pressure exerted by the actual purchase of insurance. In most cases, the actual purchaser exerts no pressure on price at all.

The existence of reverse competition in the business of title insurance is related to the structure of the title insurance transaction. Title insurance is not purchased every six months or every year as is the case with automobile or homeowners insurance, rather, it is purchased only as frequently as real estate is acquired or sold. An average person might buy or sell two or three homes in the course of a lifetime. The fact that title insurance is purchased so infrequently makes it one of the types of insurance about which the average person is least knowledgeable. Adding to the purchaser’s lack of knowledge is a certain disinterest in the title insurance which stems from the fact that the price of the title insurance policy is almost always small in relation to the total amount involved in a real estate transaction. Title insurance is, in effect, an added charge.⁸⁰

The staff report concluded that the reverse competitive market structure of title insurance created upward pressure on prices – not simply because of rebates or referral fees, but of a myriad of ways in which title insurers and title companies are encouraged to spend money which negatively affect the purchaser of title insurance.

Market forces will, in most industries, serve as an effective regulator or governor on the amount of promotional expense. In the title industry, however, the fact that downward price pressure is not exerted by policy purchasers means that the normal market forces are inoperable. As a consequence, promotional expenses aimed at producers of business, rather than insurance consumers, are not effectively limited as is the case in other industries. Instead, whatever is spent is simply passed on to the ultimate consumer in the form of higher prices.

⁷⁹ *Title Insurance Advisory Committee Final Report to the State Board of Insurance, September 1986, Part II, Staff Report on the Marketing and Pricing of Title Insurance in Texas*, page 12, hereafter, *SBI Staff Report*.

⁸⁰ *SBI Staff Report*, pages 13-14.

When the nature of reverse competition is completely understood, it becomes apparent that the manifestations of reverse competition are not limited to rebates or referral fees or to excessive promotional expenditures. The market failures which allow these problems to occur call into question almost every type of expenditure made by the title industry.

The staff report notes that decisions about the level of service are not affected by the consumers paying for the services. Whereas in most industries, price competition forces limits on service levels commensurate with consumers' willingness to pay, no such market forces are at work in title insurance.

The absence of downward price pressure, and the resulting ability of the industry to pass on to consumers whatever amount is spent, leaves the title industry without any mechanism which will guarantee efficiency or which will limit the provision of services to a level which is cost effective from the standpoint of the consumer.⁸¹

As examples of service levels determined by producers of title business and not consumers who pay for title insurance, the staff report identified the growth in title agencies resulting from controlled business arrangements⁸² and the high number of cancelled title commitments arising from producers of title referrals seeking multiple title commitments – asking several title companies and/or title insurers for a title commitment.⁸³ A real estate agent might request title commitments from several title companies for one or more of several reasons – to obtain the fastest title commitment turn-around, to have a back-up in the event the favored title company cannot or will not provide a title commitment or to leverage considerations for referral of title and escrow business. But there is no cost to the real estate agent for asking for multiple commitments. Rather, the cost of cancelled title commitments is borne by consumers who pay higher prices to reflect the additional expenses, but who exert no market pressure on the level of service provided, as discussed further in section 6.

⁸¹ *SBI Staff Report*, page 18.

⁸² *SBI Staff Report*, page 17.

⁸³ *SBI Staff Report*, page 10.

5.1.6 Nelson Lipshutz's *The Regulatory Economics of Title Insurance*

Nelson Lipshutz is a long-time student of the title insurance industry and is frequently employed by the title insurance industry to testify before state insurance regulators on title insurance matters. In 1994, Dr. Lipshutz published a primer on title insurance, *The Regulatory Economics of Title Insurance*. In his book, Dr. Lipshutz describes how title insurers compete for business.

The title insurance agent does not usually market directly to the ultimate consumer defined as the party paying for the policy. Marketing to the ultimate consumer in lines such as automobile and homeowners is possible because consumers are generally well aware of the nature of the insurance coverage that they are purchasing, because they must buy it every year. In the case of title insurance, in contrast the consumer purchases a policy only in connection with the purchase or refinance of a piece of real property, a relatively rare event for most people. In consequence, most title insurance purchasers know very little about title insurance, and rely on one of the professionals involved in the transaction to recommend a source for title insurance coverage. Therefore, title insurance marketing is generally directed toward real estate professional, including attorneys, broker, mortgage bankers, savings land loan associations, banks, and real estate developers.

Real estate, like politics, is local. With the passage of time, working relationships among title insurance producers, either agents or employees of insurer branch offices, and real estate professionals in their local area become increasingly firmly established. In contrast, the relationship between the local real estate professionals and the remote title insurer head office remains tenuous at best. Accordingly, customer loyalty runs primarily to the producer, not the insuring company as such, and so competition among insurers for established producers is intense. In some cases, established title producers can be induced to become employees of an insurer branch office. But many very effective producers prefer to conduct business as independent agents, and in the competition to attract these agents, the primary competitive tool is the commission rate. As institutional loyalties throughout the economy have eroded, switching among insurers by agents has become more common and has led to the perception that prevailing commission rates have crept upward.⁸⁴

⁸⁴ Nelson Lipshutz, *The Regulatory Economics of Title Insurance*, Praeger Press, Westport, CT, 1994, page 5.

5.1.7 2005 Fidelity Mercury Lawsuit

In 2005, Fidelity National Financial filed a lawsuit against the Mercury Companies, the parent of several California underwritten title companies, in Los Angeles Superior Court alleging unfair competition on the part of the Mercury Companies.⁸⁵ The allegations in the complaint describe a reverse competitive market for title insurance. For example, Fidelity's reference to "customers" is explicitly to the real estate settlement personnel who steer title insurance and escrow business to underwritten title companies and title insurers. "Customers" does not mean the consumer actually paying for the title insurance and escrow services.

18. Ticor, Fidelity and Chicago are all engaged in the business of providing title insurance and escrow services and products in the State of California and are required to be and are licensed by the Department of Insurance of the State of California. The customers for these products include residential and commercial real estate agents and brokers, lenders and developers. Success in the title and escrow industry depends upon generating transactions from customers by developing a reputation for, and providing, superior service, responsiveness, and expertise.

Fidelity then explains that competition in the title and escrow business is not for the ultimate consumer who purchases the product and services, but for the "customers" who can provide the business by steering consumers to a particular underwritten title company or title insurer.

19. Generally, title and escrow transactions are generated by sales representatives, title officers and escrow officers; customers are serviced and their business maintained by those and other employees including company representatives and operations personnel. Because customers are attracted and kept by personnel who have demonstrated that they can respond to and meet the customer's needs, the competition in the title and escrow industry for the services of capable title and escrow personnel is intense.

⁸⁵ The complaint is styled Ticor Title Company Of California, a California Corporation; Fidelity National Title Insurance Company, a California Corporation; Chicago Title Insurance Company, a Missouri Corporation; Fidelity National Financial, Inc., a Delaware Corporation; Plaintiffs vs. Mercury Companies, Inc., a Colorado Corporation; Alliance Title Company, a California Corporation; Investors Title Company, a California Corporation; Financial Title Company, a California Corporation; et al, Defendants, Complaint for (1) Intentional Interference with Prospective Business Advantage; (2) Below Cost Sales; (3) Misappropriation of Trade Secrets; (4) Unfair Competition; (5) Breach of Contract; (6) Breach of Fiduciary Duty; (7) Common Law Unfair Competition; (8) Intentional Interference with Contract; (9) Conversion; (10) Fraudulent Concealment; (11) Aiding and Abetting Fraudulent Concealment. Ticor subsequently filed an amended complaint which added additional plaintiffs but did not change the description of title insurance and escrow markets.

In responding to Fidelity's complaint, Mercury did not challenge Fidelity's description of title insurance markets and the nature of competition in those markets. Fidelity complained that Mercury illegally recruited Fidelity title and escrow personnel. Mercury denied the accusations. Fidelity did obtain a preliminary injunction against Mercury but that injunction contained little of the relief sought by Fidelity. Mercury disputed Fidelity's allegations and produced several witnesses who claimed that recruiting title and escrow employees from competitors was commonplace in California. Neither the allegations in this lawsuit nor the responses by Mercury describe a market where competition is based on price charged to the consumer. Rather the competition described is a bidding-up of the payments to those who can produce or steer consumers to a particular underwritten title company or title insurer.

5.1.8 United Capital Group

Two documents involving United Capital Group, the parent of United Title Insurance Company, United Title Company, First California Title Company and New Century Title Company, describe the marketing efforts towards the producers of title insurance business – reverse competition. The first is United Capital Group's 10K filing for the year ending December 31, 2004, with the Securities and Exchange Commission. In the *Operating Strategy* section, United Capital Group writes:

Commitment to Service

We believe that title insurance policies and escrow functions are generally standardized, and that the level of service provided is therefore the key differentiating factor among title industry competitors. We are committed to providing an unparalleled quality of service to our customers, and we emphasize the importance of that culture of service to all of our employees. Our advanced technology platform facilitates our prompt and efficient delivery of title and escrow services. Through our commitment to service, we build lasting and personal relationships with our real estate industry clients. We believe that our focus on providing high levels of personal service to our customers is the principal differentiating factor, which has enabled us to compete effectively with the major title insurers

Customer and Market Focus

Our services and marketing are directed primarily to real estate agents and lenders in the residential resale and refinance sectors of the market, which we believe are less prone to the cyclical industry downturns associated with changing interest rates than the commercial real estate and new home sectors.

In the residential resale market, we focus on establishing relationships with real estate agents who typically direct the selection of escrow and title insurance services by their clients. Although title insurance premiums are typically paid by the buyer or seller of residential property, depending on local custom, the real estate agent responsible for the closing generally selects the title agent because of his or her greater familiarity with service levels. All parties to the home closing are concerned with personal time schedules and the costs associated with settlement delays. We provide title search and escrow services in connection with the resale transaction, and we arrange for the issuance of owner and lender title insurance policies at closing either directly through our United Capital Title Insurance Company subsidiary or as agent for other national title insurers.

In the residential refinance market, we actively promote relationships with community banks and other lenders who refinance existing mortgage loans. Although the borrower pays our fees, we view these lenders as our customers because they typically direct the selection of escrow and title insurance by their borrowers. Our services in a refinance transaction also include title search and escrow services in connection with the refinancing of the existing mortgage loan, and the issuance of a lender title insurance policy in favor of the new lender.

Experienced Management Team

We focus on attracting and retaining the highest quality management and operational personnel available. Our executives and other key managers have an average of over 20 years experience in the title insurance industry, and directly participated in the successful development and operation of several large regional title agency networks, major title insurance underwriters and providers of bundled real estate settlement services. In addition, our entrepreneurial culture, growth record, incentive compensation structure and dedication to customer service helps us to continually attract top producers with established client relationships.

Our operational management is decentralized, with our key regional managers maintaining primary control over operations in their respective areas of geographic responsibility. Title insurance operations vary significantly from state to state, and sometimes even from county to county, based on local regulation, industry custom and personal relationships with key persons in local real estate and financing markets. The extensive experience of our key managers in their respective regions enables them to understand and respond effectively to local industry conditions.

In February 2005, First California Title Company and New Century Title Company filed a lawsuit⁸⁶ against the Mercury Companies that alleged similar conduct to that alleged in the Fidelity complaint, described in Section 5.1.7. In paragraph 14 of the first amended complaint, plaintiffs describe “The Title/Escrow Business:”

14. As set forth herein, the escrow and title business is a very competitive one. Although title insurance policies may be sold and escrow files opened by “walk in” clients, most companies depend upon referrals from real estate and mortgage brokers and agents to provide repeat and volume business. In this industry, a broker/agent client will generally turn to one escrow or title officer, with whom he or she has an established relationship, to service all of the residential or commercial real estate mortgage transactions handled by the client. Considering the number of transactions that typically are completed per year by a successful broker or agent, establishing a solid relationship between a company’s employees and these clients is of paramount importance to the success of a company.

⁸⁶ First California Title Company and New Century Title Company, Plaintiffs, vs. Financial Title Company; Mercury Companies, Inc. v. Stacy Neves; Stephanie Howard; George Willard; Tony Becker and Does 1-20, Inclusive, Defendants; First Amended Complaint for Damages and Injunctive Relief in the Superior Court of the State of California in and for the County of Los Angeles, Case BC327332.

5.1.9 Gateway Title Company vs. Mercury Companies

In June 2004, Gateway Title Company, Commonwealth Land Title Company and their corporate parent, LandAmerica Financial Group, filed a lawsuit⁸⁷ against the Mercury Companies with similar complaints as the Fidelity lawsuit against the Mercury Companies, described in Section 5.1.7.

As with Fidelity and United Capital Group, cited above, LandAmerica describes the provision of customer service – where customers are real estate agents and mortgage brokers and agents – to be of “paramount importance.”⁸⁸ Gateway explains further:

32. Plaintiffs’ residential title insurance business in California arises primarily from local relationships which have been established over time with real estate agents and brokers and by the maintenance of contacts within the financial community such as mortgage brokers, banks and escrow agents.

33. The stability of these long-standing relationships is maintained primarily by the sales force, which is supported by the underwriters, escrow, customer service representatives and administrative staff, whose combined efforts constitute the “infrastructure” of the local and regional offices.

....

36. In order to maintain profitability and the ability to compete in the marketplace, Plaintiffs have necessarily focused on both sales and infrastructure. The maintenance and expansion of customers and referral sources is integral and essential to Plaintiff’s sales and marketing strategies. The expense of maintaining and expanding referral sources over time is considerable and in constant tension with the regulations which impose restrictions on such activities.

....

⁸⁷ Gateway Title Company, Inc., Commonwealth Land Title Company, Inc., and LandAmerica Financial Group, Inc., Plaintiffs, vs. Mercury Companies, et al., in the Superior Court of the State of California, County of Los Angeles, Central District, Case BC 317441, First Amended Complaint for Damages and Injunctive Relief.

⁸⁸ Gateway First Amended Complaint, paragraph 21.

48. The compilation and maintenance of proprietary customer information is also essential to the ability of a title insurance company to compete in the marketplace. This information includes, but is not limited to, the names of individuals who refer and use title insurance services and products, their “buying history,” areas of specialization (e.g., residential or commercial, sales or refinancing of existing loans), service requirements, levels of commission income and percentage generated from the customers, marketing programs designed for general and specific customers, production reports listing the number of orders and the premium income realized from each order, and other valuable data which provide it with the ability to compete in the marketplace.

5.2 Effects of Reverse Competition

There are numerous examples of how reverse competition in title insurance and escrow service markets drives up the costs of providing title insurance and escrow services. The various examples show how title insurance and escrow services are overpriced and the rivalry among title insurers and underwritten title companies takes the form of distributing money, services and other considerations to the real estate brokers, lenders and others who are able to steer consumers to the title insurer and underwritten title company.

5.2.1 Illegal Rebates and Kickbacks

There are several reasons why we would not expect illegal rebates and kickbacks in the title insurance industry despite the reverse-competitive market forces:

- A federal law (RESPA) prohibiting kickbacks and referral fees from title companies and title insurers to real estate brokers and mortgage brokers;
- A state law – in California and most other states – prohibiting kickbacks and referral fees for title insurance;⁸⁹ and
- The existence of legal methods of paying for the steering of business, including controlled business arrangements, discussed in more detail below.

Despite the federal and state prohibitions and the existence of legal methods of rewarding producers of title insurance business, incidents of known illegal kickbacks to producers of title insurance referrals are common.

⁸⁹ See California Insurance Code, §§ 12404 and 12405, described in Section 5.1.6, above.

It is reasonable to assume that the many illegal rebate enforcement actions listed below represent only a fraction of the amount of illegal rebating in the marketplace. We come to this conclusion because of repeated violations by the same entity and because of the limited resources of regulators to monitor all the transactions of underwritten title companies and title insurers.

Professor Jack Guttentag offers a further explanation:

The direct payment of referral fees has long been illegal under the Real Estate Settlements and Procedures Act (RESPA). However, RESPA is ineffective because it does not eliminate referral power, which is the crux of the problem. Small players often ignore the rule because HUD, which is responsible for enforcement, cannot possibly police all the ways in which one party can transfer something of value to another.⁹⁰

The examples below demonstrate a variety of methods for providing cash, services or other considerations to the referrers of title insurance and escrow services by underwritten title companies and title insurers. Some of the activities identified in various complaints include cash payments, provision of a variety of free services and profit-sharing arrangements, such as captive reinsurance.

⁹⁰ Jack Guttentag, "Real Estate Settlement Services Take Bite Out of Borrowers," *Inman News*, September 6, 2005.

5.2.1.1 California Department of Insurance Enforcement Actions

- In August 2005, the California Department of Insurance reached an agreement with Investors Title Company to cease and desist engaging in illegal rebate activities, suspend sales and marketing employees engaged in the illegal activities for 10 days and pay a fine of \$1 million – roughly equal to four times the amount of illegal rebates.⁹¹ In agreeing to the fine and penalty, Investors denied any wrongdoing. The Department’s accusations included:

Fraudulent Expense Reports of over \$100,000 for expenditures made on behalf of referrers of title insurance and escrow business for gifts, food and beverage, printing costs, catering and entertainment, special events; Business Support and Promotional Services of over \$140,000 unrelated to the business of title insurance to referrers of title insurance and escrow business.

- In July 2005, the California Department of Insurance reached agreement with nine major title companies to pay \$37.8 million in refunds and penalties for illegal rebating through a captive reinsurance scheme in which national homebuilders, lenders and realtors were encouraged to steer business to particular title insurers. Under the arrangement, the homebuilder formed a reinsurance company affiliate – a captive reinsurer. Under an agreement with the title insurer, the homebuilder would steer the consumer to the title insurer and the title insurer would cede a portion of the premium – typically 50% after the first \$200 to \$350 – to the captive reinsurer with no substantive risk of loss associated with the reinsurance transaction. In effect, the arrangement allowed for the title insurer to rebate 50% of the premium to the homebuilder. The companies were accused of paying \$25.4 million in illegal kickbacks to various lenders, builders and realtors in exchange for the referral of title insurance business. The nine companies, members of three insurance groups -- LandAmerica Financial Corporation, the First American Title Insurance Company, and Fidelity National Financial Inc. -- control roughly 75% of the California title insurance market. Their actions in this case involved more than 82,000 California households which purchased or refinanced a home between 1997 and 2004. In agreeing to the settlement, the title insurers admitted no wrongdoing.⁹²

⁹¹ California Department of Insurance Press Release #78, “Insurance Commissioner John Garamendi Fines Investors Title Company \$1 Million And Orders It To Stop Steering Title Insurance Business By Using Illegal Rebate Activities,” August 25, 2005.

