

CAARE Response To Debate Questions

- 1. The impact of affiliated business arrangements has long been debated in the Title insurance industry. Basically, you're for them or against them. To start off, would each of you offer your view on how AfBAs impact the title insurance industry?**

AfBAs market themselves to consumers as being a consumer-friendly "one-stop-shopping solution." However, when parties that have a huge financial stake in the furtherance of the deal (namely real estate brokers, loan officers and builders) can influence or control vital checks and balances (namely independent title examination and auditing functions of closing), this so-called "convenience" comes at a cost, eroding or even negating important checks and balances that exist to protect the consumer.

By their very nature, AfBAs create an anti-competitive atmosphere that has an eerie resemblance to America's oil, coal and steel industries, whose monopolies once operated with impunity, to the detriment of the consumer and the free marketplace. The current conduct of many AfBAs (i.e., the boycotting of independent title companies that refuse to participate in the "controlled business model") has an equally eerie resemblance to the "Robber Barons" of the late 19th and early 20th Centuries, who suppressed competition in the quest for control.

Competition drives efficiency, lowers prices, and delivers a higher quality of service. Anti-competitive activity drives complacency, lowers quality of service, raises prices, and in the hands of unscrupulous parties, can even lead to outright fraud.

2. Do AfBAs increase efficiencies and streamline communications between real estate partners?

First, is “streamlining” communication important? If it relates to such things as data input, today’s innovative software platforms make this type of “streamlining” much easier and more error-free – so that’s a good thing. However if “streamlining” refers to AfBAs communicating among themselves at the expense of the consumer, or obviating participation by their “partners,” it is a very *bad* thing.

Many AfBAs severely limit an outside firm’s ability to use their data creating artificial inefficiencies that don’t normally exist. This might be useful for AfBAs to capture business, but it unnecessarily requires the re-entering of data and frustrates consumers who may want to utilize an independent title company in the transaction (which after all is their legal right). There are several “off-the-shelf” titleware programs that enable ALL parties (not just AfBA partners) to seamlessly integrate data across different platforms. Why then, do AfBAs tend to ignore these “open platforms” in favor of their restricted ones?

“Increased efficiency” is one of the chief ways AfBAs defend their operations to the consumer, however when this so-called “efficiency” is accomplished by their refusal to share data and means that all partners are working toward one overall objective, namely closing the deal no matter what, what does the consumer ultimately sacrifice in exchange for so-called simplicity?

3. Can AfBAs interfere with the objectivity of the title company's title examination and closing process?

In our opinion, the terms "objectivity" and "AfBA" are mutually-exclusive. Because of their very nature, most AfBAs (including real estate, mortgage and builder firms) have a huge interest in the outcome of a given transaction, leaving them little objectivity when it comes to properly managing all aspects of the deal (including title exam and closing).

If they own a title company, there is almost nothing to stop unscrupulous brokers, builders or lenders. In many situations, the easiest way to facilitate a fraud *is* to own the title company. AfBAs are incentivized to get the deal done, rather than getting it done right. And once the claim is shipped off to their underwriter, whatever "creativity" they may have employed is often obscured to lenders, and end-use consumers.

How can title examiners work objectively if they take their marching orders from a real estate broker who only gets paid if/when the deal closes? Investors who lend money should recognize that, by their very nature, AfBAs negate one of the most important defenses to mortgage fraud, which is the inclusion of an independent and unbiased title company providing vital investigative functions such as title exam and auditing functions such as funds disbursement and closing.

4. Describe the quality of title work, in your view, that is generated by AfBAs. Are there more, less, the same amount of claims compared to non-affiliated agents?

While there is no hard data tying any specific claims volume to AfBAs, there appears to be a direct correlation between increased claims and increased AfBA transactions over the last ten years. After only a bit of analysis, this correlation makes sense.

First, AfBA owners are not (themselves) experts in title or closing, increasing the likelihood that bad risks will be assumed.

Second, a broker's bad risk liability only threatens one minor aspect of his business (i.e., the title company), not his main source of business (i.e., the brokerage). So if he takes a bad risk and is unsuccessful in passing it off to his underwriter, he can simply "jettison" his title company, while keeping his main source of revenue – his commissions – intact.

Third, an AfBA's primary incentive is to get the whole deal closed, because the stakes are high. That is to say, while a title agent might have \$1000 in fees in a typical closing, an AfBA could have a \$40,000 commission on the line.

All these factors make a strong case for why an AfBA might be more prone to take considerable risk, and therefore, engage in practices that generate a higher number of claims.

