

**TITLE INSURANCE:  
A COMPREHENSIVE OVERVIEW**

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## **I. TITLE INSURANCE OVERVIEW**

The title insurance industry has been protecting the American dream of homeownership for more than 125 years. Real estate property is the nation's largest asset, and the 1990s was one of the best decades in American history for housing. The behind-the-scenes work of title companies ensures the quick and secure transfer of land, fostering lender and consumer confidence in their real estate investments.

The objective of title insurance remains the same as it has always been – helping the parties in real estate transactions to determine their rights and interests, and assuring that land transfer is expeditious and secure. Protecting the parties involved in real estate transactions is the reason the title insurance product was developed.

In this country, matters affecting ownership and other real estate interests are entered in public records. Before a transaction is completed, a title search of the records is made in an effort to locate potential problems so that they can be rectified and the transfer can proceed.

While most problems can be located in a title search by skilled professionals, there can be hidden hazards that even the most thorough search will not reveal. Examples include forgeries in the chain of title, a claim by a previously undisclosed relative of a former owner, or a mistake in the records. Liens, easements, rights-of-way, life estates, air and subsurface rights, and future interests are also found in a title search.

Title insurance is substantially different than other types of insurance coverage, which can often lead to a misunderstanding of the product. Title insurance emphasizes risk prevention rather than risk assumption. This emphasis on risk prevention is a labor intensive and costly component of doing business, but the coverage offers the best possible opportunity for avoiding claims and losses in real estate transactions.

During the title search, title companies find and fix problems with the title in 25 percent of transactions – usually unbeknownst to the consumer or lender. In addition, title companies pay millions of dollars each year in claims.

When a property is resold quickly, or refinanced within a short period of time from the original purchase or most recent refinance, a new title search and title policy are needed. The owner/seller may have created or experienced claims, liens or other encumbrances since the original policy was issued, and the lender will require a new title search to ensure that the title is clear. For instance, the owner may have taken out a second mortgage, incurred a mechanic's lien or a lien from unpaid taxes.

The American Land Title Association, the national trade association for the title industry, was founded in 1907 and currently represents 2,000 abstracters, title insurance agents, and title insurance underwriting companies.

## **II. HISTORY OF TITLE INSURANCE**

Until the nation was nearly a century old, the conveyance of real property did not include any form of guarantee or insurance. Many of the transactions were handled by conveyancers, who either personally searched titles or obtained some form of abstract (summary of public records) to determine ownership of the land and encumbrances on the title. Before taking title to property, the buyer required that the title be free of any rights, interests, liens or encumbrances of others for which he or she would be responsible. Based on the title search or abstract, the title could be examined and an opinion rendered by the conveyancer that the title was clear, and thus marketable.

There clearly were limits on the protection that the conveyancer could provide to the parties involved. This inadequacy of safeguards was emphasized in an historic court decision in 1868 that led to the creation of title insurance – which brought a new dimension of security and stability to the real estate market.

In 1876, a group of Philadelphia conveyancers founded the first title insurance company. In an initial advertisement, the company said it was beginning operation to insure “the purchasers of real estate and mortgages against losses from defective title, liens and encumbrances,” and added, “Through these facilities, transfer of real estate and real estate securities can be made more speedily and with greater security than heretofore.” Subsequently, title insurance companies were organized in other cities – among them, New York City, Chicago, Minneapolis, San Francisco and Los Angeles.

As the industry grew, title companies and their agents began providing essential services to real estate buyers, sellers, lenders, brokers, attorneys, developers, builders and others. Following World War II, returning servicemen began to buy homes in large numbers; the title industry began to change from an essentially local enterprise to business on a national level. Yet despite this national lending/investment environment and the advent of a national secondary mortgage market, title work continues to be based on local law and custom.

With the advent of new types of mortgages and the rapid growth of an aggressive secondary mortgage market, title insurance companies have responded to investor needs by creating new policies offering innovative coverages. Title companies in some locations have seen their functions evolve into much more than just title searching. Today, many are involved in completing all aspects of the closing process, from preparation of documents and recording instruments, to preparation of closing forms and collecting and disbursing funds.

The title insurance industry continues to provide security to real estate investors, especially as rapid and dramatic developments drive the real estate market. From a single-family home purchase to a multi-million dollar commercial transaction, real estate investors in this country will continue to receive title protection at a level of excellence unequalled anywhere in the world.