⁹² California Department of Insurance Press Release #69, “Insurance Commissioner John Garamendi Announces Major Settlement Agreements with Title Insurers – More Than \$37 Million to Be Paid for Illegal Kickback Schemes,” July 20, 2005.

- In April 2005, Stewart Title reached a settlement with the California Department of Insurance over allegations of unlawful rebate activities from 1999 through 2001. Stewart agreed to a cease and desist order, paid \$750,000 for a penalty and reimbursed the Department's cost of investigation.⁹³ The investigation found that the inducements Stewart gave to agents amounted to \$594,102.67. They came in the form of payments for business support services, providing gift certificates and door prizes for realtor events, making rent payments, funding special events, and sponsoring broker activities. The activities took place in Los Angeles, Orange, Riverside, San Bernardino and San Diego Counties. In agreeing to the settlement, Stewart admitted no wrongdoing.⁹⁴
- In December 2004, the California Department of Insurance reached an agreement with Commonwealth Land Title Company over allegations of unlawful rebate activity. Commonwealth agreed to pay a penalty of \$1.25 million and another \$250,000 for reimbursement of the Department's cost of investigation. Commonwealth also agreed to cease and desist the activities alleged as unlawful rebates by the Department.⁹⁵ These activities included fraudulent receipts for gifts, entertainment, food and beverage and business support services to referrers of title insurance and escrow business. In agreeing to the settlement, Commonwealth admitted no wrongdoing.⁹⁶

⁹³ "Stewart Title of California Announces \$750,000 settlement with California Department of Insurance," Press Release of Stewart Title Guaranty Company, April 22, 2005.

⁹⁴ "Insurance Commissioner John Garamendi Fines Stewart Title Of California \$590,000 For Giving Illegal Kickback Payments And Inducements To Real Estate Agents: The Company Agrees To Cease The Illegal Activities, Which It Gave To Agents In Exchange For The Referral Of New Business," California Department of Insurance Press Release, April 20, 2005

⁹⁵ State of California, Department of Insurance, San Francisco, *In the Matter of Commonwealth Land Title Company, Respondent*, File No. VA 1060-AP, "Order to Cease and Desist and for Monetary Penalty and Cost Reimbursement."

⁹⁶ State of California, Department of Insurance, San Francisco, *In the Matter of Commonwealth Land Title Company, Respondent*, File No. VA 1060-AP, "Notice of Noncompliance; Accusation, Demand for Monetary Penalty; Right to Issuer Order to Show Cause."

- In June 2004, the California Department of Insurance seized \$500,000 placed in escrow by Southland Title Corporation, Southland Title of Orange County and Southland Title of San Diego for failing to discontinue illegal rebate inducement activities set out in an April 2002 Order by the Insurance Commissioner.⁹⁷ In the April 2002 Order, the three underwritten title companies agreed to pay a penalty of \$1.5 million, suspend certain sales and marketing representatives for five days and place another \$500,000 in escrow which would be seized by the Commissioner if the Commissioner found ongoing illegal rebate activities. In agreeing to the initial settlement, Southland admitted no wrongdoing.⁹⁸
- In 2001, the California Department of Insurance initiated an enforcement action against Old Republic Title Co. for allegedly giving illegal kickbacks to real estate agents. The Department alleged that Old Republic Title Co. spent more than \$540,000 to give real estate agents computer training unrelated to title insurance products or services in Old Republic offices and that the Old Republic printed real estate booklets for the agents, valued at \$226,000.⁹⁹ Old Republic subsequently agreed to pay a \$1 million fine and stop offering illegal rebates. In agreeing to the settlement, Old Republic admitted no wrongdoing.¹⁰⁰

⁹⁷ State of California, Department of Insurance, Sacramento, *In the Matter of Licenses and Licensing Rights of Southland Title Corporation, Southland Title of Orange County and Southland Title of San Diego*, File Nos. LA15402-A, 15403-A, 15404-A, “Order Seizing Escrowed Funds.”

⁹⁸ State of California, Department of Insurance, Sacramento, *In the Matter of Licenses and Licensing Rights of Southland Title Corporation, Southland Title of Orange County and Southland Title of San Diego*, File Nos. LA15402-A, 15403-A, 15404-A, “Order of Settlement.”

⁹⁹ “Old Republic Title Faces Up to \$3.9 Million in Fines,” *BestWire*, October 18, 2001.

¹⁰⁰ “Old Republic Title Fined \$1 Million in California,” *Best Wire*, December 14, 2001.

- In 1999, the California Department of Insurance fined Chicago Title \$235,000 for unlawful rebates to real estate agents in exchange for the referral of title and escrow business. In agreeing to the settlement, Chicago Title admitted no wrongdoing. Chicago Title agreed to stop the following activities that the Department of Insurance investigators uncovered during their probe:
 1. Leasing or subleasing work space within real estate licensees' offices
 2. Providing coordinator services to real estate agents
 3. Picking up and delivering real estate flyer orders on behalf of real estate licensees
 4. Providing real estate licensees with computer software, education, and training not related to the business of title insurance
 5. Providing printing services to real estate licensees
 6. Waiving sub-escrow fees and charging unfiled rates for title and escrow services
 7. Providing certificates to customers for free installation of home security systems
 8. Offering to pay part of the costs for showing a "for sale" property on an Internet video service¹⁰¹

- In 1997, North American Title Company paid a fine to the California Department of Insurance of \$100,000 for giving cash and free services to real estate agents. The title company placed its employees in the real estate offices, paid rent for the space and used the employees as "escrow coordinators" to steer business of homebuyers to the title insurance companies placing the employees in the real estate offices. A spokesman for North American Title Company claimed that all national title companies engaged in the practice of placing "escrow coordinators" in real estate offices. In agreeing to the settlement, North American admitted no wrongdoing.¹⁰²

- In 1997, Progressive Title Company paid a fine of \$85,000 to the California Department of Insurance for illegal rebates. Progressive Title Company was a subsidiary – a controlled business arrangement – of Fred Sand real estate brokerage. The Department found that Progressive paid rebates in the form of prizes to real estate agents. In agreeing to the settlement, Progressive admitted no wrongdoing.¹⁰³

¹⁰¹ "California puts a stop to kickbacks from Chicago Title Co.," *Insure.com*, May 7, 1999.

¹⁰² "Title company agrees to pay \$100,000 fine," Robert Gunnison, *San Francisco Examiner*, December 19, 1997.

¹⁰³ "Progressive Title Settles Agent Kickback Case," Jesus Sanchez, *Los Angeles Times*, November 19, 1997.

5.2.1.2 Department of Housing and Urban Development RESPA Enforcement Actions

The United States Department of Housing and Urban Development (HUD) is responsible for enforcing the Real Estate Settlement Procedures Act.¹⁰⁴ Section 8 of RESPA – 12 U.S.C. § 2607 – is entitled “Prohibition Against Kickbacks And Unearned Fees” and contains the following provisions:

(a) Business referrals

No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.

(b) Splitting charges

No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed.

¹⁰⁴ 12 U.S.C. §§ 2601 through 2617.

HUD has a page on its web site entitled “RESPA Settlement Agreements” which provides links to some of HUD’s RESPA settlements from 1999 through present.¹⁰⁵ The following actions relate to illegal rebating for title and escrow business or sham controlled business arrangements for the purpose of referral of title and escrow business.

- Coldwell Banker Residential Real Estate, Inc. Agreement, August 2005
- First American Title Settlement Agreement, July 2005
- Metropolitan Title Company, July 2005
- Closings of Tulsa, McGraw Davisson Stewart, Residential Sales Associates and Closings of Tulsa, Builders Title and Escrow, 2003 Builders Services, March 2005
- Chicago Title Insurance Company, February 2005
- Land Settlement Services, Inc., March 2004
- Integrity Home Funding, LLC, February 2004
- Znet Financial, September 2003
- Intertrust Mortgage LLC, August 2003
- Coldwell Banker United, Realtors and Coldwell Banker Richard Smith, Realtors, July 2003
- Title Ventures.com, July 2003
- Covenant Abstract Company, Inc., May 2003
- Chicago Title, September 2002
- Fidelity National Title, September 2002
- Stewart Title, September 2002
- Austin Title, September 2002
- First American, August 2002 Gracy Title, August, 2002
- Heritage Title, August 2002
- Fidelity Financial, February 2002
- First American, October 2001

¹⁰⁵ <http://www.hud.gov/offices/hsg/sfh/res/resetagr.cfm>.

We describe a few of the settlements to highlight the nature of the illegal rebating and sham business arrangements.

- In August 2005, HUD entered into an agreement with Coldwell Banker Residential Real Estate, Inc, a real estate broker in the greater Atlanta area and an affiliate of Regency Title Company, a title insurance agency, and Cendant Mortgage Corporation, a mortgage lender. In its complaint, HUD alleged that Coldwell Banker was giving higher sales commission splits to real estate agents who referred business to Regency Title, requiring real estate agents to refer business to Regency Title in order to receive relocation referrals, allowing only those real estate agents who referred business to Regency Title to be paid their commission at settlement, and giving prizes and other benefits to those agents who referred business to Regency Title. Coldwell Banker Residential Real Estate, Inc. agreed to pay a fine of \$250,000 to settle the charges by HUD.¹⁰⁶
- In July 2005, HUD entered in a settlement for \$150,000 with a Michigan title company for illegal kickbacks. HUD determined that Metropolitan Title Company, a subsidiary of First American Title Insurance Company, paid real estate brokers rates for the use of conference rooms that far exceeded fair market rates. HUD determined that excessive rental rates were essentially referral fees, or kickbacks, paid to the real estate brokers.¹⁰⁷
- In July 2005, HUD reached a settlement with Memphis Title Company (a subsidiary of First American Title Insurance Company) over allegations that First American created sham companies for the purpose of providing kickbacks to builders, real estate agents and mortgage brokers. HUD alleged that the nine companies created by First American with builders, real estate agents or mortgage brokers as minority owners did little or no actual title insurance or escrow work, that First American provided all the services and that the businesses were not independent and constituted “sham controlled business arrangements under RESPA.” HUD concluded that the builders, real estate agents and mortgage brokers with ownership interests in the sham companies “received substantial financial benefit from the referral of title business.” First American agreed to discontinue the businesses and to pay a fine of \$680,000.¹⁰⁸

¹⁰⁶ See <http://www.hud.gov/offices/hsg/sfh/res/coldwellbanker.pdf>.

¹⁰⁷ “Michigan Title Co. to pay \$150,000 in HUD settlement: Co. allegedly involved in kickbacks with real estate brokers,” *Inman News*, July 7, 2005.

¹⁰⁸ See settlement agreement at: <http://www.hud.gov/offices/hsg/sfh/res/fametitsettl.pdf>.

- In March 2005, HUD announced a series of settlements for title insurance and escrow kickbacks in Tulsa, Oklahoma.

In settlements announced March 21, regulators broke up what they alleged to be a sophisticated kickback scheme in which realty agents, home builders, and title and escrow executives shared portions of consumers' closing fees illegally.

According to the Department of Housing and Urban Development, real estate agents in Tulsa created a shell corporation that bought a part interest in a local title insurance and escrow agency at a below-market price. A group of builders created a separate corporation that allegedly did the same.

The agents and builders sent their clients' title and settlement work to the title agencies in which they had interests. Those agencies then recycled portions of the title and settlement fees to individual agents and builders, based on the amount of business they referred. In some cases, according to the agreement, the title agencies also illegally marked up consumers' fees – charging home buyers more for certain services than the actual cost.

The participants admitted no wrongdoing but agreed to pay nearly half a million dollars to the government to close the case.

Are kickback and referral fee schemes like this unusual? Not unusual enough, in the view of federal regulators such as Ivy M. Jackson, who heads the government's real estate settlement oversight unit at HUD. Jackson's investigators receive information on hundreds of alleged kickback schemes every year and have investigations or negotiations underway nationwide on more than 60 cases. More agreements "are on the way," Jackson said. "We are anticipating a busy year."

A central thread running through many of the kickback arrangements that HUD investigates is title insurance. Though most consumers are unaware, a substantial portion of the title premium they pay at closing does not go to the national insurance company underwriting the actual title policy. Frequently, 80% or more goes to the local title agent or lawyer who ordered the policy and may well be running the closing.

If you paid title charges of \$1,500, for example, just \$300 of that might pay for the actual insurance policy; \$1,200 might go to the closing or title agent. When a title agent kicks back a portion of the premium to realty agents or loan officers solely for referring your business, that violates federal law.¹⁰⁹

¹⁰⁹ "Regulators Probe Upfront Estimates, Upcharges and Low-Balling," Kenneth Harney, *Washington Post*, April 2, 2005, Page F1. See also <http://www.hud.gov/offices/hsg/sfh/res/tulsamcgraw.pdf> and <http://www.hud.gov/offices/hsg/sfh/res/tulsabuilders.pdf>.

- In February 2005, HUD reached a settlement with Chicago Title Insurance Company over allegations by HUD that Chicago Title provided inaccurate mortgage settlement statements (HUD-1 Settlement Statement) that failed to reflect all actual charges and adjustments as part of an agreement or understanding for the referral of business to Chicago Title. Chicago Title agreed to pay a penalty of \$5 million and stop the practices cited by HUD.¹¹⁰

5.2.2 Controlled Business Arrangements

Controlled business arrangements, for the purpose of this competition analysis, refer to business organizations with joint ownership by a title insurance company, underwritten title company, real estate agent, developer, mortgage broker, lender or other entity in a position to refer business to a title insurer or underwritten title company.

Proponents of controlled business arrangements claim that – when they are not sham arrangements – they benefit consumers by providing one-stop shopping for real estate brokerage, lending, title and escrow services and provide consumers with “greater convenience, accountability, and often lower prices than exist with unaffiliated settlement vendors.”¹¹¹

The California title insurance and escrow statutes clearly reflect a legislative concern about controlled business arrangements. California Insurance Code § 12396 defines a controlled business source as an affiliate of a title insurer, underwritten title company or controlled escrow company and declares a title order to “emanate from a controlled business source if the controlled business source is acting in the capacity of a principal, lender, representative, or agent of any of the parties to the transaction, or any other person or entity with which the reporting entity has an agreement, written or otherwise, whereby title orders are traded or otherwise exchanged in order to achieve compliance with this article.”¹¹²

California Insurance Code § 12397 requires any applicant for a title insurance company or underwritten title company license to indicate its intent to actively compete in each county where it conducts business and to indicate in its license application a plan of operation that “will not involve reliance for more than 50% of its closed title orders from controlled business sources.”

¹¹⁰ See <http://www.hud.gov/offices/hsg/sfh/res/chicagosettl.pdf>.

¹¹¹ Letter from Susan Johnson, Executive Director of RESPRO Real Estate Service Providers Council, Inc., to the National Association of Insurance Commissioner’s Title Insurance Working Group, March 18, 2005, page 2, available at: <http://www.respro.org/Library/Affiliated%20Business%20Provide%20Consumer%20Benefits%2C%20RESPRO%20Tells%20NAIC%2Epdf>.

¹¹² California Insurance Code § 12396(c).

California Insurance Code § 12397.5(a) requires licensees to make submissions to the Department of Insurance “to enable the department to determine the nature and extent of the licensee’s efforts to actively compete in each county in which it transacts its business.” California Insurance Code § 12397.5(b), states:

Competitive behavior shall be measured by the source of closed title orders in each county in which the licensee engages in the title business and by the entity’s progress toward meeting the 50% objective specified in Section 12397 . . .

California Insurance Code § 12397.5(b), relieves a licensee from reporting controlled business activity if less than 5% of the business emanates from controlled business sources.

It is important to point out that the Legislature is not establishing the criteria for whether a reasonable degree of competition exists in the business of title insurance (California Insurance Code § 12401.3(a.2)) in this section. Rather, the Legislature is identifying – and prohibiting – one specific manifestation of reverse competition – the controlled business arrangement created to circumvent the earlier prohibitions on inducements for steering business.

The reference to “competitive behavior” in § 12397.5(b), sets a standard for whether a particular controlled business entity is competing for business generally or simply acting as a conduit for referrals from the affiliated business. The determination of whether a reasonable degree of competition exists in the business of title insurance in California requires a far broader analysis than the narrow test for one type of entity as set out in the controlled business sections of California law. For example, illegal rebating could occur even in the total absence of controlled business arrangements. Or a single title insurer or underwritten title company could have a monopoly on the title insurance business in a particular county without a controlled business arrangement. Both of these situations would indicate the absence of a reasonable degree of competition even with no controlled business arrangements present. Consequently, the presence of controlled business arrangements is one factor in evaluating whether a reasonable degree of competition exists in a California title insurance and escrow market.

Despite the claims of proponents of controlled business arrangements, we have found no evidence in California of reduced costs to the ultimate consumer from controlled business arrangements. There are examples of controlled business arrangements that manifest reverse competition in costs and prices of title insurance and escrow services greater than would occur in markets with price competition. In their study of title insurance, Professors Charles Nyce and M. Martin Boyer argue:

Controlled business arrangements, while facilitating one stop shopping for potential homebuyers, may also discourage new entry into the title insurance business by almost requiring partnerships with established players.¹¹³

Our review of entries into the California title insurance and escrow markets, described below, provides strong support for the Nyce and Boyer statement.

In 1979, ALTA, the trade association of title insurance companies, published a brief entitled *The Controlled Business Problem in the Title Insurance Industry*. In its paper, ALTA argues the following:¹¹⁴

Prohibitions on kickbacks and referral fees have created additional impetus for controllers of business to established controlled business arrangements.

Controlled business arrangements inevitably result in higher prices for title insurance services:

1. A controlled title insurance agency is effectively insulated from having to compete for business and has no incentive – or at best a reduced incentive – to keep its prices down.
2. Competition among title insurance companies to secure the business of controlled title insurance agencies will inevitably result in higher prices for title insurance services.
3. The growth of controlled business arrangements will tend to increase the prices independent title insurance service providers must charge for their services and will inevitably imperil the survival of many independent title agencies and title insurance companies.
4. Controlled business arrangements create major barriers to entry of new title insurance service providers into the market, thereby inhibiting the price-restraining influence such that new entrants and potential new entrants exert on existing competitors.

