



TITLE INSURANCE – UNITED STATES

Title insurance in the United States is indemnity insurance against financial loss from defects in title to real property and from the invalidity or unenforceability of mortgage liens. Title insurance is principally a product developed and sold in the United States as a result of the comparative deficiency of the US land records laws. It is meant to protect an owner's or lender's financial interest in real property against loss due to title defects, liens or other matters. It will defend against a lawsuit attacking the title as it is insured, or reimburse the insured for the actual monetary loss incurred, up to the dollar amount of insurance provided by the policy. The first title insurance company, the *Law Property Assurance and Trust Society*, was formed in Pennsylvania in 1853. Title insurance was created in the United States by Benjamin Franklin and the vast majority of title insurance policies are written on land within the U.S.

Typically, the real property interests insured are fee simple ownership or a mortgage. However, title insurance can be purchased to insure any interest in real property, including an easement, lease or life estate. Just as lenders require fire insurance and other types of insurance coverage to protect their investment, nearly all institutional lenders also require title insurance to protect their interest in the collateral of loans secured by real estate. Some mortgage lenders, especially non-institutional lenders, may not require title insurance.

Title insurance is available in many other countries, such as Canada, Australia, United Kingdom, Northern Ireland, Mexico, New Zealand, China, Korea and throughout Europe. However, while a substantial number of properties located in these countries are insured by US title insurers, they do not constitute a significant share of the real estate transactions in those countries. They also do not constitute a large share of US title insurers' revenues. In many cases these are properties to be used for commercial purposes by US companies doing business abroad, or properties financed by US lenders. The US companies involved buy title insurance to obtain the security of a US insurer backing up the evidence of title that they receive from the other country's land registration system, and payment of legal defense costs if the title is clouded.

Why Title Insurance Exists in the United States

Title insurance exists in the U.S. in great part because of a comparative deficiency in the U.S. land records laws. Most of the industrialized world uses land registration systems for the transfer of land titles or interests in them. Under these systems, the government makes the determination of title ownership and encumbrances on the title based on the registration of the instruments transferring or otherwise affecting the title in the applicable government office. With only a few exceptions, the government's determination is conclusive. Governmental errors lead to monetary compensation to the person damaged by the error but that aggrieved party usually cannot recover the property.

A few jurisdictions in the United States have adopted a form of this system, e.g., Minneapolis, Minnesota and Boston, Massachusetts. However, for the most part, the states have opted for a system of document recording in which no governmental official makes any determination of who owns the title or whether the instruments transferring it are valid. The reason for this is probably that it is much less expensive to operate than a land registration system; it doesn't require the number of legally skilled employees that the registration systems do.

Greatly simplified, in the recording system, each time a land title transaction takes place, the transfer instrument is recorded with a local government recorder located in the jurisdiction (usually the county) where the land lies. The instrument is then indexed by the names of the grantor (transferor) and the grantee (transferee) and photographed so it can be found and examined by anyone who wants to see it. Usually, the failure by the grantee to record the transfer instrument voids it as to subsequent purchasers of the property who don't actually know of its existence.

Under this system, determining who owns the title requires the examination of the indexes in the recorders' offices pursuant to various rules established by state legislatures and courts, scrutinizing the instruments to which they refer and making the determination of how they affect the title under applicable law. (The final arbiters of title matters are the courts, which make decisions in suits brought by parties having disagreements.) Initially, this was done by hiring an abstractor to search for the documents affecting the title to the land in question and an attorney to opine on their meaning under the law, and this is still done in some places. However, this procedure has been found to be cumbersome and inefficient in most of the US. Substantial errors made by the abstractor or the attorney will be compensated only to the limit of the financial responsibility of these parties (including their liability insurance). Some errors may not be compensated at all, depending on whether the error was the result of negligence. The opinions given by attorneys as to each title are not uniform and often require time consuming analysis to determine their meanings.

Title insurers use this recording system to produce an insurance policy for any purchaser of land, or interest in it, or mortgage lender if the premium is paid. Title insurers use their employees or agents to perform the necessary searches of the recorders' offices records and to make the determinations of who owns the title and to what interests it is subject. The policies are fairly uniform (a fact that greatly pleases lenders and others in the real estate business) and the insurers carry, at a minimum, the financial reserves required by insurance regulation to compensate their insured's for valid claims they make under the policies. This is especially important in large commercial real estate transactions where many millions of dollars are invested or loaned in reliance on the validity of real estate titles. As stated above, the policies also require the insurers to pay for the costs of defense of their insured's in legal contests over what they have insured. Abstractors and attorneys have no such obligation.

Types of Policies

Standardized forms of title insurance exist for owners and lenders. The lender's policies include a form specifically for construction loans, though this is rarely used today.

- Owner's Policy

The owner's policy assures a purchaser that the title to the property is vested in that purchaser and that it is free from all defects, liens and encumbrances except those which are listed as exceptions in the policy or are excluded from the scope of the policy's coverage. It also covers losses and damages suffered if the title is unmarketable the policy also provides coverage for loss if there is no right of access to the land. Although these are the basic coverage's, expanded forms of residential owner's policy exist that cover additional items of loss.

