



DEPARTMENT OF
COMMERCE
COMMUNITY AND
ECONOMIC DEVELOPMENT

Division of Insurance

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Summary of
Title Insurance Examinations
Division of Insurance
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Purpose of Examinations

On June 28, 2004, Linda Hall, Director of the State of Alaska, Division of Insurance (division), issued Bulletin #B 04-09. The bulletin was to all insurers and producers authorized to transact title insurance business in the State of Alaska and other interested parties in reference to title insurance examinations. Director Hall stated that, due to correspondence she had received from members of the title insurance industry that raised questions concerning possible violations of Alaska's rebating laws and possible improper restraint on competition because of affiliated business arrangements, she was ordering an industry wide review of title insurance compensation practices and business affiliations. Director Hall stated that she was appointing John Holley, an investigator with the division, as the examiner and that an examination call letter would be initiated in the next few months. (See Attachment #1.) This report summarizes the background and basis for the examinations and describes in general terms what the division has found, to date, and what next steps may be taken.

On August 13, 2004, Director Hall issued Examination Call Notices for the title insurance examinations that were mentioned in Bulletin #B04-09. The letters were addressed to the Compliance Officer's of the title insurance companies in question. The following is a list of the companies notified:

- a) Land Title Company of Alaska, Inc. (License #8039) and Land Title Company of Alaska, Inc. (Wasilla) (License #35331);
- b) Alyeska Title Guaranty Agency (License #35845) and Alyeska Title Guaranty Agency (License #25109);
- c) Fidelity Title of Alaska, LLC (License #30835), Mat-Su Title Insurance Agency, Inc. (Anchorage) (License #30836), and Mat-Su Title Insurance Agency, Inc. (License #8121);
- d) Pacific Northwest Title of Alaska, Inc. (License #8947);
- e) Stewart Title of Alaska (License #8077), Stewart Title of Alaska (License #38282), and Stewart Title of Alaska (Eagle River) (License #38147);
- f) TransAlaska Summit First American Title Insurance Agency (License #16020), TransAlaska Summit First American Title Insurance Agency (License #16022), TransAlaska Title Insurance Agency, Inc. (Wasilla) (License #8050), and TransAlaska Title Insurance Agency (License #9059);
and
- g) McKinley Title & Trust, Inc. (License #8575).

The division has also gathered information on Alaska title companies through means outside of this process. Under 3 AAC 27.330, the companies were required to submit financial documents to the division by March 1, 2005. The companies were required to provide five years' worth of detailed financial income concerning revenues and expenses. Despite being given five years to produce the information, not all companies have fully complied. Preliminary review of the information provided reveals that those years were profitable.

Nation-wide Scrutiny of the Title Insurance Industry

The division's review of Alaska's title insurance industry is not unique. The title insurance industry has come under increased scrutiny recently. Several states have opened investigations. Some of these have uncovered wrongdoing, and resulted in multi-million dollar civil penalties and restitution. Actions taken in Colorado and California are examples. In addition, the United States Department of Housing and Urban Development has investigated title and real estate companies, and recently entered into settlements with companies involving practices similar to those uncovered in this examination.

Among the serious wrongdoing uncovered in those investigations is the creation of sham reinsurance companies with shareholders who were customers of the title insurance companies. Although the sham companies received payment to "reinsure" certain policies, those companies were never called upon in the event of a claim against one of those policies. Payments to the sham reinsurers were considered rebating by the state insurance commissioners who have uncovered the wrongdoing.

Subject Matter Scope of Examination

In addition to the national scrutiny of the industry, the division received numerous complaints from a variety of sources indicating that illegal rebating was occurring in Alaska. Although there are no resident reinsurance companies in Alaska, the director also believed that it was prudent to examine other aspects of the title insurance industry in Alaska in order to determine if other forms of rebating were being practiced. Many of the companies that settled rebating cases in other states also do business in Alaska.

The exam looked into the corporate structure and ownership of title companies, as well as compliance with Alaska statutes. In some cases, documents were sought that would be helpful in the analysis of a company's activities.

Anchorage and Mat-Su Valley were chosen as the sites of the examination because of their comparatively large population, and the large number of real estate transactions in the area. In addition, many of the complaints the division received concerning practices in the title industry involved companies in this population center.

Legal Background

The division has the authority to conduct examinations and investigations of insurance matters under AS 21.06.080. In addition, Alaska law gives the Director authority to examine the financial and other business records of title companies to determine whether they have complied with the law. AS 21.66.120.

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Anti-Rebating Law

Alaska's anti-rebating law, AS 21.66.310, explicitly forbids title companies and their agents from giving anything of value, directly or indirectly, as an inducement to obtaining title insurance business. It prohibits a person in the real estate services industry, or "any other person" from receiving, directly or indirectly, any rebate, reduction, . . . or a special favor or advantage, or a monetary consideration or inducement."¹

The only exception to the rule is that there may be payment:

1. for services rendered as the result of a title insurance transaction; and
2. a commission may be paid to a title insurance limited producer² who issues the policy of title insurance.