¹¹³ Charles Nyce and M. Martin Boyer, “An Analysis of the Title Insurance Industry,” *Journal of Insurance Regulation*, Winter 1998, page 231.

¹¹⁴ See pages i to iii for a summary of the ALTA argument.

Controlled business arrangements are likely to result in a deterioration in the quality of title insurance services:

1. Controlled title agencies have little incentive to provide high quality service, and, in fact, have an incentive to minimize title related problems in order to ensure that the transaction is consummated.
2. Controlled business arrangements will adversely affect the quality of services provided by the title insurance companies that underwrite title insurance policies issued by controlled agencies.
3. Controlled business arrangements will adversely affect the quality of services rendered by independent title agencies and by title insurers who do not enter into agency arrangements with controlled business entities.

We now review some of the controlled business arrangements found in the California market.

5.2.2.1 Producer-Owned Title Agencies

The prototype of a title insurance control business arrangement is when an entity involved in real estate settlements – a real estate broker, lender, homebuilder or other – forms an underwritten title company and uses its position of dominance in the real estate transaction to steer the consumer to the affiliated underwritten title company and title insurer. Under this type of arrangement, the producer-owner, such as a real estate broker, receives part of the title premium and escrow fee as owner's profit from the underwritten title company. In some instances, a national title insurer forms a partnership with the real estate settlement producer to establish the underwritten title company and, for example, the real estate broker steers business to the affiliated underwritten title company which has an exclusive arrangement with the partner title insurer.

The producer-owned underwritten title company is essentially a legal form of rebating from the title insurer to the real estate agent or other producer of title insurance and escrow business. Instead of competing for the consumer's business – where consumer means the person who pays for the title insurance and escrow services – with lower prices, the title insurer locks in the referrals from the real estate agent by making him or her a partner in an underwritten title company. Instead of revenues in excess of reasonable costs going back to consumers in the form of lower prices, title insurers distribute the excess revenues to the real estate agents and others who “produce” the business.

**NON-PUBLIC INFORMATION REDACTED FOR PUBLIC VERSION
OF THIS REPORT¹¹⁵**

5.2.2.2 Buying Market Share

There has been significant consolidation – both vertical and horizontal – in the California and national title insurance industries. The largest title insurers have not only been acquiring other title insurers, but have also been acquiring underwritten title companies. In acquiring underwritten title companies, the title insurers are buying market share. The acquired underwritten title company ceases to do business with multiple title underwriters after the acquisition and directs all title business to the acquiring title insurer.

The Fidelity-Mercury lawsuit, cited above, alleges just such behavior of buying market share by, allegedly, paying huge salaries to hire away underwritten title company personnel with established relationships to “customers” – producers of title insurance referrals and not the ultimate paying consumer.

**NON-PUBLIC INFORMATION REDACTED FOR PUBLIC VERSION
OF THIS REPORT**

5.2.3 Expenses in Excess of Efficient Production

There are several examples of expenses incurred by underwritten title companies and title insurers unrelated to the efficient provision of title insurance and escrow services to consumers who pay for the product and services. These types of expenses are examples of what we would expect to find in the absence of price competition among title insurers and the presence of other types of rivalry for referrals from real estate agents, mortgage brokers and lenders that provide benefits to the referrers of business at the expense of the paying consumers.

¹¹⁵ In the sections that follow, non-public information is redacted from the report made available to the public. The non-public information in this section describes specific examples of the type of controlled business arrangements described in the previous paragraph. The information was obtained from underwritten title company annual reports and from correspondence related to the UTC annual reports, which are declared non-public information by California Insurance Code. In some cases the redacted information is from a public source, which, if disclosed, would reveal the names of the entities described in the paragraph and, consequently, reveal non-public information.

5.2.3.1 Free Services to Referrers of Title and Escrow Businesses

Many underwritten title companies provide free services to real estate professionals and call this activity “customer services.” The services include information about properties including real-time title reviews over the phone and information about neighborhood real estate activities. Other “customer services” include printing of publications for real estate agents with pre-printed mailing labels generated from targeted mailing lists. These “customer services” are targeted to “customers” as understood by the title industry – the real estate settlement providers who are able to steer consumers to a particular underwritten title company and/or title insurer. Our examination of underwritten title company annual reports and responses to the California Department of Insurance June 7, 2005, request for title plant information revealed significant payments by underwritten title companies to entities like First American Real Estate Solutions for services and information provided to real estate agents, such as real estate information about specific properties and neighborhoods.

NON-PUBLIC INFORMATION REDACTED FOR PUBLIC VERSION OF THIS REPORT

5.2.3.2 Multiple Commitments

Underwritten title companies submit an annual report to the California Department of Insurance describing their financial condition, financial activity, title and escrow activity and other information. Data compiled from these annual reports show about 3,823,000 title orders opened in 2004, about 2,783,000 million title orders closed and about 1,161,000 title orders cancelled.¹¹⁶ The sum of title orders closed and cancelled exceeds the number of title orders opened because some orders closed or cancelled in 2004 were opened in 2003. For 2004, cancelled title orders represent over 40% of closed title orders and about 30% of the total of title orders closed and cancelled.

¹¹⁶ The data on title orders came from Schedule F of the underwritten title companies’ annual statements. We reviewed these data for consistency with the table of title and escrow activities on the Income Statement Write-Ins page, when available. We also reviewed the Schedule F data for reasonableness by calculating average revenue per closed title order and escrow order. The California Department of Insurance queried about 25 underwritten title companies, out of 83 submissions, about Schedule F. Corrections submitted by underwritten title companies were incorporated in our analysis of Schedule F.

A cancelled title order typically represents the production of a preliminary title report that does not result in the issuance of a title policy. Cancelled title orders are a result of real estate transactions that fail to close or multiple requests for title commitments by real estate settlement professionals.

A real estate broker or lender may ask for multiple commitments and use the commitment produced in the shortest time. The request for multiple commitments may be part of a strategy to engage title insurers or underwritten title companies in a competition for the producer's business. Because the underwritten title companies do not charge for a preliminary title report, there is no cost to the real estate professional for asking for multiple commitments. But there is an expense associated with providing cancelled orders, and the underwritten title companies and title insurers must absorb that expense. California Insurance Code § 12401.1 declares the furnishing of a preliminary report without charge to be an illegal rebate, but also allows for free preliminary reports under specified conditions:

The furnishing of a preliminary report by any title insurer, controlled escrow company or underwritten title company, without charge to any person, shall constitute a violation of Section 12404. The charge for a preliminary report shall have a reasonable relation to the cost of production of the report but in no event shall it be less than the rate for a standard owner's policy, minimum liability, as set forth in the company's rate schedule. After billing any person for a preliminary report the title insurer, controlled escrow company or underwritten title company shall promptly make a good faith attempt to collect; provided, however, that notwithstanding Section 12404, but without limiting the applicability of that section to other transactions, this charge may be waived or cancelled, if the company follows uniform practices as to all customers under like circumstances.

We found no underwritten title company or title insurer who has charged or charges for preliminary reports for residential property transactions. A title insurer or underwritten title company, which did charge for a preliminary report that does not result in the issuance of a title policy would be at a competitive disadvantage compared to other title insurers or underwritten title companies that did not charge.

Since it is typically the real estate agent, mortgage broker or lender who orders the preliminary report, the agent, broker or lender would have to pay for the preliminary report and is generally unable to pass this cost on to the home buyer or borrower. For example, most real estate agents are paid for their services from a commission on the purchase or sale of a property. If a property fails to sell, the real estate agent is not paid for his or her work and is unable to recoup his or her expenses – such as the cost of a preliminary report if there were a charge from the title insurer for a cancelled order – from the consumer.¹¹⁷

There is clearly a cost associated with over a million cancelled title orders. As a ballpark estimate of this cost, we will assume that 50% of underwritten title company personnel costs are associated with the production of preliminary reports.¹¹⁸ For ease of illustration, we will add only title plant rent and maintenance expenses to personnel costs for total cost of production for preliminary reports. If we then apply the 30% percentage of cancelled title orders to this expense amount for 2004, we get almost \$400 million in expenses associated with cancelled title orders.

It may be that actual consumers – those who pay for title insurance – might desire and be willing to pay for multiple title commitments. On the other hand, consumers might be quite happy with a seven-day turnaround for a title commitment instead of a two-day turnaround and prefer to pay significantly less for the longer turnaround time. In the case of multiple commitment requests and cancelled orders, reverse competition leads underwritten title companies to incur the substantial expenses to offer free services to producers of title business because there is no price pressure from the paying consumer to indicate otherwise.

¹¹⁷ Interview with real estate agent Kate Morgan, August 8, 2005.

¹¹⁸ The underwritten title company annual reports do not break out personnel costs by major function, so our selection of 50% of personnel costs for production of preliminary reports should be seen as an illustrative example and not a definitive estimate. Any costs incurred by title insurers for cancelled orders and any non-personnel expenses other than title plant rent for cancelled orders are not included in the estimate. The 30% for cancelled orders is the share of cancelled orders to the total of orders closed and cancelled.

Other Dimensions of Competitive Market Structure

Title insurance and escrow services fit the competitive ideal in some ways and not in others. The product is homogenous. At least in the market for residential title insurance and escrow services, there are many buyers, none of whom is able to exert any pressure on price. The number of residential title and escrow transactions in California each exceeded 3,000,000 in 2004.

There is a series of measures used in traditional analysis of competition, including market concentration, market entries and exits, barriers to entry and exits, availability of product substitutes and profitability. Some of these market characteristics are discussed in the United States Department of Justice and Federal Trade Commission Horizontal Merger Guidelines.¹¹⁹ The Guidelines are based on standard principles of industrial organization – structure, conduct and performance. The theory is that market structure influences market conduct of industry participants, which, in turn, influences market performance.¹²⁰ We now examine measures of structure, conduct and performance in the California title insurance and escrow industry.

6.1 Concentration by State and County over Time

Concentration is one of the key measures of market structure. If there are many sellers with small market shares, there is little concentration and each seller has little market power. If there is one seller or a few sellers with great market share, those sellers will likely have greater market power than a seller in a perfectly competitive market. A market with few sellers is described as an oligopoly. For underwritten title companies we examine market share and concentration for both title insurance and escrow services.

6.1.1 Title Insurer Concentration at the State Level

The standard measures of competitive market structure are the degree of market concentration as measured by market share of the largest companies and by the Herfindahl-Hirschman Index (HHI). Markets with high concentration are more likely to depart from the competitive ideal because of the greater market power of the fewer, larger participants.

¹¹⁹ http://www.usdoj.gov/atr/public/guidelines/horiz_book/hmg1.html. The guidelines were issued on April 2, 1992, and revised on April 8, 1997.

¹²⁰ Joe S. Bain originated the structure/conduct/performance paradigm in 1956 in his book *Barriers to New Competition*. John Sutton summarizes Bain's work and the criticism of it in his book *Sunk Costs and Market Structure*. Sutton describes the development of industrial organization research since Bain, including the more recent use of game-theory models to explain industrial organization and market structure.

Table 3 shows market shares, total number of title insurer groups writing and the HHI from 1998 through 2004, based on data from statutory Annual Statement Schedule T filed by the insurers.¹²¹ We use title insurance groups as opposed to title insurance companies because title insurance companies within an insurance group are under common management and do not represent independent decision centers. Professors Nyce and Boyer state:

Given that insurance is regulated at the state level, it is not useful to measure competition and market share at the national level. Furthermore, there are firms that are significant competitors at the state level, but they appear insignificant when we look at the national numbers.¹²²

Table 3¹²³
California Title Insurer Statewide Market Shares and Concentration

	<i>Market Share</i>			Insurer Groups	HHI
	Top 3	Top 4	Top 5		
1998	59.6%	71.6%	80.8%	11	1,567
1999	60.3%	72.9%	82.5%	11	1,623
2000	74.4%	81.4%	89.1%	12	2,256
2001	73.2%	81.7%	88.5%	12	2,237
2002	72.5%	82.4%	88.6%	12	2,243
2003	73.0%	83.4%	89.1%	12	2,262
2004	75.9%	85.1%	90.9%	11	2,318
Nine Months of 2005	77.9%	87.0%	92.0%	10	2,454

¹²¹ The calculations were based on total written premiums reported on Schedule T, including direct (no title agent involved), affiliated title agent and non-affiliated title agent business. Title agents are known as underwritten title companies in California.

¹²² Charles Nyce and M. Martin Boyer, “An Analysis of the Title Insurance Industry,” *Journal of Insurance Regulation*, Winter 1998, pages 219 and 222.

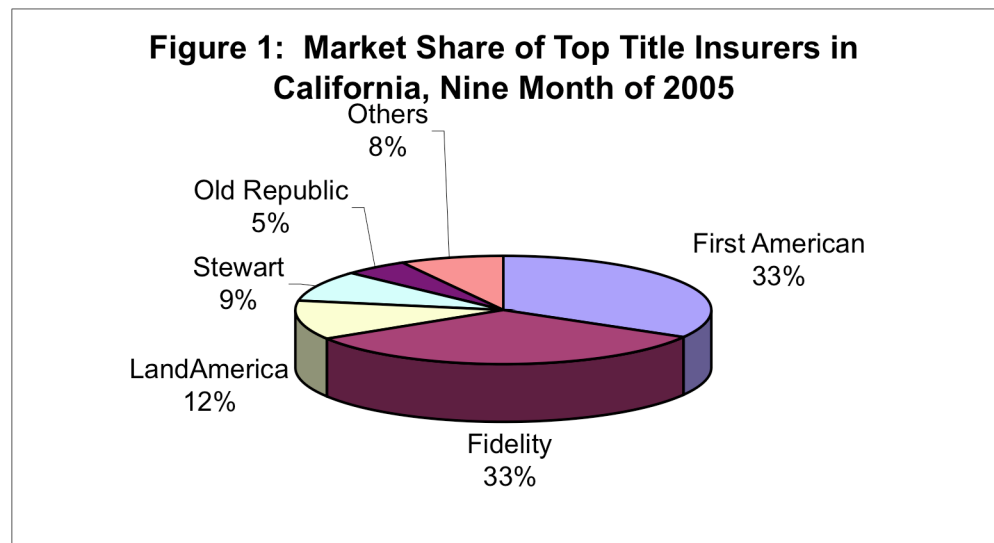
¹²³ Data for 1998 through 2004 from NAIC database of title insurer Annual Statements, Schedule T. Data for first nine months of 2005 from ALTA preliminary market share reports by insurer family by state. See <http://www.alta.org/industry/financial.cfm>.

This point is further demonstrated in a declaration, from the Fidelity-Mercury lawsuit, described in Section 5.1.7 above, by Donald DuBois, who explains that, as Western Regional Manager of Fidelity National Financial, he oversees the title insurance companies that are members of the Fidelity group:

I am the Executive Vice President and Western Regional Manager of Fidelity National Financial, Inc. (“FNF”). Plaintiffs Ticor Title Company of California (“Ticor”), Fidelity National Title Company (“Fidelity”) and Chicago Title Insurance Company (“Chicago”) are wholly owned subsidiaries of FNF. I have oversight responsibility for Ticor, Fidelity and Chicago in the Southwestern United States, including California, Arizona, Nevada and Colorado.¹²⁴

Even at the statewide level, the title insurance industry is highly concentrated. According to the DOJ FTC Horizontal Merger Guidelines and the National Association of Attorneys General Horizontal Merger Guidelines, a market is “highly concentrated” if the HHI is greater than 1800.¹²⁵ Table 3 shows the statewide title insurer HHI was 2,318 in 2004, far in excess of 1,800. The HHI jumped in 2000 after the second largest title insurer, Fidelity National Financial acquired the third largest title insurer, Chicago Title.

Beyond the HHI, the market shares of the top three, four and five title insurers indicate that a very small number of companies control the vast majority of the title insurance market – a characteristic inconsistent with competitive markets. Figure 1¹²⁶ shows the market share of the five largest title insurer groups through the first nine months of 2005.



¹²⁴ Declaration of Donald DuBois, March 8, 2005, Paragraph 2, filed in the Fidelity-Mercury lawsuit.

¹²⁵ Section 1.51 of the DOJ-FTC *Horizontal Merger Guidelines* and Section 4 of the NAAG *Horizontal Merger Guidelines*. The NAAG guidelines were adopted on March 30, 1993, and can be found at www.naag.org.

¹²⁶ Data from ALTA preliminary market share reports by insurer family by state for first nine months of 2005. See <http://www.alta.org/industry/financial.cfm>.

Finally, the market shares of the top title insurers have grown since the Fidelity acquisition of Chicago Title, indicating growing concentration and market power of the few top title insurers. In early 2005, First American acquired United General Title Insurance Company, resulting in further market concentration and fewer independent decision centers. The growth in market share for the top writers – to 77.4% for the top three title insurers and to 86.7% for the top four – raises concerns about both the market power of these largest title insurers and barriers to entry by new participants.

6.1.2 Title Insurer Concentration at the County Level

Using data from DataQuick, in conjunction with the 2004 underwritten title company annual reports, we calculated the market shares of title insurer groups by county. This analysis allows us to examine the number of title insurers actually selling in a particular county and whether this number, as well as market shares and concentration varies by geographic region across California. While some markets may be larger than an individual county, the HHI calculations by county provide a good indication of how market penetration varies across the state. Table 4 summarizes the HHI analysis based on title insurer market share by county.¹²⁷

Table 4
Number of Counties by Title Insurance HHI Range

<u>HHI Range</u>	<u>Number of Counties</u>
0 to 1,800	0
1,801 to 2,200	5
2,201 to 2,500	7
2,501 to 3,000	12
3,001 to 4,000	15
4,001 to 7,500	13
7,501 to 9,990	6

Table 4 shows that all 58 counties in California have an HHI greater than 1,800 – the level above which the DOJ FTC *Horizontal Merger Guidelines* considers a market highly concentrated.

¹²⁷ See Appendix 3 for a detailed description of the data and analysis presented in Table 4.

Because of data limitations, described in detail in Appendix 3, the HHIs are understated. We calculated the HHIs using the most conservative assumptions, where conservative means assuming any unknown market activity is independent and trivial. For some of the entities reported in the DataQuick data, we could not identify the title insurer group associated with the title activity. We treated these entities as “blanks,” meaning the activity was included in county market totals, but we assigned zero market share to the “blank” entity. This approach understates the HHIs because, for example, we know that one entity with significant title activity does at least part of its work on behalf of First American, the market share leader in many counties. Because we could not identify the amount of the entity’s business for First American, we added none of the entity’s business to First American or any other title insurer group.