### **III. TYPES OF TITLE INSURANCE**

There are two types of title insurance – owner’s title insurance (an Owner’s Policy), which protects the buyer, and lender’s title insurance (a Loan Policy), which protects the lender. In a typical residential transaction, the title policy often required by the mortgage lender will not safeguard the rights and interests of the homebuyer, therefore, a separate Owner’s Policy is necessary.

An Owner’s Policy is typically issued in the amount of the real estate purchase price, and remains in effect for as long as the owner, or his or her heirs, retains an interest in the property. In addition to identifying risk before a transaction is completed, the Owner’s Policy will pay valid claims and all defense costs against attacks on the title.

A Loan Policy assures the lender of the validity, priority and enforceability of its lien (mortgage) – serving as protection for the lender’s security interest in the property. A Loan Policy is issued in the amount of the loan, and liability decreases as the mortgage debt is reduced.

Who pays for the title insurance is a matter of local custom. In some parts of the country, the seller purchases the Owner’s Policy for the buyer, in effect telling them the title is clear. In other parts of the country, both the Loan Policy and Owner’s Policy are issued simultaneously, and in still others, the buyer must ask for an Owner’s Policy and pay separately for it.

### **IV. COSTS OF TITLE INSURANCE**

Title insurance protection is significantly different from other lines of insurance. Typically, other types of insurance assume a particular risk and provide financial indemnity in the event the risk occurs. Title insurance, on the other hand, emphasizes loss prevention by eliminating risks caused by title problems arising from past events.

Approximately 25 percent of all residential real estate transactions have issues with the title – issues that are resolved by title professionals before closing. This emphasis on loss prevention results in fewer claims paid by title insurers compared to other lines of insurance. However, loss prevention and clearing title issues is a labor-intensive and costly component of a title company’s operating budget. To compare, the expense ratio for title insurers averages 90 percent, while the expense ratio for property and casualty companies is less than 30 percent.

## **V. THE SEARCH PROCESS**

Searching the public records provides a basis for title insurance and usually includes visits to the offices of recorders or registers of deeds, clerks of courts and other officials. Title searchers look in the records for mortgages, judgments, street and sewer system assessments, special taxes and levies, and numerous other matters.

In many jurisdictions, information about a piece of property and any liens against it may be filed in different ways. They can be filed under the seller's name, the owner's name, by lot number or by street address. To make the search process less cumbersome, many title companies have created title plants, which contain virtually the same information as the county records, but indexed in a consistent matter (i.e. by name or lot number) so that title searches may be performed more quickly and accurately. In major metropolitan areas, the title can be searched and title insurance issued within 24-48 hours.

The following shows why it is a good idea to involve the title company in the early stages of a land transfer. In one transaction, the title search revealed that two acres of land being purchased were once part of a five-acre tract. A prior deed to the five acres restricted use of the property to "a single family dwelling and the usual out-buildings." The other three acres from the original tract already contained a single family dwelling, and there was a serious question as to whether the purchaser could build a home on his two acres. With assistance from the title company, releases were obtained from the appropriate parties to remove the problem and allow the house to be built.

Occasionally, title problems may be so serious that the most prudent course is not to proceed with a transaction. For example, a buyer was about to close his purchase when the title search revealed pipeline, utility, flood and road easements across the property that would have severely limited his use of the land. When these findings became known, the buyer declined to continue with the transaction. Only a title search would have uncovered these problems.

## **VI. BENEFITING PARTIES**

Title insurance services offer a wide range of protection to the many different parties who have various interests in real estate transactions. The benefits of title insurance protect:

- Real Estate purchasers
- Sellers
- Lenders
- Real Estate Brokers
- Attorneys
- Homebuilders

### **VI-A. Buyers**

Whether the transaction involves a multi-million dollar office building or a single-family home, the purchaser faces possible serious financial loss, or could lose the right to own the property altogether, if a serious cloud on the title goes undetected. An expert title search before the purchase will identify the nature of title and fix most problems that might be present.

An Owner's Policy offers protection against various hazards, including those even the most thorough search of the public records do not disclose, such as forgeries, missing heirs or recording errors. And, the Owner's Policy will pay valid claims as well as defense costs against attacks on the title.