RESPA

The Real Estate Settlement Practices Act is the primary Federal Act dealing with certain residential real estate sales. It contains analogous prohibitions on rebating. The Act prohibits accepting of any fee, kickback, or thing of value in connection with a federally regulated mortgage loan. Fee splitting is not permitted unless services are actually performed. RESPA has exceptions that permit payment for bona fide services rendered in a title insurance transaction. 12 USC § 2607. Pursuant to regulations promulgated under RESPA, a split of charges is permitted only where there are actual services performed. Nominal services are not considered actual services performed. 24 C.F.R. § 3500.14(c).

¹ AS 21.66.310 states in full:

(a) A title insurer, or officer, employee, attorney, or title insurance limited producer of a title insurer, may not pay, allow, or give or offer to pay, allow, or give, directly or indirectly, as an inducement to obtaining a title insurance business, a rebate, reduction, or abatement of a rate or charge made incident to the issuance of the title insurance, a special favor or advantage, money consideration, or other inducement. A charge made incident to the issuance of the insurance is construed to include, without limitation, escrow, settlement, and closing charges.

(b) An insured named in a title insurance policy or any other person directly or indirectly connected with the transaction involving the issuance of a title insurance policy, including, but not limited to a mortgage lender, real estate broker, builder, or attorney, or an officer, employee, agent, representative, or solicitor of a mortgage lender, real estate broker, builder, attorney, or other person, may not knowingly receive or accept, directly or indirectly, a rebate, reduction, or abatement or a charge or premium or a special favor or advantage, or a monetary consideration or inducement.

(c) Nothing in this section prohibits

- (1) the payment of fees for services actually rendered as a result of a title insurance transaction; or
- (2) the payment of a commission to a legally appointed title insurance limited producer who issues the policy of title insurance.

² Under AS 21.66.480(8), a "title insurance limited producer" is a person or business authorized in writing by a title insurance company to solicit title insurance, collect premiums, determine insurability, issue policies, etc. The list of functions is those consistent with those of an agent of a title insurance company. The definition does not apply to the officers and salaried employees of a title insurance company.

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RESPA also establishes the principle that the buyer chooses which title company to use, and imposes a treble damages penalty on any seller that makes using a particular title company a condition of the sale. 12 USC § 2608.

RESPA regulations also address affiliated business relationships, which will be discussed later in this report. For purposes of this section, it is enough to say that the regulation does not proscribe affiliated business relationships. However, the regulations subject such relationships to a complicated balancing test to determine whether an arrangement is a bona fide business or merely a sham vehicle for sharing the title company's profits. 24 C.F.R. § 3500.15

State attorneys general or insurance regulators may bring actions for violations of certain provisions of RESPA, including violations of the anti-kickback laws. 12 USC § 2607(d)(4).

Title Companies Contribution to Alaska's Economy

The division's examinations were conducted with regard to the unique role of title insurance. Title insurers play a vital role in Alaska's economy. They make it possible for buyers to purchase property with the assurance that they will receive good title, free and clear of liens and encumbrances. Lenders also rely upon title companies to facilitate loan transactions, and to protect their interests by researching the condition of title prior to a sale, removing liens and encumbrances prior to the transaction, and insuring their work through the issuance of a lender's policy.

Title companies also serve the public interest by continually cleaning title records. A title company will not close a loan until issues that affect title are resolved. This includes reconveying deeds of trust that have been paid, removing liens that have been resolved, and resolving errors or gaps in the chain of title.

The real estate market is vital to Alaska's economy. For housing and commercial transactions, certainty of title is required in order that land be freely alienable. Without the services that title companies perform, the overall record of title would become muddled. Consequently, each real estate transaction would become highly risky, and more expensive. Mortgages would become difficult to obtain, and sales would slow to a trickle. The impact upon Alaska's economy would be profound.

Understanding this, the division is committed to protecting the public interest in two ways. First, the division must ensure that title companies are operating in compliance with the law, in order to protect consumers from abuses that have occurred in the industry. Second, the division must also ensure that title companies operate profitably, so that they can continue to provide their vital services to the public.

Current Market Conditions and the Conduct of Title Insurers

Currently, the real estate market in Alaska is very active. Interest rates remain low, housing prices are increasing, and sales are strong. Low interest rates have tended to bolster the housing market in Alaska, as in other places, and encouraged continued growth in housing prices.

As a result of these favorable conditions, title companies in Alaska have prospered in the last several years. This is apparent from a preliminary review of financial statements for the last five years submitted by title companies pursuant to the division's order. A preliminary review of the companies' submissions indicates that virtually all title companies have been profitable over that time period.

Profitability of title companies is also apparent in the arrangements that many have entered into with other real estate providers. Many title companies have entered into business arrangements with such providers. Typically, they include some sort of revenue sharing with other real estate services providers. Title companies assert that these arrangements are legitimate business relationships or lawful strategic alliances. Regardless of their description, they are clearly attempts to get more business from entities that refer real estate transactions by involving the provider in the business of the title company, and making it in the interest of the provider to refer business to the title company. Considered in the light of Federal and Alaska law, such arrangements are blurring the line between legitimate transactions and illegal rebating/kickbacks.