The two lowest county HHIs are found in Nevada and Yolo Counties with 1,989 and 2,014, respectively. These two counties also have the fourth and first highest percentage of “blank” activity, respectively, among the counties.

Mono, Inyo and Modoc Counties have the highest HHIs with 9,504, 8,819 and 8,064, respectively. Among the larger counties, the HHIs were Los Angeles 2,307; San Diego 2,493; Orange 2,480; Alameda 2,526; and San Francisco 3,167.

The DataQuick data and HHI analysis also reveal that many underwritten title companies’ business consists almost entirely of refinance title policies. The number of title companies is smaller and the market shares of title insurers are greater by county for resales and new home sales than for refinance and home equity loan business. The HHIs by county are higher for resale and new home sale activity than for refinance and home equity loan activity.¹²⁸

As Samuelson and Nordhaus note, market concentration is an important characteristic of markets “because more concentrated industries usually (though not always) show much of the unhealthy symptoms of imperfect competition.”¹²⁹

6.2 Barriers to Entry

The market power of sellers in a market with few sellers may be mitigated by ease of entry by potential competitors. Ease of entry is a condition of competitive markets and one of the departures from the competitive ideal may be barriers that keep out potential competitors.

¹²⁸ See Appendix 3 for tables showing HHIs by county for resales and new home business and for refinance and home equity loan business.

¹²⁹ Samuelson and Nordhaus, *Economics, 15th Edition*, page 166.

6.2.1 Monoline Product

Title insurance is a monoline product, meaning that an insurance company licensed and authorized to conduct title insurance business may not sell any other type of insurance. This is different from other lines of insurance-company licensing. A property casualty insurer can sell dozens of different types of insurance, from auto insurance to commercial liability.

The fact that title insurance is a monoline product means that other property casualty insurers cannot enter the title insurance market without first creating a new title insurance company. And while creating a new title insurer and obtaining a license to do business is not impossible, it is not a trivial undertaking. It requires millions of dollars in capital and a detailed application and approval process. In other property and casualty lines of insurance, an existing insurer licensed to sell insurance in one line can enter another line of insurance without a new insurance company application and approval.

6.2.2 Title Plant

Historically, the ownership of a title plant was a prerequisite for engaging in the business of title insurance. At one point in time, the existence and quality of a title insurer's back plant was a key factor in the ability of the title insurer to do an effective title search and analysis. Over time, two trends have made more comprehensive historical title information available to more title insurers and underwritten title companies. First, there has been consolidation in the title industry as some title insurers have acquired other title insurers and underwritten title companies.¹³⁰ This consolidation allowed disparate title plants to merge into fewer, more comprehensive title plants. Second, title insurers have worked together to create "joint plants," which further consolidate disparate title plants and create great efficiencies for maintaining and updating title information.¹³¹ The creation of joint plants allows any underwritten title company or title insurer to access a complete county title plant – back plant and current plant – for a subscription fee.¹³²

¹³⁰ See the history of the First American Corporation at: <http://www.firstam.com/faf/company/history.html> and the history of Fidelity National Financial at <http://www.fnf.com/TimeLine.asp>. See also the history of Property Insight at: <http://www.propertyinsight.biz/background.html>.

¹³¹ See the history of DataTrace at: <http://www.edatatrace.com/history.html>. See also the history of Property Insight at <http://www.propertyinsight.biz/background.html>.

¹³² Author's review of responses to California Department of Insurance request for title plant information, issued June 7, 2005.

As title plants have become consolidated and come under joint title insurer ownership, access to title plants is generally available to new entrants for a fee, at least in the larger counties. In smaller counties, one or two underwritten title companies may still have their own title plant which they do not share with other underwritten title companies or title insurers. In a situation like this, the title plant is a major barrier to entry because a new competitor would have to acquire copies of all real estate information from county officials to create a title plant. Such an effort would not be cost-effective in a small county with a limited number of real estate transactions.

When Fidelity National Financial sought to merge with Chicago Title in 1999, the Federal Trade Commission ordered Fidelity to divest itself of either Fidelity's or Chicago Title's ownership in the title plant or to sell a copy of the complete title plant in Merced, Napa, San Benito, Tehama and Yolo Counties. The FTC also ordered Fidelity to divest itself of the voting rights of either Fidelity or Chicago Title in the San Luis Obispo joint title plant.¹³³ Fidelity subsequently divested the Merced, Napa, Yolo and Tehama County title plants to Old Republic Title Company and San Benito and San Luis Obispo County title plants to Stewart Title of California.¹³⁴

Our review of information submitted by underwritten title companies in their annual reports to the Department of Insurance and our review of responses to the Department's request for title plant information shows that access to title plant information is not a barrier to entry for underwritten title companies or title insurers in California – at least in the larger counties.¹³⁵ In the larger counties, title insurers and underwritten title companies that do not own their own title plant can gain access to joint plants for a relatively small fee. In 2004, underwritten title companies reported title plant rent and maintenance expenses of about 5% of gross title premium.¹³⁶

We also found that title plants do not represent a significant fixed cost for underwritten title companies or title insurers. Title plant maintenance, in theory, represents a fixed cost – title-related transactions must be posted to the title plant regardless of whether there are few or many real estate transactions. In addition to finding the cost of title plant rent and maintenance to be small relative to premium, we also found that subscription agreements provide – and have provided – for changes in fees only for inflation and not in relation to changes in the amount of real estate activity. Consequently, title insurers and underwritten title companies pay the same amount for opening a title order and searching the title plant regardless of overall real estate activity.

¹³³ Federal Trade Commission, *In the Matter of Fidelity National Financial, Incorporated*, Docket No. C-3920, "Decision and Order," February 17, 2000, page 3.

¹³⁴ Letter of June 12, 2000, from Donald S. Clark, Secretary of the Federal Trade Commission to John A. Herfort approving the divestitures.

¹³⁵ See discussion of large versus small counties in Section 6.2.2, below.

¹³⁶ Gross title premium means the total amount of premium paid by the consumer, including the portion retained by the UTC and the amount remitted to the title insurer.

Although we found that the owners of the joint title plants make the title plant available to any other title insurer or underwritten title company, we believe the ownership of the major joint plants by First American, LandAmerica and Fidelity National Financial confers a significant competitive advantage on these organizations. The availability of title plant information to new entrants for a fee is significantly different from ownership and ultimate control over a title plant by an in-place competitor. The largest title insurers have consolidated the market power by acquiring other title insurers and the title plants of those insurers. A new title insurer would be unable to re-create or match the title plant information capacity or the economies of scale achieved by the largest market participants, including First American, Fidelity and LandAmerica.

Another FTC action illustrates this problem. In a 1998 antitrust action, the FTC prevented Commonwealth Land Title Insurance Company and First American from creating a joint title plant in and for Washington, D.C. The FTC complaint said that many users of the new joint title plant were paying significantly higher prices for title plant services and had lost some forms of title plant access compared to the situation when Commonwealth and First American each operated independent title plants.¹³⁷ The Federal Trade Commission ordered Commonwealth to re-establish its title plant as an independent competitor to First American's title plant in Washington, D.C. In this instance, ownership of a title plant – even a joint title plant that provides subscription access to other title insurers or underwritten title companies – can provide a competitive advantage for the owner of the plant.

6.2.3 Skilled Underwriters / Established Salespeople / Real Estate Settlement Personnel

Unlike other industries where a new entrant can actually increase the overall amount of a product purchased by offering the product at a lower price than other competitors, the overall demand for title and escrow services is fixed outside of any action by title insurers, underwritten title companies and escrow companies. These entities are fighting for a share of a fixed demand from home buyers and borrowers.

¹³⁷ Federal Trade Commission, Docket C-3835, *In the Matter of Commonwealth Land Title Corporation*, November 10, 1998, paragraphs 8 – 13.

Based on the aggressive efforts by title insurers and underwritten title companies to recruit staff from other title insurers and underwritten title companies, as illustrated in the lawsuits described in Sections 5.1.7, 5.1.8 and 5.1.9, above, it would seem that a barrier to entry is the limited supply of skilled title officers, sales staff and escrow and settlement personnel. However, while there are no substitutes for the most senior title underwriters or most established salespeople and escrow personnel, we also found that many underwritten title companies utilize temporary agencies for contract personnel for title and escrow services, including title officers and escrow closers with a few years of experience. But there is a big difference between hiring someone who can examine title or handle escrow and hiring someone who can bring a substantial amount of business and other key personnel with him or her.

We do not believe the availability of skilled personnel for title examination and escrow services is a barrier to entry. However, the availability of established relationships to the referrers of title insurance business is a barrier to entry. Because of reverse competition in the California title insurance and escrow markets, existing firms with established relationships to the referrers of title insurance business have a significant competitive advantage over new entrants who do not possess such relationships. In our view, that is why the new entrants are either acquiring existing firms with such relationships and controlled business arrangements owned, in whole or in part, by the referrer of title insurance and escrow business.

6.3 Product Substitutes

A limitation on the market power of sellers in an oligopoly is the availability of product substitutes – if the price of a product increases, consumers look to alternatives that, while not providing the same benefit as the original product, provide sufficient benefit for the relatively lower price.

There are no substitutes for title insurance, which gives greater market power to title insurers. Lenders require assurance of title before agreeing to make a loan and, in 49 states and the District of Columbia, the only acceptable method of providing title assurance is title insurance.

In recent years, an attempt was made by Radian to introduce a title substitute – an endorsement on mortgage guarantee insurance at a significantly lower price than title insurance. The title industry challenged the legality of that product, arguing that it was title insurance and that a mortgage insurer could not offer title insurance – only a monoline title insurance could offer the type of product Radian sought to introduce. The Insurance Commissioner held that California law does not permit Radian to sell its title-substitute product.¹³⁸

¹³⁸ California Department of Insurance Press Release #90, July 22, 2003, “Garamendi Issues Final Order Prohibiting Sale of Radian Lien Protection Policy.”

6.4 Price Elasticity of Demand

An issue related to product substitutes is price elasticity of demand. As discussed above, price elasticity refers to changes in amounts purchased by consumers in response to changes in price for the product.

Consumer demand for title and escrow services is inelastic, meaning that changes in the price for title insurance and escrow services have very little or no effect on the amount of these products purchased. Changes in price cause little change in consumer demand for title and escrow products for two reasons.

First, the demand for title insurance and escrow services is derived from the demand for real estate purchases and real estate loans. The cost of title insurance and escrow services is relatively small in comparison to the size of the underlying real estate or loan transaction and are often financed as part of the larger transaction or paid for by another party to the transaction. Even though the cost of title insurance and escrow may be thousands of dollars, a consumer – who generally has little knowledge of title insurance and escrow because he or she infrequently uses the services¹³⁹ – is unlikely to stop a real estate or loan closing because of concerns about the cost of title or escrow.

¹³⁹ American Land Title Association, *The Controlled Business Problem in the Title Insurance Industry*, November 1979, p 14.

Another reason that consumers who pay for title and escrow services are unable to exert market pressure on title insurers and escrow companies to lower prices is because lenders can demand title insurance and additional title insurance endorsements and require the buyer or borrower to pay for the added coverage. If, for example, a lender decided that it wanted a title policy with enhanced coverage or additional endorsements, the consumer must either accept the additional costs or forego the loan or purchase. It is difficult for the consumer to stand on principle and say no to the additional charges because he or she is then put in the position of obtaining a new loan, which involves considerable time and expense. Compare this situation to a consumer buying a big-screen television from an electronic store chain. The store tells the customer it will only sell the product if the consumer finances the purchase and buys an extended warranty. The consumer can easily leave the store and, within minutes, go elsewhere to buy the big-screen television without the requirements set out by the first store.

The lack of price elasticity of demand for title insurance and escrow services is a major departure from the competitive ideal. It raises the possibility that sellers, as a group or individually, could raise the price of title insurance and escrow services without seeing any decline in the quantity of title insurance policies or escrow services demanded.

It is important to note that, while inflated prices for title insurance and escrow services will have little effect on the demand for those services, there may be, if prices rise enough, an impact on overall demand for real estate transactions. Inflated prices for title insurance and escrow services will price some consumers out of a real estate purchase, just as higher interest rates or higher property prices will do. Consequently, an absence of price competition in title insurance and escrow markets will not only lead to inflated prices, but may also affect the affordability of home-ownership.

6.5 Entries and Exits over Time

6.5.1 Title Insurance Company Entries and Exits

Data from UTC annual reports and title insurer statutory annual statements show 11 or 12 title insurer groups writing business in California over the past decade. The number of title insurer groups fell to 10 by early 2005 with First American's acquisition of United General.¹⁴⁰ The number of large writers declined when Fidelity merged with Chicago Title in 2000. The absence of new title insurer entrants in recent years is surprising because of dramatic increases in title premium (due to major increases in the number of transactions and the average sale price of homes) and because of high profitability. Given a rapidly growing and profitable market, we would expect new title insurer entrants, but that has not occurred. Rather, we have seen an acquisition or merger of an existing title insurer.

There has been significant consolidation and growth in concentration in the title insurance industry on a countrywide basis and in California. The American Land Title Association web site lists 46 mergers or acquisitions of title insurance companies that appears to cover the period 1987 through 1999.¹⁴¹ Between 1986 and 1991, three of the seven largest title insurers were acquired by two of the remaining four. Chicago Title acquired Safeco Title and Ticor Title and Commonwealth Land Title acquired Transamerica Title (now Transnation Title).¹⁴²

At the end of 1996 countrywide, there were seven major title insurer groups responsible for about 89% of title insurance written premium: First American – 21%, Allegheny (Chicago Title) – 19%, Reliance (Commonwealth, Transnation) – 13%, Stewart – 11%, Fidelity – 10%, Lawyers Title – 9%, Old Republic – 6%. The countrywide HHI was 1,286.¹⁴³

By the end of the 1990s, Lawyers Title had acquired the title insurance operations of Reliance and formed LandAmerica, and Fidelity merged with Chicago Title. The HHI, based on written title insurance premiums, in 2003 was 2,040. The top three title insurers in 2003 wrote 72.5% of the market, up from 53% in 1996 and the top five title insurers in 2003 wrote over 90% of the market compared to 74% in 1996.¹⁴⁴ By 2003, the top five title insurers wrote a greater share of the total premium than the top seven insurers in 1996.¹⁴⁵

¹⁴⁰ See <http://www.ugtic.com/news.html> for press release describing acquisition.

¹⁴¹ <http://www.alta.org/consumer/mergers.cfm>. The list includes Safeco Title's acquisition by Chicago Title in 1987, but does not include Fidelity's merger with Chicago Title in 1999.

¹⁴² Lipshutz, *The Regulatory Economics of Title Insurance*, page 34.

¹⁴³ Nyce and Boyer, *An Analysis of the Title Insurance Industry*, page 221.

¹⁴⁴ Author's calculation of data published by the American Land Title Association. See <http://www.alta.org/industry/financial.cfm>.

¹⁴⁵ See Table 3, above.

In 1995 in California there were 19 title insurance companies in 12 insurer groups. By the end of 2004, there were 21 insurance companies in 11 insurer groups with the top five groups controlling a much higher percentage of the market, as shown in Table 3. Not counting ACE Title Reinsurance Company which writes only title reinsurance, there were two new entries over the ten-year period.

United Title Company, an established underwritten title company, became part of a holding company that included a Nevada-domiciled title insurance company. That title insurance company subsequently redomesticated to California and became United Capital Title Insurance Company.¹⁴⁶ **NON-PUBLIC INFORMATION REDACTED FOR PUBLIC VERSION OF THIS REPORT**

The other new title insurance company entry is Westcor Land Title Insurance Company, which was a Nevada-based title insurance company that redomesticated to California and changed its name to Westcor in 1999.¹⁴⁷ **NON-PUBLIC INFORMATION REDACTED FOR PUBLIC VERSION OF THIS REPORT**

The most recent title insurance company entry into California has been the acquisition of Diversified Title Insurance Company by TransUnion Real Estate Services in July 2005.¹⁴⁸ This acquisition replaces the ownership of an existing title insurance company and does not add an additional title insurance company to the market.

¹⁴⁶ See history of United Title Company at: <http://www.unitedtitle.com/companyoverview.aspx?id=1>.

¹⁴⁷ See history of Westcor Land Title Insurance Company at <http://www.wltic.com/about.htm>.

¹⁴⁸ *Inman News*, "TransUnion Enters Real Estate Title Biz in California," July 20, 2005.

The consolidation and concentration in California has continued, with First American acquiring United General in early 2005. Based on written premium for the first half of 2005, the countrywide HHI has grown to 2,110 and the countrywide share of the top three, top four and top five insurers has grown to 74.6%, 86.4% and 92.0%, respectively.¹⁴⁹ As Table 3 shows, the California title insurer HHI has grown to over 2,400 with First American's acquisition of United General.

6.5.2 Underwritten Title Company Entries and Exits

The number of underwritten title companies has declined gradually over time as the national title insurers have acquired local underwritten companies and independent escrow companies and incorporated them into an existing underwritten title company structure. Recent examples include:

Stewart:

- **NON-PUBLIC INFORMATION REDACTED FOR PUBLIC VERSION OF THIS REPORT**
- Acquired North Bay Title Company in July 2005¹⁵⁰
- Acquired Celebrity Escrow of Northridge in November 2004¹⁵¹
- Acquired Cal Land Title of Marin County in April 2004¹⁵²
- Acquired Santa Cruz County Title in April 2004¹⁵³
- Acquired 80% of Cuesta Title in 2001 and the remaining 20% in February 2004¹⁵⁴

¹⁴⁹ Calculations based on ALTA preliminary market share reports by insurer family by state.

See <http://www.alta.org/industry/financial.cfm>.

¹⁵⁰ Stewart Information Services Corporation press release, July 7, 2005, at www.stewart.com.

¹⁵¹ Stewart Information Services Corporation press release, November 22, 2004 at www.stewart.com.

¹⁵² Stewart Information Services Corporation press release, April 4, 2004, at www.stewart.com.

¹⁵³ Stewart Information Services Corporation press release, April 26, 2004, at www.stewart.com.

¹⁵⁴ Stewart Information Services Corporation press release, February 27, 2004, at www.stewart.com.