For a one-time premium that is modest in relation to the value of property involved, the purchaser receives the protection of a title policy backed by the reserves and solvency of an insurance company. In the unlikely event the insurance company ceases to operate, reserves offer the assurance that another insurer will accept risk for the existing policyholders.

### **VI-B. Sellers**

Similarly, the seller wants to be sure his or her title is marketable in order to sell the property. A title insurer facilitates the flow of mortgage money by identifying title problems so they can be resolved whenever possible, and then by insuring against title risks. Title insurance encourages the expeditious completion of a transaction, thus the seller receives his or her money in a timely fashion.

### **VI-C. Lenders**

Financial organizations are acutely concerned when it comes to the security of the funds they lend for real estate investments. The Loan Policy provides the lender a high degree of safety against loss of capital from title hazards. By identifying risks and eliminating them whenever possible, the title industry is a major element in encouraging lenders to invest in mortgages – rather than in other assets with lower risk.

The Loan Policy guarantees the lender a valid and enforceable lien, and assures that no claimant other than those noted in the policy has a prior claim against the real estate. The policy assures that the purchaser-borrower has title to the property being pledged as security for the loan. And, the policy obligates the title insurer to pay for defending against any claim filed against the title that might supersede the lender's lien. If unsuccessful, it must also satisfy that claim should it be upheld in court.

Another benefit is the in-depth expertise of title company experts, who facilitate the mortgage loan process and help in resolving differences among the various parties in a transaction. This can range from relatively routine assistance in a basic residential loan to helping with the multifaceted legal and financial aspects of a complex, multi-million dollar commercial transaction. In the more complicated examples, the title company's efforts on behalf of the lender can extend even further.

#### **VI-D. Brokers**

There is much to be gained by the real estate broker who calls the title insurance company in the early stages of a transaction. The security of title insurance greatly enhances the possibility for loan approval. And, abstract or title insurance personnel – by fast accurate verification of title or by swift resolution of a title problem – often make it possible to promptly complete a transaction that would have been seriously delayed or lost altogether.

By calling the title company or its agent, the broker promptly becomes informed of the alternatives for clearing up title problems found in a search of public records, and learns in a timely manner what information the title company needs to issue the insurance. This close contact also enables the broker to become better informed on available title coverage so the parties can be readily assisted with their needs.

#### **VI-E. Attorneys**

In some states, it is a real estate attorney who handles the closing. The attorney will create an attorney's opinion to assess the condition of the real estate title. Title insurance enables the real estate attorney to offer the client substantially greater protection than what is attainable with a legal opinion alone. Title insurance resolves this dilemma by backing up the attorney's title search with guaranteed financial indemnity from a licensed, regulated corporate insurer, and providing adequate capital and reserves to respond to claims.

The protection of title insurance extends far beyond the risk that may be incurred by the purchaser as a result of an error or negligence by the person performing the search and examination. Among the many risks covered by title insurance (that would not be covered by the attorney's malpractice insurance) are:

- Mistakes in the interpretation of wills or other legal documents
- Impersonation of the owner
- Forged deeds, mortgage releases, etc.
- Instruments executed under fabricated or expired powers of attorney
- Deeds delivered after death of seller or buyer
- Undisclosed or missing heirs
- Wills not probated
- Deeds or mortgages by those mentally incompetent or of minor age (or supposedly single but actually married)
- Birth or adoption of children after date of will
- Mistakes in the public records
- Falsified records
- Confusion from similarity of names
- Transfer of title through foreclosure sale where requirements of foreclosure statute have not been strictly met

While ALTA recommends that all parties to real estate transactions be represented by their own counsel, it is the view of the association that no real estate attorney

adequately protects the interest of a client without advising that client of the availability and protection of title insurance.

#### **VI-F. Homebuilders**

Delays for the homebuilder can also be minimized by contacting the title company early in the building process. Actions initiated by the title company that have a positive effect on the builder's project completion time can include the following:

- Calling a meeting of everyone involved to establish coordination and minimize problems (builder, developer, attorney, engineer, architect, escrow holder, etc.)
- Expediting title search and examination so any difficulties can be dealt with more quickly
- Advising on mechanic's lien coverage and other title insurance needs of parties to the transaction
- Setting up sale escrow accounts and handling disbursements upon closing
- Coordinating with subcontractors so their problems can be dealt with in the early stages of the project
- Arranging for prompt handling of any title claims that arise

By assuring priority of the first lien mortgage for the lender, title insurance makes construction loan financing considerably more attractive.