In addition to the subtler forms of profit sharing, the division has received anecdotal evidence of overt pressure to rebate. Title employees have told the division that it is commonplace for others in the real estate services industry to place overt or subtle pressure on title companies to give something of value in exchange for referrals. Although the allegations concern relatively minor matters, the blatant disregard for the law is disconcerting. The division is concerned that this goes beyond "testing" of the anti-rebating laws into the category of outright disregard for the law.

Title Insurance Rates

Title insurance rates are uniform throughout the State of Alaska. They have been uniform since the title insurance premiums were last changed in 1992. Escrow rates are not uniform, but do not differ substantially from producer to producer. Because there is no competition based upon rates, title insurance companies compete on other grounds.

Traditionally, the field of battle has been service, and in particular, escrow service. Title companies demonstrated their competence by consistently closing transactions quickly and competently, resolving conflicts between parties and title problems quickly and effectively. Highly skilled title companies have typically received a larger market share than companies whose services were lacking. Both real estate service providers and the customers benefited from this arrangement. Providers had an interest in referring business to the title company that provided the best customer service.

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Revenue sharing arrangements may undermine competition by service. All parties to a transaction usually want the deal to go through. Buyers and sellers want to close the transaction and move on. Lenders and real estate agents want to get paid. Where a real estate service provider refers customers to a title company based upon the company's ability to close a transaction quickly and effectively, the interests of the provider and the customer are identical.

However, when a real estate services provider stands to share in the revenue of the title insurance company, the referral may be tainted. Buyers and sellers cannot be certain that the referral is their best interest. No amount of disclosure can make up for the fact that the motivation for the referral is (or appears to be) unrelated to the service provided by the title company. This may undermine the public's confidence in real estate service providers (including title insurance companies).

There is a counter argument that affiliated business relationships do not significantly undermine competition. Consumer choice between several different alliances of real estate service providers may be as effective as consumer choice between individual real estate service providers. Alliances may provide benefits such as more efficient case management that may benefit consumers in the long run.

In determining whether these alliances inhibit consumer choice, the division does not seek to stifle innovation in the industry. Rather, within legal and policy limits, it supports and encourages innovation that results in improved customer service, lower costs to consumers and greater efficiency and profitability for the industry.

Another implication of profit sharing goes to the rates charged by title companies. Profit sharing may be an indication that rates are excessive, and that the division needs to examine whether they should be lowered. Many companies can stay profitable even though they share revenues with other real estate service providers. There is an argument that those "excess" revenues should be given to the consumers in the form of lower premiums, rather than to real estate service providers as an incentive for using a particular title company.

A further consideration raised by revenue sharing is the ability of the industry to continue to provide services in the event of a market downturn. Continuing increases in interest rates may cause a slow down in the real estate industry, which will, in turn, result in lower revenues for the entire real estate industry, including title insurance companies. A downturn may make affiliated business relationships less attractive to title companies, and disrupt those relationships – at a time where the nontitle insurance real estate service providers are in bad need of revenues. (In addition, real estate service providers might put even more pressure on title companies to share revenues during a downturn in the industry.) The impact of a downturn on affiliated business relationships, and the individual companies involved, is unpredictable, and could be devastating to the companies involved.

The Division's Next Steps

It is clear that the title insurance industry has changed in significant ways over the last few years. On a national- and a state-wide basis, changes in corporate structure and alliances between real estate service providers have tested the limits of anti-rebating laws and RESPA. The legality of many of these arrangements needs to be addressed by the division in an intelligent and clear manner, so that everyone concerned understands what the rules are.

The division believes that it is important to seek public input before issuing regulations or orders relating to those matters. The division will seek to clarify its position in areas where it believes that there are credible legal and policy arguments for and against certain practices.

Toward that end, the division will hold hearings on several of the issues raised in this report. The division will seek the input beyond the title insurance industry, and would like to hear from other real estate service providers, consumer advocates, and the public on these issues. Input from these parties will help the division shape its position on these issues. The time, date, location, and scope of the hearings will be announced soon.

The division also has the authority to take administrative or civil action, or even to refer a case for criminal prosecution, where it believes that insurance laws have been violated.

One goal of this exam process is to clarify many of the issues raised in this summary, and to provide guidance to the industry with respect to what the division considers legal and illegal practices. Whether the guidance will ultimately take the form of regulations, bulletins, orders of the director, or a combination, has not yet been determined.

Conclusion

The division's examination of the title insurance industry in Anchorage and the Mat-Su Valley revealed significant changes in the last few years in the way in which title companies do business. The limits of the anti-rebating laws and RESPA are being tested. The division intends to look into this further. Whatever form the division's final action will be, it would be appropriate to provide guidance to the industry regarding the issues raised in the examination. If all participants in the title insurance industry understand the division's position, they will be in a better position to make the strategic decisions that will insure the continuance of a competitive, healthy industry, working within the parameters of applicable law. Given the importance of the real estate industry to the economy of Alaska, the division is committed to ensuring a strong and stable title insurance industry in Alaska.