LandAmerica:

- **NON-PUBLIC INFORMATION REDACTED FOR PUBLIC VERSION OF THIS REPORT**
- Acquired Channel Island Escrow, Inc. of Oxnard in May 2004¹⁵⁵
- Acquired Southland Title, Southland Title of Orange County and Southland Title of San Diego in April 2004¹⁵⁶
- Acquired Gateway Title in October 2004¹⁵⁷

First American:

- Acquired United General in February 2005¹⁵⁸
- Acquired San Benito Title in November 2002¹⁵⁹
- Acquired Mariposa County Title in June 2002¹⁶⁰
- Acquired Del Norte County Title in February 2001¹⁶¹

While the number of established underwritten title companies has declined over the past decade, some new underwritten title companies have been created. However, the number is small and the ones created have been controlled business arrangements. Examples include:

NON-PUBLIC INFORMATION REDACTED FOR PUBLIC VERSION OF THIS REPORT

6.6 Profitability

One of the measures of market performance is profitability. In a competitive market, sellers earn a reasonable, but not excessive, profit. In theory, an imperfect market, such as an oligopoly, can produce excessive profits. In this section, we examine available information on title insurer and underwritten title company profitability and describe the limitations in the available data.

¹⁵⁵ *Inman News*, "LandAmerica Buys Real Estate Cos.," May 13, 2004.

¹⁵⁶ *Inman News*, "LandAmerica Expands in California, New Mexico," April 7, 2004; *Inman News*, "LandAmerica to Purchase Southland Title," January 6, 2004.

¹⁵⁷ *Inman News*, "LandAmerica Absorbs Gateway Title," October 29, 2004.

¹⁵⁸ United General Title Insurance Company Release, February 24, 2005 at: www.ugtic.com/news.html.

¹⁵⁹ First American Corporation press release, November 22, 2002, at www.firstam.com.

¹⁶⁰ First American Corporation press release, June 17, 2002, at www.firstam.com.

¹⁶¹ First American Corporation press release, February 13, 2001, at www.firstam.com.

6.6.1 Title Insurer Profitability

There is insufficient information available to determine the profitability of title insurer business in California. Although some states require title insurers to report state-specific balance sheet and income statement information, such information is not reported in California. At this time, we are only able to review title insurer profitability at the countrywide level by examining Statutory Annual Statements for title insurers.

A further caveat is required about countrywide profitability of title insurers. The largest title insurers – members of the Fidelity National Financial, LandAmerica, First American and Stewart insurance groups – have transformed their businesses over the past 10 to 15 years from providers of title insurance to providers of an array of information services and technology for the real estate industry. As a result, the title insurance entities are part of larger holding companies and are involved in a variety of affiliate transactions and holding company allocations. Stated differently, title insurer profitability can be masked within the broader holding company profitability.

Table 5 shows the analysis of countrywide profitability of title insurers licensed to conduct business in California based on data from the statutory Annual Statements of these insurers. The profitability is measured as after-tax net income divided by mean policyholder surplus.¹⁶²

Table 5
Countrywide Profitability of Title Insurers Licensed in California

<u>Year</u>	<u>Profitability</u>
1999	20.5%
2000	10.2%
2001	22.3%
2002	23.2%
2003	38.4%
2004	24.7%
Average	23.2%

¹⁶² Appendix 4 provides more detailed tables of profitability by year. Mean policyholder surplus is the average of year-beginning and year-ending surplus.

We have also examined the profitability of the publicly-traded parents of the four largest insurer groups – First American, Fidelity National Financial, LandAmerica and Stewart. Title insurance premiums comprise the vast majority of revenues for these four corporations – 73% for First American Corporation,¹⁶³ 70% for Fidelity National Financial Corporation,¹⁶⁴ 94% for LandAmerica,¹⁶⁵ and 97% for Stewart Information Services Corporation.¹⁶⁶

Table 6 shows the profitability of these corporations from 1995 through 2004, calculated as the net income divided by average shareholder equity. The table shows all four title insurer holding companies have been very profitable over the past three years. The two largest title insurer holding companies – First American and Fidelity – that also generate the most revenue from real estate information and software services, have been more profitable than LandAmerica and Stewart.

¹⁶³ First American Corporation 2004 Annual Report to Stockholders, page 15.

¹⁶⁴ Fidelity National Financial 2004 Annual Report to Stockholders, page 25. Author's calculation of direct and agency title insurance premiums plus escrow and other title related fees divided by total revenue.

¹⁶⁵ LandAmerica 2004 Annual Report to Stockholders, page 14.

¹⁶⁶ Stewart Information Services Corporation, page 18, Author's calculation of title segment revenue divided by total revenue.

Table 6¹⁶⁷
Profitability of Title Insurer Holding Companies, 1995 - 2004

<u>Year</u>	<u>First American</u>	<u>Fidelity</u>	<u>LandAmerica</u>	<u>Stewart</u>
1995	2.8%	7.0%	7.7%	4.2%
1996	16.5%	21.2%	14.6%	7.9%
1997	16.7%	21.7%	9.4%	7.6%
1998	34.7%	31.6%	17.5%	20.0%
1999	10.9%	17.1%	7.2%	10.4%
2000	9.8%	14.1%	-11.6%	0.2%
2001	16.9%	22.3%	8.7%	14.1%
2002	19.0%	27.3%	18.8%	21.3%
2003	27.8%	28.1%	20.0%	22.2%
2004	16.1%	17.3%	13.3%	12.5%
10yr	17.1%	20.8%	10.6%	12.0%
5yr	17.9%	21.8%	9.8%	14.1%
4 yr	20.0%	23.7%	15.2%	17.5%
3 yr	21.0%	24.2%	17.4%	18.7%
2 yr	22.0%	22.7%	16.7%	17.4%

These profit levels are significantly higher than we would expect in a competitive market and higher than indicated by so-called market-based derivations of cost of capital. In a series of title insurance rate hearings over the past decade in Texas, the Texas Insurance Commissioner has determined reasonable costs of capital relying upon testimony based on both the Capital Asset Pricing Model and Discount Cash Flow methods of determining cost of capital. In the April 23, 2004, order, following a hearing in December 2003, the Commissioner determined that a reasonable cost of capital was 10.5%.¹⁶⁸ In the 2002 order, following a hearing in February 2002, the Commissioner determined that a reasonable cost of capital was 11.0%.¹⁶⁹

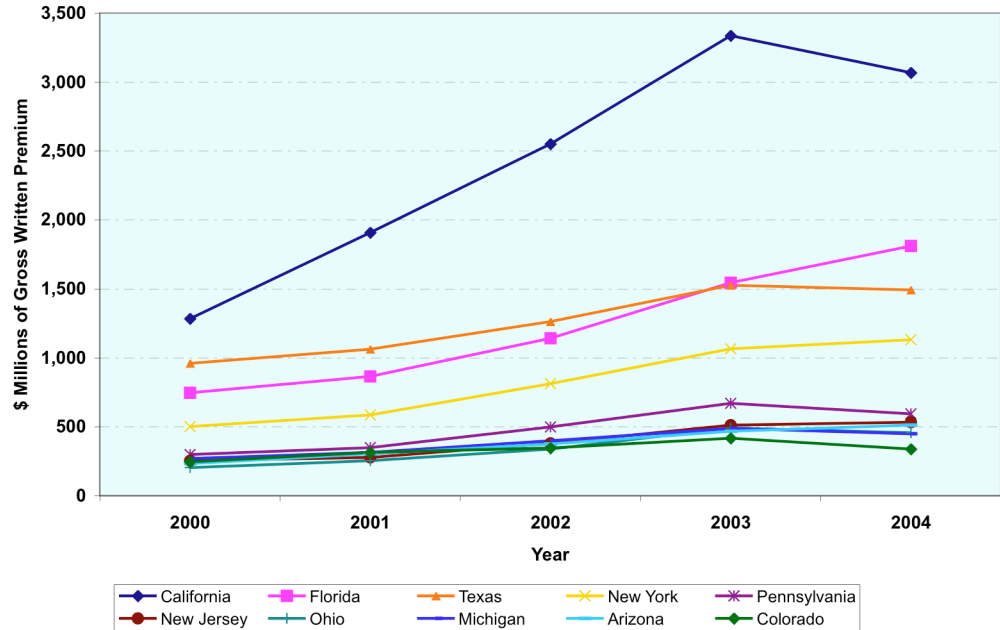
¹⁶⁷ Data for Table 5 from the annual reports to stockholders, various years, of First American Corporation, Fidelity National Financial, LandAmerica Corporation and Stewart Information Services. The net loss reported by the LandAmerica for 2000 resulted from a change in the Company's method for assessing the recoverability of goodwill (not associated with impaired assets) during the fourth quarter of 2000 which resulted in net-of-tax charges of \$110,369,000. Absent this change, net earnings would have been 4.2% of average stockholder's equity.

¹⁶⁸ Texas Insurance Commissioner's Order No. 04-0405, April 23, 2004, Finding of Fact 113.

¹⁶⁹ Texas Insurance Commissioner's Order No. 02-0901, August 23, 2004, Finding of Fact 126.

Further, we expect that these profitability figures understate California profitability because of greater economies of scale in California, relatively greater real estate activity and greater housing price appreciation. As Chart 2, below, shows, title insurance premium grew faster in California from 2000 through 2003 than in any of the ten largest states, ranked by amount of title insurance premium in 2000.

Chart 2: Title Insurance Premium in Largest States, 2000-2004



6.6.2 UTC Profitability

The California Department of Insurance collects information on income, expenses, assets, liabilities and other information about underwritten title companies in an annual report submitted by underwritten title companies. We compiled the balance sheet and income statement data submitted by underwritten title companies in their reports for experience year 2004. The compilation includes the data from 83 underwritten title companies.¹⁷⁰

Table 7 summarizes the combined income statements of the underwritten title companies.¹⁷¹ The table shows total revenues for underwritten title companies of \$4.6 billion in 2003 and \$4.3 billion in 2004, of which gross title insurance premium¹⁷² comprises about 68% and escrow fees about 26%. Underwritten title companies, as part of their underwriting agreements with title insurers, remitted an average of a little less than 10% of title premiums to title insurers.¹⁷³

Table 7 shows that underwritten title companies also paid small amounts for title insurance losses. Some losses are paid by underwritten title companies instead of title insurers because many underwriting agreements between title insurers and underwritten title companies include a provision that the underwritten title company is responsible for the first \$5,000 of any claim paid.¹⁷⁴ Table 7 shows that personnel expenses are, by far, the most significant portion of operating expenses and that title plant rent and maintenance is about 4% of total revenue.¹⁷⁵

¹⁷⁰ Appendix 5 contains a list of the underwritten title companies included in the analysis.

¹⁷¹ Appendix 5 provides the income statement in greater detail.

¹⁷² Gross title insurance premiums are total premiums before any sharing of premium with title insurance companies.

¹⁷³ Table 6 calculates expenses, including title premiums remitted to title insurers, as a percentage of total revenue. In calculating the percentage of title premium remitted by underwritten title companies to title insurers, we compared amounts remitted to gross title premiums.

¹⁷⁴ Author's review of numerous underwriting agreements between underwritten title companies and title insurers.

¹⁷⁵ Reported amounts for title plant maintenance are 6.2% and 5.7% of gross title premiums in 2004 and 2003, respectively. After reviewing the responses to the Department's June 7, 2005, request for title plant information and additional inquiries regarding many underwritten title companies' 2004 annual report submissions, we have concluded that these amounts are overstated because of the incorrect inclusion of customer service expenses in the title plant rent and maintenance category.

Table 7
California Underwritten Title Company
Combined Income and Expenses, 2003 and 2004
(\$ Millions)

	<u>Year</u>	<u>% of</u>	<u>Year</u>	<u>% of</u>
	<u>2004</u>	<u>Operating</u>	<u>2003</u>	<u>Operating</u>
<u>Operating Revenues</u>		<u>Revenue</u>		<u>Revenue</u>
Gross Title Insurance Premiums	\$2,924	67.5%	\$3,147	68.6%
Escrow Fees	\$1,125	26.0%	\$1,208	26.3%
Other Service Charges	\$278	6.4%	\$233	5.1%
Aggregate Write-Ins for Oper. Rev.	\$2	0.1%	\$1	0.0%
Total Operating Revenue	\$4,329	100.0%	\$4,589	100.0%
<u>Operating Expenses</u>				
Underwriting Premium to Title Insurers	\$284	6.6%	\$301	6.6%
Personnel Expenses	\$2,318	53.5%	\$2,376	51.8%
Losses - Title	\$19	0.4%	\$24	0.5%
Losses - Escrow	\$9	0.2%	\$15	0.3%
Title Plant Rent & Maintenance	\$182	4.2%	\$180	3.9%
Other Operating Expenses	\$971	22.4%	\$944	20.6%
Total Operating Expenses	\$3,783	87.4%	\$3,840	83.7%
Net Operating Income	\$546	12.6%	\$749	16.3%
Other Income / Expensees	\$45	1.0%	\$50	1.1%
Net Income Before Income Taxes	\$592	13.7%	\$800	17.4%
Provision for Income Taxes	\$233	5.4%	\$301	6.6%
Net Income After Income Taxes	\$359	8.3%	\$499	10.9%

A review of net income alone is insufficient to evaluate underwritten title company profitability. The net income must be compared to invested capital to determine the return on investment achieved by underwritten title companies. Table 8 performs this analysis based upon total shareholder equity reported in the 2004 underwritten title company annual report balance sheets.

For 2004, after-tax net income was 32.3% of the mean shareholder equity. For 2003, we are unable to calculate average shareholder equity because we only have year-ending shareholder equity. Consequently, we calculated after-tax net income as a percentage of year-ending shareholder equity for 2003. The result – 49% – is *lower* than if calculated on average shareholder equity for the year.

Aggregate underwritten title company profitability for 2003 and 2004, as indicated by return on shareholder equity, was very high. Yet the results almost certainly understate the actual profitability because many owners of underwritten title companies were also paid salaries, commissions and bonuses as employees of or contractors to their underwritten title companies. In some cases, the salaries, commissions and bonuses paid to owners were in the millions of dollars.¹⁷⁶

Table 8
California Underwritten Title Company Profitability, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Net Income Before Income Taxes (\$ Millions)	\$592	\$800
Provision for Income Taxes	\$233	\$301
Provision for Income Taxes, % of Net Income Before Taxes	39.3%	37.7%
Net Income After Income Taxes (\$ Millions)	\$359	\$499
Shareholder Equity, End of Year (\$ Millions)	\$1,209	\$1,017
Pre-Tax Net Income to Mean Shareholder Equity	53.2%	
Pre-Tax Net Income to Ending Shareholder Equity		78.6%
After-Tax Net Income to Mean Shareholder Equity	32.3%	
After-Tax Net Income to Ending Shareholder Equity		49.0%

¹⁷⁶ Author's review of 2004 underwritten title company annual reports and of CDI inquiries regarding the annual report submissions.

6.7 Price Competition and Response to Changes in Costs of Production

An important indicator of price competition in title insurance and escrow markets is whether title insurers modify rates in response to changing market conditions and costs of production.

California Insurance Code § 12401.1 sets out the requirements for the filing of rates and forms with the Department of Insurance:

Every title insurer, underwritten title company, and controlled escrow company shall file with the commissioner its schedules of rates, all regularly issued forms of title policies to which such rates apply, and every modification thereof which it proposes to use in this state. Every schedule of rates filed by a title insurer shall set forth the entire charge to the public for each type of title policy included within such schedule and shall include without separate statement thereof that portion of the charge, if any, which is based upon work performed by an underwritten title company; there shall be no separate filing by an underwritten title company for such work. Every filing shall set forth its effective date, which shall be not earlier than the 30th day following its receipt by the commissioner, and shall indicate the character and extent of the coverages and services contemplated.

Once filed, and after the effective date of the filing, the rates must be used by the title insurer or the underwritten title company. Underwritten title companies adopt the title insurance rates filed by those title insurance companies who are the underwriters, or insurers issuing the policies, for the underwritten title companies.

As a further preliminary matter, it is important to distinguish between a rate and a premium charge. Title insurers file a schedule of rates, which are charges per unit of exposure. For example, the title insurance or escrow rate might be 1% of the mortgage loan amount. The premium is the dollar charge to the consumer resulting from the application of the rate to the individual consumer's amount of insurance. Using the 1% as our sample rate, the premium for a \$300,000 policy would be $0.01 \times \$300,000$ or \$3,000.

According to the title insurance industry, a significant amount of title insurance expenses are fixed:

Since large infrastructures of personnel and title plants must be maintained to provide title services, a title company’s profitability is highly sensitive to real estate market activity. A significant portion of a title company’s cost structure is fixed, and the variable component largely is related to personnel.¹⁷⁷

On the other hand, title insurance and escrow revenue varies with economic conditions – the amount of underlying real estate transactions and the value of those transactions. Table 9 shows the dramatic growth in California title insurance premium over the past ten years – nearly 350% from 1995 through 2004.

Table 9

Year	Written Premium in \$ Billions	Annual Change in WP	Cumulative Change from 1995
1995	0.69		
1996	0.88	29%	29%
1997	1.01	14%	47%
1998	1.47	46%	114%
1999	1.43	-3%	108%
2000	1.28	-10%	87%
2001	1.91	49%	178%
2002	2.55	34%	272%
2003	3.34	31%	386%

Given that title insurance revenues are so variable based upon economic conditions, and given the title insurance industry’s belief that fixed costs comprise a significant portion of expenses, we would expect, in a competitive market, to see title insurers routinely change rates to reflect different economic conditions.

