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Title inflation

Title insurance seems like a fair deal, but it's insurance rarely called on.

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NEW YORK (MONEY Magazine) - On its face, title insurance seems like a fair deal. For around $1,000, a policy protects you for the life of your mortgage against the possibility that the person who sold you your home was not the full and rightful owner.

So if, for example, a letter comes in the mail saying the previous owner never paid off the mortgage and the bank plans to foreclose, no problem: The title insurer will make the bank whole.

In fact, virtually nobody ever gets one of those letters. Most potential claims are cleared up with a title search before the policy goes into effect. Since 1995, title insurers have on average spent less than 5 percent of their revenue on claims, according to a recent industry report. By contrast, property and casualty insurers typically pay out 80 percent of their premiums to cover policyholders' losses.

Given those juicy numbers, why hasn't competition lowered title insurance premiums? Because home buyers almost never shop prices for title insurance. They rely instead on recommendations from advisers like real estate agents, whose firms frequently get a cut of the premiums.

Again, this is made possible by the Real Estate Settlement Procedures Act, or RESPA, loophole that allows referral payments to in-house or affiliated service providers. It's fully within the law for realty outfits to set up their own in-house title agency -- essentially the sales office for a title insurer -- in return for a substantial chunk of the insurance premium.

Such agents have long argued that they're being paid for substantive title work, not for a referral. But regulators are increasingly accusing in-house and third-party agents of being shell companies created solely to skirt RESPA's prohibition against outside referral payments.

Colorado shut down 11 such entities in November and is investigating some 450 other title agents. And among HUD's 14 major case settlements last year, 13 involved alleged kickbacks in the title insurance business.

Keeping the consumer in the dark

"This is an industry that is not based on price competition," says California Insurance Commissioner John Garamendi, whose office is also investigating the title business. "It's based on keeping the consumer in the dark."

Not surprisingly, most home buyers we spoke to on Aquila paid substantial sums to in-house or affiliated title agents. When Lewis Leung bought his house, for example, his Century 21 Luger agent suggested he buy a policy from Old Republic National Title, one of the country's largest title insurers.

"She said I could find my own title insurer or use the one that she trusted," says Leung.

About $895 went to something called Reliance Title. Reliance -- you guessed it -- is owned by realtor Jim Luger, who founded Century 21 Luger 30 years ago.

Assuming industry norms, experts estimate Luger's title agency pocketed 80 percent of the total, passing on just 20 percent to Old Republic, which carries the risk on Leung's policy.

Jim Luger wouldn't confirm the breakdown, saying it was a private matter between his firm and Old Republic.

"It's legal and standard industry practice," says Luger of using affiliated title agents. "The people who come to us get good service and good rates."

Rande Yeager, CEO of Old Republic (and president of his industry's trade group), echoes Luger's claim that agency relationships serve home buyers well. As for the industry, "Customers get a good service at a fair price," Yeager says.

It's doubtful Leung would see it the same way. He would have paid $250 less, for instance, had he bought a policy from independent Minneapolis-based insurer Title-1.

The stubborn 6 percent commission

Inside a closing

Lewis Leung bought 3012 Aquila in 2004 with a $164,000 loan. He used the mortgage broker and title company that his realtor suggested -- unaware of the behind-the-scenes incentives.

The players

Mortgage broker: HomeQuest is an affiliate of the real estate agency Leung hired. Realtors are prohibited from collecting referral fees from lenders. But mortgage brokers are not.	**Realtor:** Century 21 Luger owner Jim Luger also owns Leung's mortgage broker and title agency. Luger's total take from the close: $9,785, including a share of a 7 percent seller's commission.	**Title insurer:** Old Republic sent a portion of Leung's charges to sales agency Reliance Title. The estimated $716 ended up in the same pocket as the other fees: Reliance Title is also owned by Jim Luger.	**Lenders:** Lenders pay mortgage brokers more for customers who pay higher rates. Leung paid 0.25 percentage points more than Bank of America's best rate for him, according to his closing papers.

The costs

$515	Paperwork charges to mortgage broker
$189	Admin. fees to realtor
$1,260	Title search, insurance charges and fees to title insurer, who pays
$716	back to realtor.
$450	Admin. fees and
$9,000	higher interest payments to lender, who pays
$2,215	back to the mortgage broker as a referral fee.
$11,414	**Total closing and borrowing costs**

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