The liability limit of the owner's policy is typically the purchase price paid for the property. As with other types of insurance, coverage's can also be added or deleted with an endorsement. There are many forms of standard endorsements to cover a variety of common issues. The premium for the policy may be paid by the seller or buyer as the parties agree; usually there is a custom in a particular state or county on this matter which is reflected in most local real estate contracts. Consumers should inquire about the cost of title insurance before signing a real estate contract which provides that they pay for title charges. A real estate attorney, broker, escrow officer (in the western states), or loan officer can provide detailed information to the consumer as to the price of title search and insurance before the real estate contract is signed. Title insurance coverage lasts as long as the insured retains an interest in the land insured and typically no additional premium is paid after the policy is issued.

- Lender's Policy

This is sometimes called a loan policy and it is issued only to mortgage lenders. Generally speaking, it follows the assignment of the mortgage loan, meaning that the policy benefits the purchaser of the loan if the loan is sold. For this reason, these policies greatly facilitate the sale of mortgages into the secondary market. That market is made up of high volume purchasers such as Fannie Mae and the Federal Home Loan Mortgage Corporation as well as private institutions.

The *American Land Title Association* ("ALTA") forms are almost universally used in the country though they have been modified in some states. In general, the basic elements of insurance they provide to the lender cover losses from the following matters:

1. The title to the property on which the mortgage is being made is either:

- Not in the mortgage loan borrower,
- Subject to defects, liens or encumbrances, or
- Unmarketable.

2. There is no right of access to the land.

3. The lien created by the mortgage:

- is invalid or unenforceable,

- is not prior to any other lien existing on the property on the date the policy is written, or
- is subject to mechanic's liens under certain circumstances.

As with all of the ALTA forms, the policy also covers the cost of defending insured matters against attack.

Elements 1 and 2 are important to the lender because they cover its expectations of the title it will receive if it must foreclose its mortgage. Element 3 covers matters that will interfere with its foreclosure. Of course, all of the policies except or exclude certain matters and are subject to various conditions.

There are also ALTA mortgage policies covering single or one-to-four family housing mortgages. These cover the elements of loss listed above plus others. Examples of the other coverage's are loss from forged releases of the mortgage and loss resulting from encroachments of improvements on adjoining land onto the mortgaged property when the improvements are constructed after the loan is made.

- Construction Loan Policy

In many states, separate policies exist for construction loans. Title insurance for construction loans require a Date Down endorsement which recognizes that the insured amount for the property has increased due to construction funds that have been vested into the property.

Land Title Associations & Standardized Policies

In the United States, the *American Land Title Association* (ALTA) is a national trade association of title insurers. ALTA has created standard forms of title insurance policy "jackets" (standard terms and conditions) for Owner's, Lender's and Construction Loan policies. ALTA forms are used in most, but not all, U.S. states. ALTA also offers special endorsement forms for the various policies; endorsements amend and typically broaden the coverage given under a basic title insurance policy. ALTA does not issue title insurance; they provide the policy forms that title insurer's issue.

Some states, including Texas and New York, may mandate the use of forms of title insurance policy jackets and endorsements approved by the state insurance commissioner for properties located in those jurisdictions, but these forms are usually similar or identical to ALTA forms.

While title insurance generally insures owners and lenders against things that have occurred in the past, in some limited circumstances, in some states, coverage is available for certain events that can occur after a title insurance policy is issued. Most notably, coverage is now available that includes the risk that a third party may place a forged mortgage or deed of trust against a property after the owner's policy has been issued. This coverage is included in the "Homeowners Policy of Title Insurance" (a specific policy form), published by ALTA and the *California Land Title Association* (CLTA). Note that this is not the same as a so-called CLTA Standard Policy, which provides much less coverage than the Homeowners Policy of Title Insurance.

Comparison with Other Forms of Insurance

Title insurance differs in several respects from other types of insurance. Where most insurance is a contract where the insurer indemnifies or guarantees another party against a possible specific type of loss (such as an accident or death) at a future date, title insurance generally insures against losses caused by title problems that have their source in past events. This often results in the curing of title defects or the elimination of adverse interests from the title before a transaction takes place. Title insurance companies attempt to achieve this by searching public records to develop and document the chain of title and to detect known claims against or defects in the title to the subject property. If liens or encumbrances are found, the insurer may require that steps be taken to eliminate them (for example, obtaining a release of an old mortgage or deed of trust that has been paid off, or requiring the payoff) before issuing the title policy. In the alternative, it may except from the policy's coverage those items not eliminated. Title plants are sometimes maintained to index the public records geographically, with the goal of increasing searching efficiency and reducing claims.