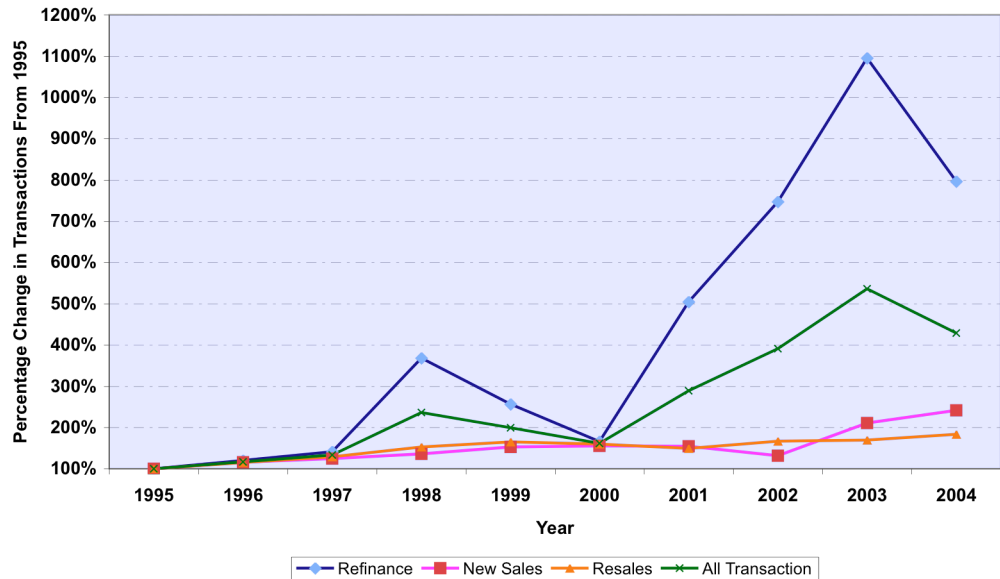
For example, in periods of high transactions – lots of home sales and refinancing activity and rapidly growing housing values – meaning more revenue per transaction at a given rate, we would expect title insurers to lower rates. In periods of slow real estate activity and declining home values, we would expect insurers to raise rates.

¹⁷⁷ A.M. Best Special Report, *Title Industry Running on All Cylinders*, October 4, 2004, page 5. This report is an update of earlier reports of the title insurance industry by A.M. Best. The authors of the 2004 Special Report are Gary Davis, senior financial analyst at A.M. Best and Rich McCarthy, director of research at ALTA. A.M. Best is primarily engaged in the business of providing ratings of the financial condition of insurance companies, but also publishes news and data about the insurance industry. The ALTA is the national trade association for the title insurance industry.

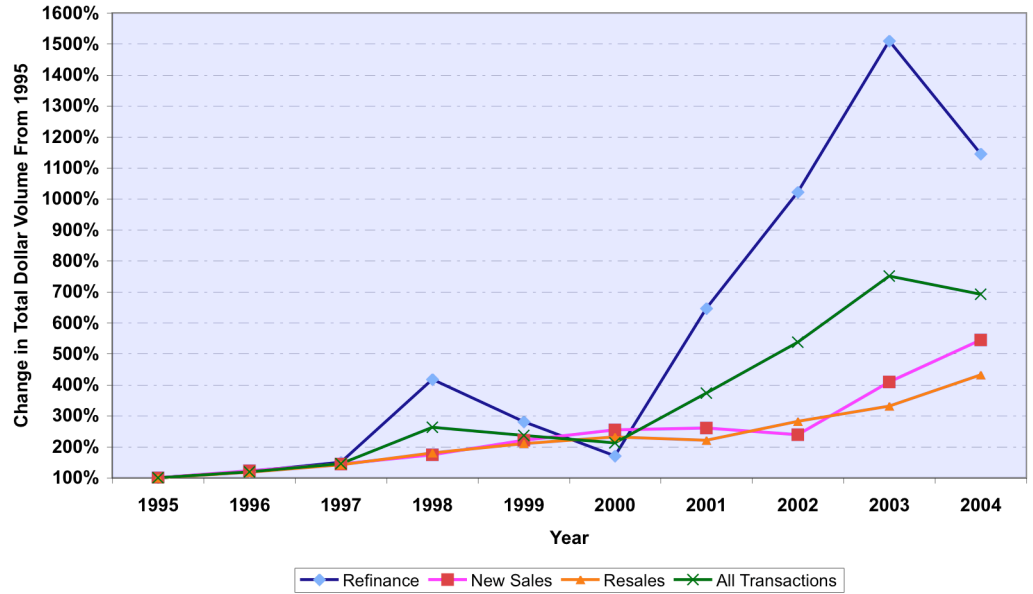
Over the past five years, California has experienced dramatic increases in real estate transactions and home values. Consequently, we would have expected title insurers to lower rates several times over the past five years to reflect the lower cost of production per unit sold.

Charts 3, 4 and 5 show the number of real estate transactions, the total dollar volume of real estate transactions, and the average amount per transaction, respectively, in California since 1995 by type of transaction. The charts show major increases in both the number of transactions and the average amount of transactions. Total transactions – refinance, resales and new sales – were four to five times greater in 2003 and 2004 than in 1995 and two to three times greater than in 2000. Total transaction volume in 2003 and 2004 was seven times greater than in 1995 and twice as great as in 2000. Average transaction size more than doubled from 1995 to 2000 for new sales and resales.

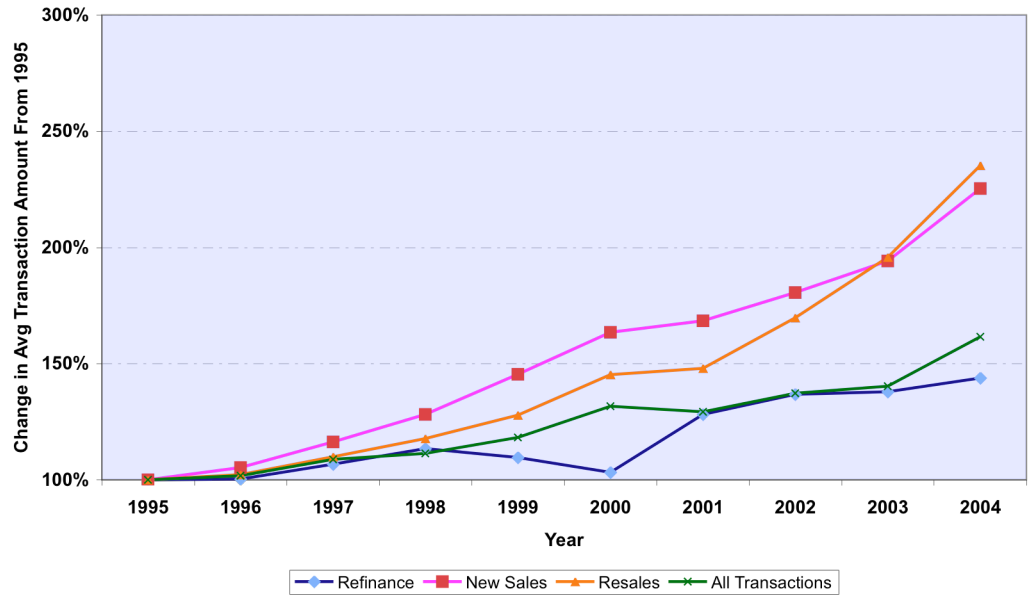
**Chart 3: California Real Estate Activity, 1995 - 2004:
Change in Number of Transactions**



**Chart 4: California Real Estate Activity, 1995 - 2004:
Change in Total Dollar Volume**



**Chart 5: California Real Estate Activity, 1995-2004:
Change in Average Transaction Amount**



A recent news article describes the results of heightened real estate activity in combination with rising home prices:

In 2003, pretax operating gains, including net investment income, had soared to about \$1.5 billion, a “staggering” 87% leap over 2002, according to an October 2004 report by A.M. Best done for ALTA. “Obviously, with the prices going through the roof, it helps everybody in the industry because our fees are based on sales price,” said James Cortese, division president of Stewart Title of California’s Santa Clara County Division. “So as prices go up so do the fees we collect.”

The breakdown of company earnings is jaw-dropping.¹⁷⁸

For example, the average new sale transaction in Alameda County grew from \$274,922 in 1999 to \$498,983 in 2004. For Stewart Title, the basic premium for the average new sale transaction grew 48% – from \$1,170 to \$1,726¹⁷⁹ – from 1996 to 2005 due solely to increased real estate values. In Los Angeles County, the basic title insurance premium for the average resale transaction grew 51% – from \$1,106 to \$1,668 – during the same period as the average resale transaction grew from \$253,491 to \$474,492.

As title insurance and escrow revenue have grown dramatically since 1995, other factors were at work to lower the cost of production for title insurers over the same period.

¹⁷⁸ Janis Maria, “Real Estate Boom Pumps Up Title Insurance,” *Inman News*, August 26, 2005.

¹⁷⁹ Data on Alameda County and Los Angeles County resale transaction and dollar volume from DataQuick, a member of the First American family of companies. Title premium information from Stewart Title Guaranty Company rate filing, effective July 14, 1994, and refiled May 2, 2000.

Lower Expense Costs Due to Automation

The acquisition and maintenance of title plants gradually is becoming more cost-effective as the business becomes computerized. Modern title insurance companies feature the computerization of order taking, title search and examination, and policy issuance. These advances have permitted companies to increase premium volume dramatically with only a modest increase in personnel. This capability not only enhances the profitability of a title company but also makes it easier to manage expense levels during slow real estate markets.¹⁸⁰

Lower Loss Costs Due to Improved Technology and Increased Volume

Although faster claims development might be one byproduct of a higher turnover rate, a property becomes a better title insurance risk the more it is bought and sold, because a property's title and tax records are searched each time it is sold. Frequent examination of a property's title records increases the odds of perfecting the property's title. The benefit, of course, comes from the fact that the new policy not only supersedes and effectively terminates the old policy but also generates new revenue. The term "perfecting" is the removal of any discovered potential defects in the title to real property prior to closing.¹⁸¹

According to a review by CDI, California title insurers filed few or no title insurance base rate changes from 2000 to 2004 – despite a significant reduction in the cost per unit sold over this period. The one company that did file new rates filed for a rate increase. Charts 6 through 8 below show filed rates by major title insurance companies – including companies within the same insurer group – over time, as compiled by California Department of Insurance staff.

The results are startling for two reasons. First, there were no base rate reductions filed over the period from 1998 to present. Insurers in other lines of insurance – say, private passenger automobile or homeowners insurance – typically file rates one or more times a year.

Second, the filed base rates show very little diversity or spread. Stated differently, the rates of the major insurers are very similar. The absence of diversity among filed rates also indicates a lack of price competition.

¹⁸⁰ A.M. Best Special Report, *Title Industry Running on All Cylinders*, October 4, 2004, page 10.

¹⁸¹ A.M. Best Special Report, *Title Industry Running on All Cylinders*, October 4, 2004, page 15.

Chart 6, derived from the results of the CDI rate filing review, shows filed rates for the seven largest title insurance companies in the five largest insurer groups, ranked by California premium. The insurance companies and their corporate family are:

First American Title Insurance Company	First American
Fidelity National Title Insurance Company	Fidelity
Chicago Title Insurance Company	Fidelity
Commonwealth Land Title Insurance Company	LandAmerica
Lawyers Title Insurance Company	LandAmerica
Stewart Title Guaranty Company	Stewart
Old Republic National Title Insurance Company	Old Republic

Chart 6 shows the premium for a \$500,000 CLTA standard owner’s policy for each of the title insurance companies from 1998 through mid-2005, based upon the CDI review of rates filed by each title insurance company in those years. Chart 6 shows that from 1998 through 2004, five of the six companies filed no changes in rates. The two companies that did file rate changes during the period – Fidelity and Commonwealth – raised rates following a merger or acquisition.

Chart 6 also shows the premium charges for the six largest insurance companies are all in a narrow range. The current base premiums for this \$500,000 owner’s policy range from \$1,572 to \$1,726 with a simple average of \$1,670. The dotted line makes should go. The rates are within a band of only 3.4% above to 5.9% below the average.

**Chart 6: California Title Insurers' Premium Charges
\$500,000 Owners Policy, 1998 - 2005**

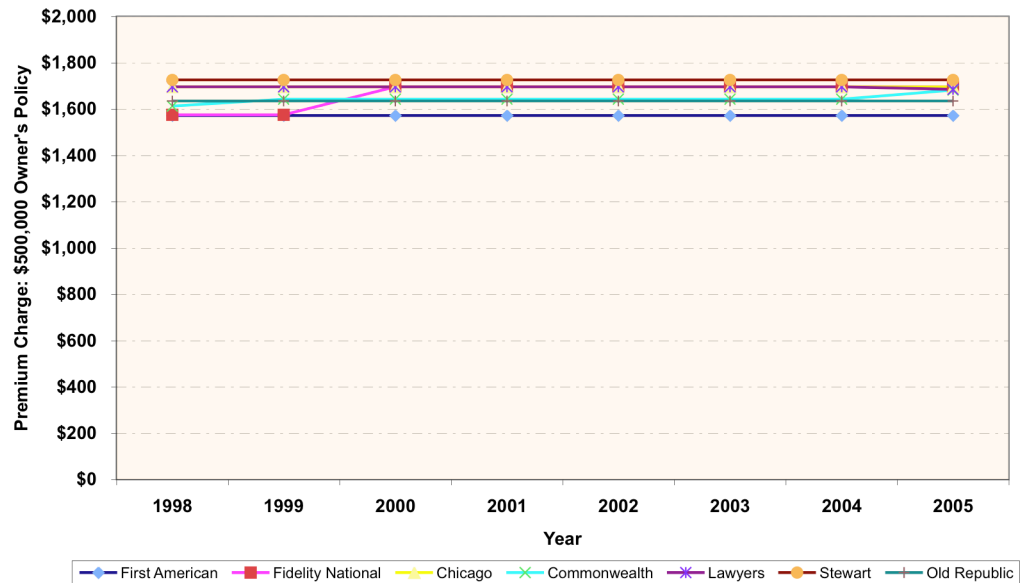


Chart 7, again based on the CDI filed rate review, shows the premium charges over time for a CLTA standard lender’s policy of \$500,000. The results are identical to those in Chart 6 in terms of rate changes and range of prices – few rate changes and a narrow range of prices.

**Chart 7: California Title Insurers' Premium Charges
\$500,000 Lender's Policy, 1998 - 2005**

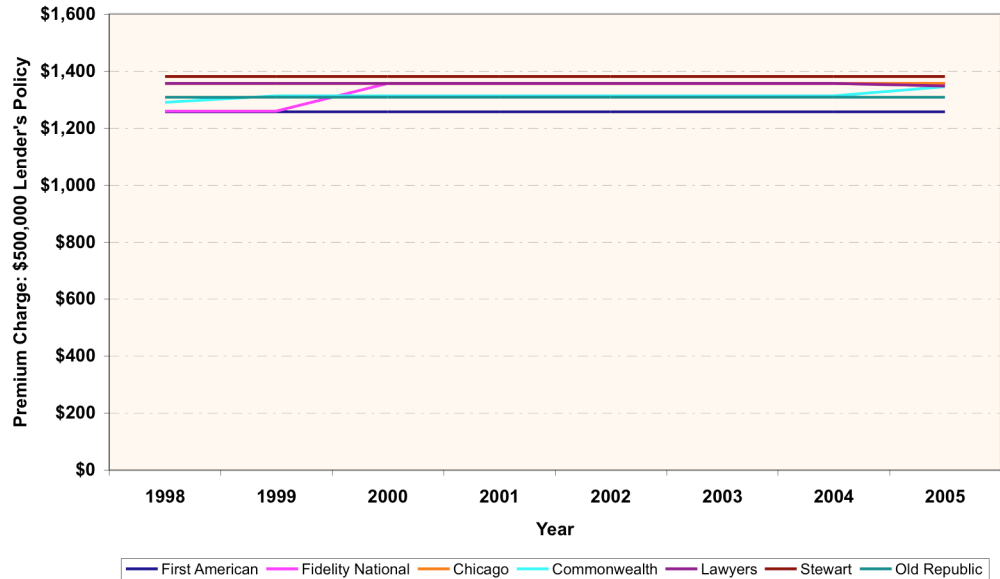
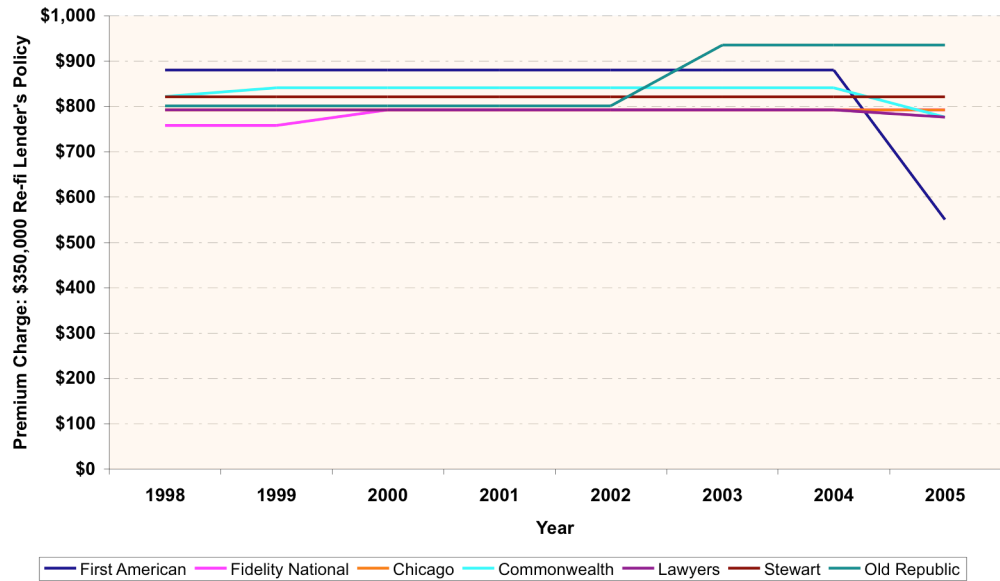


Chart 8 (also based on the CDI filed rate review) shows the premium charges over time for a refinance transaction, based on a \$350,000 CLTA standard lender’s policy. For the period, 1998 to 2004, the results are the same as for purchase transactions in Charts 6 and 7 – few rate changes and a narrow range of prices. In 2004, the premium charges for this refinance transaction ranged from \$792 to \$935 with an average of \$836. The premium charges ranged from 11.8% above to 5.3% below the average – a slightly bigger range than found in Charts 6 and 7. In 2005, First American filed new rates for refinance transactions with the result that First American’s premium charge is now significantly below those of other title insurers.

Chart 8: California Title Insurers' Premium Charges \$350,000 Refinance Lender's Policy, 1998 - 2005



Charts 6, 7 and 8 provide compelling evidence of the absence of price competition in California title insurance and escrow markets. As stated above, we would expect frequent rate changes by title insurance companies in response to changing real estate activity because of the impact on real estate transaction volume on production costs per unit sale. Yet, during a period when the number of real estate transactions soared, revenue per transaction jumped because of rising home prices and production costs dropped because of enhanced technology and perfection of title for millions of properties, not one major title insurance company lowered its rates and only two changed their rates at all by increasing rates.