5. It has been argued that title companies engaged in AfBAs don't have to compete for their business. Do you view AfBAs as pro-competition or do they lessen competition for AfBA title company participants? Whether there's less competition or not, what does this mean for consumers?

Today, competition for title business is limited to that which escapes AfBA control. In many markets, brokerage capture rates are around 70%. Another 20-25% goes to AfBAs that are controlled by lenders, builders or attorneys. This leaves a miniscule fraction for independents. And when independents do get an opportunity to compete, AfBAs "compete" by lowering their fees (also known as "dumping" in other industries).

Due to the transaction structure and product complexity, title companies market primarily to those who have "front line" dealings with the consumer, namely brokers, lenders and builders. The efficacy of the entire system relies on title selection advice being objective. However, AfBA "partners" (i.e., brokerages) view outside title companies as competition and use their power to steer clients to their own title company. That creates an impossible situation for independents that now look to brokers as both marketing prospects and as competition.

The AfBAs' monopolistic power has even caused underwriters to raise premiums by requiring underwriters to make "preferred provider" payments and by dictating lopsided commission splits. It's a take it or leave it proposition for underwriters who are then left with no choice but to raise rates. And who pays? The consumer.

6. Do the typical government-approved AfBA disclosure statements adequately serve their purpose for consumers?

First, it is important to recognize that AfBA's are required to make disclosures because they possess serious conflicts of interest that impede their "partners" ability to advise consumers on selecting a title company. Independents and professionals who recommend them don't have to make these disclosures, since they have no "relationships" that stand between them and acting in the consumers' best interest.

Second, the fact is that most consumers don't even know what a title company is let alone know enough to give their informed consent to waive their rights in selecting one. Asking consumers to waive their right to competitive pricing and objective investigative and closing work is a lot to ask in a disclosure statement. And yet AfBAs routinely ask consumers to "sign away" these important rights as though it was standard operating procedure. So why bother disclosing something that consumers are not likely to understand? The better choice is not to engage in the conduct in the first place. If you can't disclose it, then you shouldn't be doing it.

What would happen if the AfBAs did a "full disclosure?" We hazard to guess that very few consumers, so informed, would ever knowingly agree to them.

7. Is it misleading to advertise AfBAs as "One Stop Shopping" to consumers? Do AfBAs save consumers money in settlement costs or does the alleged reverse competition result in higher prices?

"One stop shopping" is a marketing slogan that "bundles" the very things that make AfBAs *bad* to make them sound *good*. You might as well call dual agency "One Stop Shopping." The parallels are striking. And "One Stop Shopping" is not even a unique differentiator. Regardless of whether an AfBA or independent is selected, all the ordering of services is almost invariably done by real estate professionals, not consumers. And from the consumers' perspective, most real estate services come to them, with the exception of the one stop they do have to make – the closing. On the subject of "misleading," RESPRO manufactured the term "AfBA" to "rebrand" a practice formerly known as "controlled business," which carried too many negative connotations.

AfBA's cannot claim they save anyone money, despite surveys designed to prove that point (based on data supplied by RESPRO's own membership). In reality, they cost more and drive up prices for everyone (see Q. 5).

As for competition, most consumers don't even know that they've been steered into an AfBA until the closing. When consumers rely on AfBAs to select their title company and the selection process is anything but objective, how can they possibly know if they are getting a fair price? And in the AfBA scenario, who would encourage the consumer to do research to see if the "price" (whatever that may be) is competitive?

8. To wrap up, make your case as to why AfBAs improve or harm the marketplace and what changes, if necessary, should be made?

Any "business arrangement" that gives financially-interested parties undue influence over critical checks and balances ought to be viewed with utmost scrutiny. Our economy is suffering enormously because of the mortgage and housing crisis, and while there is plenty of blame to go around, the real estate industry must assume a significant share of it.

We believe America's real estate industry suffers from a serious endemic flaw, in which the selection of title companies, home inspectors, appraisers and even attorneys, is controlled by parties with a huge financial interest to see the deal go through, no matter what. Current practices give brokers a nearly monopolistic control over "who's in and who's out" of the deal in regards to services providing checks and balances. This power becomes almost omnipotent through the outright ownership of title companies, giving AfBAs control over vital investigative, auditing and decision-making processes.

This is all detrimental to a healthy real estate industry and the millions of homeowners who depend on it.

For all these reasons, it is time to eliminate AfBA's and return integrity to our real estate industry.