The explanation above discloses another difference between title insurance and other types: title insurance premiums are not principally calculated on the basis of actuarial science, as is true in most other types of insurance. Instead of correlating the probability of losses with their projected costs, title insurance seeks to eliminate the source of the losses through the use of the recording system and other underwriting practices. As a result, a relatively small fraction of title insurance premiums are used to pay insured losses. The great majority of the premiums is used to finance the title research on each piece of property and to maintain the title plants used to efficiently do that research. There is significant social utility in this approach as the result conforms to the expectations of most property purchasers and mortgage lenders. Generally, they want the real estate they purchased or loaned money on to have the title condition they expected when they entered the transaction, rather than money compensation and litigation over unexpected defects. This is not to say that title insurers take no actuarial risks. There are several matters that can affect the title to land that are not disclosed by the recording system but that are covered by the policies. Some examples are deeds executed by minors or mentally incompetent persons, forged instruments (in some cases), corporate instruments executed without the proper corporate authority and errors in the public records. However, historically, these problems have not amounted to a high percentage of the losses paid by the insurers.

The Homeowner's Right to Choose a Title Insurance Company (United States)

A federal law called the *Real Estate Settlement Procedures Act* (RESPA) entitles the individual homeowner to choose a title insurance company when purchasing or refinancing residential property. Typically, homeowners don't make this decision for themselves, instead relying on their bank's or attorney's choice; however, the homeowner retains the right. RESPA makes it *unlawful* for any bank, broker or attorney to mandate that a particular title insurance company be used. Doing so is a gross violation of federal law and any person or business doing so can be heavily fined or lose its license.

Section 9 of RESPA prohibits a seller from requiring the home buyer to use a particular title insurance company, either directly or indirectly, as a condition of sale. Buyers may sue a seller

who violates this provision for an amount equal to three times all charges made for the title insurance. The only exception to this rule applies to commercial real estate transactions, which is not within the parameters of RESPA.

Cost of Title Insurance

The cost of title insurance has two components: premium charges and service fees.

- **Premium Charges**

Some states do not regulate the premiums for title insurance. Examples are Illinois, Georgia and Massachusetts. However, the vast majority of state governments do individually regulate the insurance premiums charged for properties located in the state. The regulation runs from requiring the filing of rates by the insurers (and requiring their use while they are in effect) to promulgating the rates that will be used by all title insurers within the states. An example of the latter is Texas, where rates are set after comprehensive hearings each year. In most states, there is an approval requirement. This varies from rates being deemed approved if no complaints are filed within a specified period of time after filing, to the requirement of approval by the state's insurance regulator before use of the rates is allowed. The rates may include discounts if title insurance is ordered within a specified time after the last policy issued or if the mortgage being insured is a refinance of an earlier mortgage. In the states employing any of these regulations, it is illegal for title insurance companies to charge a higher or lower rate than the regulated rate.

- **Service fees**

In some states, the regulated premium charge does not include part of the underwriting costs necessary for the process. In those states, title insurers may also charge search or abstracting fees for searching the public records, or examination fees to compensate them for the title examination. These fees are usually not regulated and in those cases may sometimes be negotiated. In some states, regulation requires that the title insurer base its policy on the opinion of an attorney. The attorney's fees are not regulated. They are also not part of the title insurance premium, though the title insurer may include those fees within its invoice as a convenience to the attorney rendering the opinion. Similarly, fees for closing a sale or mortgage transaction are not regulated in most states though the charge for closing may appear in the invoice disclosing the total charges for the transaction.

Industry Profitability

The title insurance industry is a profitable one. In 2003, according to ALTA, the industry paid out about \$662 million in claims, about 4.3% percent of the \$15.7 billion taken in as premiums. By comparison, the boiler insurance industry, which like title insurance requires an emphasis on inspections and risk analysis, pays 25% of its premiums in claims. However, no reference to the relationship between when claims are made and when policies are issued is found.

Comparing claims with premiums tells only part of the story, because, for example, title insurance companies have marketing expenses not incurred by the boiler insurance industry.

Also, the boiler insurance inspections do not provide the certainty of risk level that the recording laws provide for title insurers. But the industry's profitability is also hinted at by the repeated instances of state regulators uncovering cases where title insurers have engaged in illegal marketing tactics. Although owners are free to shop around for title insurance, many owners defer such decisions to lenders or real estate agents, and title insurance companies have sometimes used illegal tactics in marketing to those decision-makers. Illegal tactics noted in a *CNN/Money* article include kickbacks, free vacations, and the free use of office space and equipment. The article noted that in 2005 alone over a dozen title insurers settled with regulators for tens of millions of dollars over these practices.

Further evidence of the industry's profitability can be found by comparing the title insurance costs in the 49 states where such insurance is issued with the costs associated with the state-run *Title Guaranty Program* in Iowa, where title insurance is illegal. The program is run by the Iowa Finance Authority. It costs \$110 for up to \$500,000 in coverage in the state; after adding costs for the services of an abstractor (who does the research on the property) and the legal fees, such a title guaranty costs about \$400.00, versus the \$1,100.00 paid for that same home in other states (based on figures cited by the *Iowa Bar Association*).

In many states, the price of title insurance is regulated by a state *Insurance Commissioner*. In these states, such as Florida, the rate for the insurance premium cannot be controlled by the industry. Unlike other forms of insurance such as life, medical or home owners; title insurance is not paid for annually, it has one payment for the term of the policy, which is in effect until the property is resold.