These charts indicate that prices charged by title insurers and underwritten title companies are not responsive to the changing costs of production or increasing revenue per transaction at a given set of rates. Rather, the title insurers maintain excessive rates and use the additional revenue to provide services to real estate settlement personnel as a means for competing for the referral business. This is not a result that would obtain in a workably competitive market.

Findings and Conclusions

Based on an analysis of market structure, market conduct and market performance, we find that a reasonable degree of competition does not exist in the markets for title insurance and escrow services in California, where competition is understood as price competition that drives the price of the title insurance and escrow services to levels consistent with efficient production, service levels desired by consumers and reasonable profits. More specifically, we find that a reasonable degree of competition does not exist in the four phases of the business of title insurance in California:

1. Title Search, Examination and Commitment
2. Issuance and Servicing of Title Insurance Policy
3. Escrow and Closing
4. Other Services

Title Insurance

In the markets for title search, examination and commitment and for policy issuance and service, we found the following.

Reverse-Competitive Market

Title insurance and escrow markets are characterized by reverse competition where the marketing of the products is directed at the real estate agents, mortgage brokers and lenders who steer and direct the home purchaser or borrower – the consumer who actually pays for title and escrow services – to particular title insurers, underwritten title companies and escrow companies. Residential consumers have little, if any, market power because title insurance and escrow services are required for the closing of a real estate transaction, resulting in inelastic demand. In a reverse-competitive market, expenses are inflated as title insurers compete for the producers of title business – the real estate brokers, mortgage lenders and others involved in real estate settlements. Title insurers are able to pass along inflated costs – costs in excess of efficiently providing title and escrow services – because the paying consumer has no market power to exert downward pressure on prices. The reverse-competitive market structure for title insurance prevents consumers from exerting market power on seller behavior in terms of price, product or service levels.

High Market Concentration

We found title insurance markets highly concentrated – a few title insurers account for the vast majority of title insurance sales – at both the statewide level and at the county level in California. The number of title insurers is small and the top three title insurer groups account for 77.4% of the market at a statewide level and the top five account for 92%. At the statewide level, the Herfindahl-Hirschman Index, a standard measure of market concentration, was over 2,400, well above the 1,800 level that the Department of Justice considers to be highly concentrated. At the county level, the HHI in every county was above 1,800, with the majority of counties above 3,000. High market concentration is a departure from the competitive ideal and confers market power on the few sellers in the market.

Excess Profits

In a competitive market, sellers earn a reasonable profit. In the California title insurance and escrow services markets, both the title insurers and the underwritten title companies realized excessive profits. During a period when the cost of capital for title insurers was no greater than 10% to 12%, the insurers had returns on invested capital of two to three times this reasonable level. In 2003 and 2004, underwritten title companies in California earned after-tax profits of 49.0% and 32.3% – excessive by any reasonable measure.

Barriers to Entry

We found that access to title plants was generally not a barrier to entry, but we found the concentrated ownership of title plants to confer a significant competitive advantage on the largest title insurers. We found the biggest barrier to entry to be established relationships between the entities that can steer the consumer's title and escrow business to the entities who sell title insurance and escrow services. We found intense competition among title insurers and underwritten title companies for senior title officers, senior escrow managers and senior sales people who have established relationships with real estate brokers, lenders, homebuilders or mortgage brokers. We found all new entrants – title insurers or underwritten title companies – were entities who had such a relationship.

Few Entries into the Market

We found few title insurer entrants over the period from 1995 through 2005 and found the number of title insurer groups declining as some title insurers acquired others. We found few underwritten title company entrants over the period from 2000 to 2005. We found that the new underwritten title companies were typically a controlled business arrangement, whereby one of the entities able to steer business to a title insurer – a real estate broker, a homebuilder, a lender – establishes an underwritten title company to capitalize on its ability to steer business. The new entrants did not result in price competition. Rather, the new entrants provided a means for funneling profits from excessively-priced title insurance to the owners of the controlled business arrangement.

Illegal Rebating and Kickbacks

We found numerous examples in California of illegal rebates and kickbacks where the title insurer or the underwritten title company provides money, free services or other things of value to a real estate agent, a lender or homebuilder in exchange for business referrals. These illegal rebates and kickbacks – a consequence of reverse competition – show that title insurance and escrow charges are excessive and that some portion of the overcharge is passed from the underwritten title company or title insurer to the referrer of business. The consumer paying for the title insurance or escrow service pays for the illegal rebates and kickbacks by paying higher prices than would occur if title insurance and escrow markets were competitive.

No Price Movement in Response to Changing Costs

According to a review by the CDI, from 1998 through mid-2005, there was an absence of base rate changes. During a period when costs per unit of production declined significantly – due to greater productivity and large increases in the number of transactions – and when revenue per transaction increased due to rising property values and loan amounts, underwritten title companies and title insurers maintained excessive rates. The prices charged by title insurers and underwritten title companies were not and are not responsive to the changing costs of production or increasing revenue per transaction at a given set of rates. Rather, title insurers maintain excessive rates and use the additional revenue to provide services to real estate settlement personnel as a means for competing for the referral business.

Escrow and Closing

We found that the markets for escrow and closing services suffer from the same problems as those for title insurance. In Northern California, escrow and closing are performed by the same entities providing title insurance services and the same market dynamics exist for escrow and closing services as for title insurance products. In Southern California, escrow is performed by both independent escrow companies and the controlled escrow companies that are also underwritten title companies. Despite the greater number of businesses offering escrow services, the cost of escrow services are higher in Southern California than in Northern California. The presence of independent escrow companies in Southern California adds another layer of cost for the consumer instead of driving down prices because of greater supply of services. The existence of “sub-escrow” is further evidence of the absence of competition in escrow and closing markets. Lenders dictate how and what type of entities will conduct escrow and closing – demanding additional services with sub-escrow – and pass along the additional costs to consumers. The consumers who pay for the service have no market power to determine the level of service required. Instead, the lender is able to dictate the nature of escrow and closing services and to require consumers to pay for the level of service desired by the lender. In a competitive market, the consumers paying for the service could exert market power to reject – and cause sellers to eliminate – unnecessary or unwanted services. Consumers do not have that market power in California escrow and closing services markets.

Other Services

We found that the markets for other services are similar to the markets for title insurance and escrow and closing services. The demand for other services comes from parties in the title insurance or escrow transactions other than the consumer who pays for the other service. The consumer does not have the market power to either affect the services required or the price charged for those services. The consumer who objects to the requirement for other services or the price charged puts the larger real estate or borrowing transaction at risk.

**Report to the California Insurance Commissioner
An Analysis of Competition in the
California Title Insurance and Escrow Industry**

**Birny Birnbaum
Consulting Economist**

December 2005

Appendix 1

**Qualifications of
Birny Birnbaum, Consulting Economist**

Birny Birnbaum is a consulting economist whose work focuses on community development, economic development and insurance issues. Mr. Birnbaum has served as an expert witness on a variety of economic and actuarial insurance issues in several states on several types of insurance, including title insurance. Birny has analyzed title and other insurance markets on behalf of numerous state and federal agencies and consumer organizations. He has studied title insurance markets since 1991.

Mr. Birnbaum served for three years as Associate Commissioner for Policy and Research and the Chief Economist at the Texas Department of Insurance. At the Department, Mr. Birnbaum provided technical and policy advice to the Insurance Commissioner and performed policy research and analysis for the Department on a variety of topics, including analyses of competition in insurance markets.

Prior to his work at the Texas Department of Insurance, Mr. Birnbaum was the Chief Economist at the Office of Public Insurance Counsel (OPIC), working on a variety of insurance issues, including title insurance, on behalf of Texas consumers. Prior to OPIC, Mr. Birnbaum was a consulting economist working on community and economic development projects. Mr. Birnbaum also worked as business and financial analyst for the Port Authority of New York and New Jersey.

Mr. Birnbaum was educated at Bowdoin College and the Massachusetts Institute of Technology where he received Master's Degrees in Business (M.S., Management) and Urban Planning (M.C.P.) with concentrations in finance and applied economics and in regional economics.

**Report to the California Insurance Commissioner
An Analysis of Competition in the
California Title Insurance and Escrow Industry**

**Birny Birnbaum
Consulting Economist**

December 2005

Appendix 2

**Key Provisions of Selected Underwriting Agreements
Between Underwritten Title Companies and Title Insurers in California**

**NON-PUBLIC INFORMATION REDACTED FOR PUBLIC VERSION OF THIS
REPORT**

**Report to the California Insurance Commissioner
An Analysis of Competition in the
California Title Insurance and Escrow Industry**

**Birny Birnbaum
Consulting Economist**

December 2005

Appendix 3

**Description of County-Level Market Share Analysis
And Detailed Tables**

Description of Data and Analysis for Table 4: Market Share and HHI by County

The data for Table 4 and the detailed data tables in this Appendix are based on title market share data from DataQuick and on information in the 2004 underwritten title company annual reports.

The underwritten title company annual reports break out title and escrow activity by county (Schedule F) and provide a breakout of statewide title premium by underwriter (Schedule G). We first attempted to utilize the underwritten title company annual reports' Schedule F data to calculate market shares by county. This seemed logical because Schedule F requires the underwritten title companies to report the following data items by county: gross title premium, escrow fees, other service fees, title orders open at the beginning of the year, title orders opened during the year, title orders closed during the year, title orders cancelled during the year, title orders open at end of year, escrow orders open at beginning of year, escrow orders opened during the year, escrow orders closed during the year, escrow orders cancelled during the year and escrow orders open at end of year.

Upon investigation, we learned that many or most underwritten title companies had reported Schedule F based on the county where the office producing the title or escrow business was located and not based on the county where the property that was the subject of the title or escrow was located. Many underwritten title companies operate joint production facilities, wherein an office in one county performs title activity for properties located in other counties. Because we had no way to evaluate how the activity reported by county related to actual activity for properties in that county, we could not rely upon the Schedule F data for market share analysis.

We then acquired data from DataQuick, a division of First American. DataQuick, among other things, acquires information on all transactions recorded in all counties. One of the reports available from DataQuick is the Title Market Share report. We obtained the Title Market Share report for each county in California for the twelve-month period of calendar year 2004. The Title Market Share Reports provide a breakout of the number of transactions and the dollar amount of the transactions (the amount insured) for each title company for all transactions recorded in the county. The data are further broken out by types of transaction, including new home sales / resales, refinance / home equity and others.

The DataQuick reports only identify the "title company" and do not identify the title insurer underwriting the policies. We turned to the underwritten title company 2004 annual reports' Schedule G to identify the underwriters (title insurers) used by each underwritten title company. For underwritten title companies that utilized more than one underwriter, we estimated the amount of title activity in each county by underwriter by applying the statewide shares of title premium by underwriter to the activity of each DataQuick title company by county. For example, if the title company in the DataQuick data utilized

Fidelity for 50% of its statewide title premium according to Schedule G, we applied a 50% share to each of the DataQuick title company's county title activity to establish Fidelity's share of that title company's county activity. This approach likely leads to an understatement of HHIs by

county because the market share of underwriters for whom the underwritten title company uses predominantly in a particular county will be muted.

Another issue arose with the DataQuick data. DataQuick reported over 280 different “title companies” in the various county Market Share Reports. There are only about 90 licensed underwritten title companies. Some of the entities reported by DataQuick as “title companies” are not underwritten title companies. Of the entities listed that are not underwritten title companies, most have only a few transactions and do not affect market share and HHI calculations. Some of the entities that are not underwritten title companies are easily identified as affiliates of underwritten title companies or title insurers. In those cases, we were able to assign the transactions to a title insurer group. A list of the “identifiable” title companies is provided below with an explanation of the assignment to a title insurer group. In a few remaining instances, the “title company” was not identifiable as an affiliate of an underwritten title company or title insurer and had a large number of transactions. The largest of these was Title Court Services and its affiliates California Hall Services and Environmental title with over 22,000 transactions on a statewide basis. In some counties, Title Court Services represented 15% of total refinance / home equity transactions.

We calculated market share by assigning the transactions to a title insurer group when we could identify the title insurer group. In some situations, as described above, we allocated a DataQuick title company’s transactions to several title insurer groups based upon Schedule G data. We calculated market share by dividing the identifiable title insurer transactions by total county transactions, which included all transactions.

We calculated market shares and HHIs for six data sets for each county – all transactions dollar volume, all transactions number of transactions, new sale / resale dollar volume, new sale / resale number of transactions, refinance / home equity dollar volume and refinance / home equity number of transactions.

California Title Insurance HHIs by County
Sorted by County

County	<u>All Insured</u>		<u>Sales</u>		<u>Refi / Home Equity</u>	
	<u>Transactions</u>	<u>All Insured</u>	<u>Transactions</u>	<u>Sales</u>	<u>Transactions</u>	<u>Equity</u>
	<u>Amount Insured</u>	<u>Transactions</u>	<u>Amount Insured</u>	<u>Transactions</u>	<u>Amount Insured</u>	<u>Transactions</u>
	<u>Dollars</u>	<u>Number</u>	<u>Dollars</u>	<u>Number</u>	<u>Dollars</u>	<u>Number</u>
Alameda	2,526	2,556	2,470	2,451	2,591	2,643
Alpine	6,998	6,284	7,427	7,314	6,054	4,961
Amador	3,180	3,038	3,738	3,941	2,682	2,548
Butte	4,470	4,401	4,558	4,545	4,327	4,288
Calaveras	4,787	4,822	5,100	5,197	4,435	4,486
Colusa	3,644	3,761	3,367	3,506	4,041	4,189
Contra Costa	2,438	2,427	2,371	2,286	2,503	2,533
Del Norte	6,346	6,100	5,858	6,160	6,769	6,091
El Dorado	2,181	2,289	2,100	2,276	2,405	2,386
Fresno	3,508	3,405	3,621	3,606	3,377	3,293
Glenn	4,111	3,932	4,314	4,449	3,997	3,882
Humboldt	3,543	3,041	3,349	3,323	4,317	2,911
Imperial	3,336	3,163	3,586	3,176	3,435	3,348
Inyo	8,819	8,304	9,994	9,963	7,000	6,438
Kern	3,397	3,344	3,648	3,337	3,169	3,307
Kings	3,157	3,111	3,260	3,317	3,049	3,015
Lake	4,555	4,433	5,084	5,038	4,077	3,931
Lassen	5,342	4,856	5,975	5,528	4,849	4,320
Los Angeles	2,307	2,211	2,474	2,442	2,208	2,139
Madera	4,285	3,900	5,100	5,022	3,570	3,242
Marin	2,634	2,615	2,549	2,520	2,729	2,680
Mariposa	4,439	4,381	4,670	4,344	4,541	4,734
Mendocino	5,321	4,972	6,396	6,401	4,428	4,318
Merced	3,404	3,366	3,458	3,515	3,345	3,278
Modoc	8,064	8,291	9,266	9,260	6,634	5,560
Mono	9,504	8,848	9,977	9,830	8,669	7,916
Monterey	2,627	2,676	2,589	2,745	2,743	2,718
Napa	2,538	2,543	2,615	2,580	2,581	2,608
Nevada	1,989	1,851	2,156	2,184	1,899	1,687
Orange	2,480	2,404	2,602	2,586	2,393	2,385
Placer	2,243	2,091	2,563	2,578	2,005	1,854
Plumas	5,170	4,839	5,280	4,964	5,157	4,867
Riverside	2,325	2,184	2,506	2,531	2,116	2,056
Sacramento	2,401	2,380	2,316	2,373	2,570	2,444
San Benito	3,558	3,567	3,678	3,758	3,400	3,482
San Bernardino	2,287	2,108	2,626	2,570	1,973	1,882
San Diego	2,493	2,398	2,838	2,835	2,307	2,255
San Francisco	3,167	3,084	3,321	3,096	3,031	3,108
San Joaquin	2,815	2,710	2,861	2,934	2,714	2,602
San Luis Obispo	3,547	3,387	3,894	3,762	3,241	3,190
San Mateo	2,641	2,707	2,437	2,427	2,853	2,867
Santa Barbara	3,414	3,424	3,383	3,603	3,409	3,350
Santa Clara	2,878	2,895	2,852	2,887	2,868	2,921
Santa Cruz	3,235	3,142	3,370	3,341	3,037	3,058
Shasta	3,538	3,445	3,138	3,273	4,074	3,687
Sierra	4,689	3,503	3,765	3,973	5,645	3,196
Siskiyou	4,385	4,393	4,148	4,073	4,698	4,869
Solano	2,390	2,286	2,359	2,308	2,440	2,325
Sonoma	2,328	2,355	2,299	2,272	2,434	2,437
Stanislaus	3,440	3,433	3,500	3,518	3,350	3,377
Sutter	2,945	2,931	2,882	2,814	3,005	3,127
Tehama	4,869	4,676	5,406	5,312	4,272	4,123
Toulumne	2,575	2,546	2,596	2,561	2,609	2,650
Trinity	4,651	4,588	4,813	4,779	4,403	4,405
Tulare	4,126	3,938	4,358	4,376	3,857	3,642
Ventura	2,577	2,482	2,759	2,770	2,396	2,360
Yolo	2,014	1,998	2,329	2,322	1,792	1,859
Yuba	3,580	2,991	3,791	3,624	2,980	2,348
Statewide	2,418	2,359	2,515	2,548	2,327	2,283

California Title Insurance HHIs by County
Sorted by HHI of All Insured Transaction Amount Insured

County	All Insured		Sales		Refi / Home	
	Transactions	Transactions	Transactions	Transactions	Equity	Equity
	Dollars	Number	Dollars	Number	Dollars	Number
Mono	9,504	8,848	9,977	9,830	8,669	7,916
Inyo	8,819	8,304	9,994	9,963	7,000	6,438
Modoc	8,064	8,291	9,266	9,260	6,634	5,560
Alpine	6,998	6,284	7,427	7,314	6,054	4,961
Del Norte	6,346	6,100	5,858	6,160	6,769	6,091
Lassen	5,342	4,856	5,975	5,528	4,849	4,320
Mendocino	5,321	4,972	6,396	6,401	4,428	4,318
Plumas	5,170	4,839	5,280	4,964	5,157	4,867
Tehama	4,869	4,676	5,406	5,312	4,272	4,123
Calaveras	4,787	4,822	5,100	5,197	4,435	4,486
Sierra	4,689	3,503	3,765	3,973	5,645	3,196
Trinity	4,651	4,588	4,813	4,779	4,403	4,405
Lake	4,555	4,433	5,084	5,038	4,077	3,931
Butte	4,470	4,401	4,558	4,545	4,327	4,288
Mariposa	4,439	4,381	4,670	4,344	4,541	4,734
Siskiyou	4,385	4,393	4,148	4,073	4,698	4,869
Madera	4,285	3,900	5,100	5,022	3,570	3,242
Tulare	4,126	3,938	4,358	4,376	3,857	3,642
Glenn	4,111	3,932	4,314	4,449	3,997	3,882
Colusa	3,644	3,761	3,367	3,506	4,041	4,189
Yuba	3,580	2,991	3,791	3,624	2,980	2,348
San Benito	3,558	3,567	3,678	3,758	3,400	3,482
San Luis Obispo	3,547	3,387	3,894	3,762	3,241	3,190
Humboldt	3,543	3,041	3,349	3,323	4,317	2,911
Shasta	3,538	3,445	3,138	3,273	4,074	3,687
Fresno	3,508	3,405	3,621	3,606	3,377	3,293
Stanislaus	3,440	3,433	3,500	3,518	3,350	3,377
Santa Barbara	3,414	3,424	3,383	3,603	3,409	3,350
Merced	3,404	3,366	3,458	3,515	3,345	3,278
Kern	3,397	3,344	3,648	3,337	3,169	3,307
Imperial	3,336	3,163	3,586	3,176	3,435	3,348
Santa Cruz	3,235	3,142	3,370	3,341	3,037	3,058
Amador	3,180	3,038	3,738	3,941	2,682	2,548
San Francisco	3,167	3,084	3,321	3,096	3,031	3,108
Kings	3,157	3,111	3,260	3,317	3,049	3,015
Sutter	2,945	2,931	2,882	2,814	3,005	3,127
Santa Clara	2,878	2,895	2,852	2,887	2,868	2,921
San Joaquin	2,815	2,710	2,861	2,934	2,714	2,602
San Mateo	2,641	2,707	2,437	2,427	2,853	2,867
Marin	2,634	2,615	2,549	2,520	2,729	2,680
Monterey	2,627	2,676	2,589	2,745	2,743	2,718
Ventura	2,577	2,482	2,759	2,770	2,396	2,360
Toulumne	2,575	2,546	2,596	2,561	2,609	2,650
Napa	2,538	2,543	2,615	2,580	2,581	2,608
Alameda	2,526	2,556	2,470	2,451	2,591	2,643
San Diego	2,493	2,398	2,838	2,835	2,307	2,255
Orange	2,480	2,404	2,602	2,586	2,393	2,385
Contra Costa	2,438	2,427	2,371	2,286	2,503	2,533
Statewide	2,418	2,359	2,515	2,548	2,327	2,283
Sacramento	2,401	2,380	2,316	2,373	2,570	2,444
Solano	2,390	2,286	2,359	2,308	2,440	2,325
Sonoma	2,328	2,355	2,299	2,272	2,434	2,437
Riverside	2,325	2,184	2,506	2,531	2,116	2,056
Los Angeles	2,307	2,211	2,474	2,442	2,208	2,139
San Bernardino	2,287	2,108	2,626	2,570	1,973	1,882
Placer	2,243	2,091	2,563	2,578	2,005	1,854
El Dorado	2,181	2,289	2,100	2,276	2,405	2,386
Yolo	2,014	1,998	2,329	2,322	1,792	1,859
Nevada	1,989	1,851	2,156	2,184	1,899	1,687

Description of Assignment of Data Quick “Title Companies”

Custom Recording Solutions, Lenders Service, Custom Title Solutions

Assigned to Fidelity for Underwriter. Web search for “Custom Recording Solutions” yielded a link to elendersolutions.com which was redirected to LSI (www.lsi.fnf.com), a company acquired by Fidelity in 2003. LSI stands for Lender’s Service, Inc. Web search for “Custom Title Solutions” also yielded a link to elendersolutions.com.

Security Union Title

Assigned to Fidelity for Underwriter. Security Union is a title insurance company and member of the Fidelity group.

Title Court Service, California Hall Service, Title Court

NOT Assigned. Variety of real estate related services, including filing services and environmental chain of title. California Hall Service and Environmental Title are subsidiaries responsible for documents and environmental chains of title. Secretary of State Search finds corporate record from 1978 with Glenn M. Perrell, 205 South Broadway, # 302, Los Angeles, CA 90012 as agent for service. Google search for Perrell turns up nothing.

California Land Title

Assigned some counties to CA Land Title Marin and some counties to CA Land Title Nevada based on proximity to Marin and Nevada counties, respectively. Some counties left blank. Marin has several underwriters and is owned by Stewart; Nevada’s underwriter is Old Republic and appears to be an independent.

Nationwide Appraisal & Title

Assigned to United Capital for Underwriter. Shows Nationwide Appraisal & Title is part of Capital Title Group:

<http://www.nascopgh.com/website/NascoWebContent.nsf/0/12e54bc56144d2d785256f40004e0c26?OpenDocument> and

<http://www.nascopgh.com/website/NascoWebContent.nsf/UNIDL/AE2AD07E7D904BF48525705A0051C25C?OpenDocument>.

Capital Title Group is owner of United Title Company, First California Title Company and New Century Title Company. Underwriter in CTG is United Capital Title Insurance Company.

Progressive Closing and Escrow

NOT Assigned. Web site provides no info on ownership.

<http://www.progressiveclosing.com/PCE/Default.asp>.

National Closing Solutions

NOT Assigned to Underwriter. MLHC is parent of Westcor Land Title Insurance Company, Placer Title and Sterling Title. <http://www.nationalclosingsolutions.com/index.html>. U.S. Recordings, Inc.

NOT Assigned. Company is a “virtual backroom provider of integrated recording services.” MN company with no indication of ownership. http://www.usrecordings.com/main_content.html.

Transcontinental Title

Assigned to First American as Underwriter. Based in Florida, company provides complete title and escrow services in 48 states and DC. Provides title rates on line, link indicates relationship – “in affiliation” – with First Am: http://www.tctitle.com/tidb_interface/Documents/CALIFORNIA.pdf.

American Title Association

NOT Assigned. Google search turns up ATA as forerunner of ALTA and as a Florida Title Abstract Company.

LT National Title Services

NOT Assigned. Google search turns up company based in Hoboken, N.J.

TransUnion National Settlement Solutions

Assigned to TransUnion for Underwriter. In 2004, TNSS was national title agency, has since acquired Diversified (7/05).

State Title

NOT Assigned. State Title Agency is based in Arizona, operates in two Arizona counties and uses Old Republic, United General and Title Resources Guaranty as underwriters. <http://www.statetitleagency.com/index.html>. Google search for “State Title” brings up many references.

Escrow Closing Services, Inc.

NOT Assigned. Assigned to E-Loan for Owner. Subsidiary of E-Loan, that provides mortgage closing and appraisal services for E-Loan’s loans.

Lenders Service

Assigned to Fidelity for Underwriter. Lenders Service assumed to be the same as LSI.

Accufile, Inc.

NOT Assigned. Google search turns up a Boston-based professional library service for law and accounting firms and financial institutions. www.accufile.com.

General American Corporation

NOT Assigned. www.gac.com says company is “leading provider of technology solutions and settlement services, offering nationwide assistance to the real estate finance industry for first mortgage refinance, home equity, and purchase money settlement transactions.”

American Consolidated Title

Assigned to First American for Underwriter.

<http://www.floridabyowner.com/Sponsors.html> indicates ACT is a Florida title agency underwritten by First Am.

ATI Title

Assigned to First American for Underwriter. UTC names provided by Financial Analysis Division indicate Advantage Title is new name for ATI title.

Lenders First Choice

Assigned to First American for Underwriter. Web search indicates Lenders First Choice is a Mercury company and Mercury's underwriter is First American.

National Title, National Title Insurance

Assigned to Fidelity for Underwriter. Only for San Fran and San Bern counties. Fidelity has a number of "National Title Company of ..." entities.

**Report to the California Insurance Commissioner
An Analysis of Competition in the
California Title Insurance and Escrow Industry**

**Birny Birnbaum
Consulting Economist**

December 2005

Appendix 4

**Countrywide Profitability of Title Insurers Licensed in California,
For the Years 2000 through 2004**

**Countrywide Profitability for Title Insurers Licensed in California
For the Years 2000 through 2004.**

Five Years' Profitability	2004	2003	2002	2001	2000
Direct Operations	\$1,885,395,205	\$2,036,639,858	\$1,444,597,127	\$1,110,587,558	\$883,141,946
Non-affiliated Agency Operations	\$8,275,259,800	\$8,180,431,000	\$6,246,372,953	\$4,526,564,683	\$3,784,157,161
Affiliated Agency Operations	\$3,744,968,922	\$3,835,697,413	\$3,018,072,678	\$2,397,803,895	\$1,680,927,680
Total Direct Title Premiums Written	\$13,905,623,927	\$14,052,768,271	\$10,709,042,758	\$8,034,956,136	\$6,348,226,787
Premiums Earned	\$13,531,338,194	\$13,584,463,804	\$10,383,628,724	\$7,817,603,467	\$6,226,913,665
Escrow and Settlement Service Changes	\$444,507,181	\$486,202,378	\$339,488,125	\$250,319,837	\$168,910,617
Title Examinations	\$196,129,850	\$206,721,047	\$160,283,880	\$137,524,253	\$131,182,130
Searched and Abstracts	\$208,336,397	\$222,685,766	\$178,597,510	\$134,819,049	\$107,774,500
Surveys	\$2,924,055	\$2,637,681	\$2,785,815	\$2,434,031	\$1,624,663
Aggregate Write-ins for Service Changes	\$156,245,094	\$184,499,976	\$127,786,561	\$105,926,781	\$101,963,218
Aggregate Write-ins for Other Operating Income	\$2,505,308	\$4,066,226	\$2,592,798	\$4,069,884	\$678,170
Total Operating Income	\$14,541,986,079	\$14,691,276,878	\$11,195,163,413	\$8,452,697,302	\$6,739,046,963
Net Operating Gain or (Loss)	\$595,883,146	\$863,705,152	\$395,408,845	\$199,272,939	(\$1,366,203)
Net Investment Gain or (Loss)	\$399,485,779	\$519,611,718	\$292,616,658	\$317,836,479	\$231,430,013
Total Other Income	\$2,414,309	\$2,529,490	\$2,472,242	\$957,904	\$1,169,904
Federal Income Taxes Incurred	\$320,872,160	\$422,754,005	\$203,414,859	\$130,381,532	\$71,556,188
Net Income	\$676,911,074	\$963,092,355	\$487,082,886	\$387,685,790	\$159,677,526
Change in Surplus from Prior Year	\$51,658,277	\$415,517,102	\$399,143,505	\$333,631,688	(\$8,359,060)
Prior Year's Policyholders' Surplus	\$2,715,736,628	\$2,300,532,113	\$1,901,255,558	\$1,570,082,946	\$1,575,633,494
Current Year's Policyholders' Surplus	\$2,767,394,905	\$2,716,049,215	\$2,300,399,063	\$1,903,714,634	\$1,567,274,434
2-year Average Policyholders' Surplus	\$2,741,565,767	\$2,508,290,664	\$2,100,827,311	\$1,736,898,790	\$1,571,453,964
ROE	24.69%	38.40%	23.19%	22.32%	10.16%

**Report to the California Insurance Commissioner
An Analysis of Competition in the
California Title Insurance and Escrow Industry**

**Birny Birnbaum
Consulting Economist**

December 2005

Appendix 5

**List of Underwritten Title Companies
Submitting Annual Reports for Experience Year 2004**

and

**Detailed Aggregate Income Statement of
California Underwritten Title Companies for 2004**

**List of California Underwritten Title Company 2004 Annual Reports
Included in Aggregate Income Statement**

Advantage Title, Inc.	LSI Title Company
Alliance Title Company	Mid Valley Title and Escrow Company
American Coast Title Company, Inc.	Modoc County Title Company
Bidwell Title And Escrow Company	Mountain Title Company
Calaveras Title Company	Mt. Shasta Title And Escrow Company
California Counties Title Company	Napa Land Title Company
California Land Title Co. of Nevada County	National Title Company of Southern CA
California Land Title of Marin	National Title Company of Ventura County
California Title Company	Nations Title Company of California
California Title Co. of Northern CA	New Century Title Company
Cal-Sierra Title Company	North American Title Company, Inc.
Chicago Title Company	North Bay Title Company
Commerce Title Company	North State Title Company
Commonwealth Land Title Company	Northern California Title Company
Community Title Company	Old Republic Title Company
Cornerstone Title Company	Orange Coast Title Company
Crescent Land Title Company	Orange Coast Title Company of Los Angeles
Cuesta Title Company	Orange Coast Title Co. of the Inland Empire
Diversified Title & Escrow Services Company	Placer Title Company
Equity Title Company	Priority Title Company
Fidelity National Title Company	Progressive Title Company, Inc.
Fidelity National Title Co. of California	Provident Title Company
Financial Title Company	Redwood Empire Title Co. of Mendocino Cty.
First American Title Company	Saddleback Title Company
First American Title Company of Napa	Santa Cruz Title Company
First American Title Company of Stockton	Sierra Valley Title
First California Title Company, Inc.	Siskiyou County Title Company
First Southwestern Title Company of America	Southland Title Corporation
First Southwestern Title Co. of CA	Southland Title of Orange County
Frontier Title Company	Southland Title of San Diego
Gateway Title Company	Sterling Title Company
Glenn County Title Company	Stewart Title of California, Inc.
Guardian Title Company	Stewart Title of Sacramento
Home Connects Title Services, Inc.	Ticor Title Company of California
Humboldt Land Title Company	Transcounty Title Co.
Inter-County Title Co. of El Dorado County	Trinity County Title Company
Inter-County Title Co., Tuolumne - Mariposa	United Title Company
Investors Title Company	Western Land Title Company, Inc.
Investors Title Company of Southern CA	Western Title Colusa County
Inyo-Mono Title Company	Westminster Title Company, Inc.
Landwood Title Company	Yosemite Title Company
Lawyers Title Company	

Detailed Aggregate California UTC Income Statement for 2004

		% of Operating Revenue		% of Operating Revenue
	Year 2004		Year 2003	
<u>OPERATING REVENUES</u>				
1	Gross Title Insurance Premiums	\$2,923,506,440	67.53%	\$3,146,887,611 68.58%
2	Escrow Fees	\$1,125,067,480	25.99%	\$1,208,354,467 26.33%
3	Other Service Charges	\$278,062,112	6.42%	\$232,692,164 5.07%
4	Aggregate Write-Ins for Oper. Rev.	\$2,493,944	0.06%	\$951,093 0.02%
5	Total Operating Revenue	\$4,329,129,976	100.00%	\$4,588,885,335 100.00%
<u>OPERATING EXPENSES</u>				
6	Underwriting Premium to Title Insurers	\$283,674,357	6.55%	\$301,417,453 6.57%
<u>Personnel expenses</u>				
7	Salaries	\$1,567,068,187	36.20%	\$1,581,960,730 34.47%
8	Bonuses	\$404,881,378	9.35%	\$435,357,044 9.49%
9	Employee Relations & Welfare	\$164,125,212	3.79%	\$160,729,206 3.50%
10	Payroll Taxes	\$132,082,984	3.05%	\$129,280,705 2.82%
11	Aggregate Write-Ins for Personnel	\$49,604,224	1.15%	\$68,185,678 1.49%
12	Total Personnel Expenses	\$2,317,761,985	53.54%	\$2,375,513,363 51.77%
<u>Other underwriting expenses</u>				
13	Losses - Title	\$19,344,457	0.45%	\$23,927,412 0.52%
14	Losses - Escrow	\$9,200,709	0.21%	\$14,762,743 0.32%
15	Title Plant Rent & Maintenance	\$181,674,694	4.20%	\$180,071,559 3.92%
16	Advertising Expenses	\$19,000,528	0.44%	\$16,596,560 0.36%
17	Business Promotion / Public Rel.	\$59,979,569	1.39%	\$53,635,975 1.17%
18	Travel / Travel Items	\$52,896,994	1.22%	\$50,163,930 1.09%
19	Rent / Rent Items	\$202,166,462	4.67%	\$179,066,830 3.90%
20	Depreciation and Amortization	\$55,701,633	1.29%	\$47,860,533 1.04%
21	Printing / Stationery / Supplies	\$81,291,570	1.88%	\$88,488,287 1.93%
22	Telephone / Utilities	\$72,082,929	1.67%	\$75,260,203 1.64%
23	Messenger Service	\$69,713,593	1.61%	\$72,318,094 1.58%
24	Insurance	\$16,490,651	0.38%	\$14,047,236 0.31%
25	Bad Debt Expense	\$5,743,478	0.13%	\$15,374,885 0.34%
26	Licenses / Fees / Other Taxes	\$5,031,691	0.12%	\$4,506,816 0.10%
27	Dues / Subscriptions	\$5,253,056	0.12%	\$4,742,805 0.10%
28	Accounting / Auditor's Fees	\$4,703,716	0.11%	\$4,149,404 0.09%
29	Director Fees	\$864,100	0.02%	\$1,025,887 0.02%
30	Legal Fees	\$34,584,488	0.80%	\$10,421,963 0.23%
31	Management Fees	\$49,847,809	1.15%	\$46,647,571 1.02%
32	Aggregate Write-Ins Other UW Exp	\$235,737,772	5.45%	\$259,703,980 5.66%
33	Total Other UW Expense	\$1,181,309,899	27.29%	\$1,162,772,673 25.34%
34	TOTAL OPERATING EXPENSES	\$3,782,746,241	87.38%	\$3,839,703,489 83.67%
35	NET OPERATING INCOME <LOSS>	\$546,383,735	12.62%	\$749,181,846 16.33%
<u>Other Income <Expenses></u>				
36	Interest / Dividends / Rental Income	\$9,263,420	0.21%	\$7,465,746 0.16%
37	Interest Expense	-\$2,741,380	(0.06%)	-\$2,291,572 (0.05%)
38	Aggregate Write-Ins Other Income	\$38,780,511	0.90%	\$45,254,083 0.99%
39	Total Other Income <Expenses>	\$45,302,551	1.05%	\$50,428,257 1.10%
40	INCOME BEFORE INCOME TAXES	\$591,686,286	13.67%	\$799,610,103 17.42%
41	Provision for Income Taxes	\$232,660,519	5.37%	\$301,060,901 6.56%
42	NET INCOME	\$359,025,767	8.29%	\$498,549,202 10.86%