Title company personnel help the builder or developer establish ownership rights to assure local government that a project may proceed. This normally expedites plat approval. And, title companies will insure titles to individual lots in a development on a mass production basis, often at a reduced rate, so new owner's policies can be promptly furnished to home buyers after updating of title work, rather than extensive and time-consuming back searches upon the issuance of each policy.

Besides the basic owner and loan policies, title insurers offer various special coverages that are important to different parties. Additional coverages relating to new construction are available in some areas. These coverages could include mechanic's lien protection, or special coverage regarding surveys or zoning.

### **VII. SECONDARY MORTGAGE MARKET**

Beginning in the mid-1940s, the nationwide growth of a secondary mortgage market has proved to be an especially dramatic benefit for millions of American home buyers. The positive effects of this phenomenon have reached out to numerous other related sectors of the economy.

Essentially, the purpose of the secondary market is to broaden the base of investment for mortgage financing and attract funds from areas of the country with abundant capital to areas where mortgage money is needed.



Unlike the New York Stock Exchange and other organized trading markets where representatives of buyers and sellers meet in a single location, the secondary market consists of a complex network of organizations, intermediaries and various channels of communication. Through this facility, lenders in one area of the country with funds to invest can readily make or purchase mortgage loans on real property located elsewhere.

Secondary market operations may be as simple as a lender in California selling mortgage loans to another lender in New York, or as complex as the development and sale of Government National Mortgage Association pass-through securities, which are guaranteed by GNMA and are backed by a pool of mortgages worth millions of dollars.

The need for protection from title problems is even more acute in dealing with mortgages in the secondary market than what is normally encountered by a local lender. Knowing the local customer and the attorney rendering an opinion may be sufficient for a local lender to lend and portfolio a mortgage. However, a title opinion from a local attorney will not provide the assurance for a national lender that is unfamiliar with local risks and/or unwilling to take a chance.

In view of these considerations, it is easy to see why virtually every mortgage traded in the secondary market is covered by a Loan Policy. With financially sound corporate insurers standing behind the validity and enforceability of mortgage liens, marketability of insured loans is greatly improved. National or out-of-town lenders know that, should a title problem develop on property located in a distant part of the country, they can deal with title company experts whose capabilities are well known who can quickly come to grips with the difficulty and initiate appropriate action.

Mortgage loans on all types of real property constitute the nation's largest single category of institutional investment. Loan policies have enhanced the remarkable growth in the availability of mortgage funds, which has brought an impressive stimulus to real estate investment from coast to coast.

This expansive viability has been characterized by two major developments -- both directly linked to title insurance.

- Mortgage investment has become more secure.
- Mortgage money has become widely available throughout the country through the post -World War II development of a nationwide secondary mortgage market.

Safety of investment ranks at least equally with return realized where institutional investors are concerned. This fiduciary emphasis on security by the lending community means that the protection brought to real estate transactions by title insurance is vital if mortgage money is to remain widely available. Without the title company's assurance that the lender has a valid and enforceable lien, and that the

borrower has marketable title, real estate investment would be considered highly speculative and would not enjoy its current high acceptance among lending institutions.

Most lenders also know that the familiar ALTA Loan Policy, developed based on their input and voluntarily used by ALTA member title insurers, is a nationally prominent means of protection that adds even greater facility to trading within the secondary market.

## **VIII. REGULATORY ENVIRONMENT**

### **VIII-A. State Vs. Federal Governance**

In 2004, Congress began to review the state insurance regulatory system to analyze the strengths and weaknesses of the current product approval, rate setting and consumer protection programs at the state level. Of all the lines of insurance, none are as inextricably linked to state and local conditions as the title insurance industry.

The underwriting of title insurance involves a review and assessment of state and local records affecting titles to real estate. Title insurance policies are issued in connection with inherently local transactions – real estate settlements and mortgage loan closings. Reflecting the diversity of state and local laws, as well as the variety of local practices regarding real estate, varies from state to state, and even from region to region within a state. It would represent an enormous undertaking for a federal agency to establish federal regulations that would reflect variations in the real property law of the 50 states.

Leaders in the title insurance business have generally held the view that state regulation is the most effective form of governmental supervision for their industry. However, ALTA is committed to participate in any process that seeks to strengthen and streamline the regulatory process governing the title insurance industry.

### **VIII-B. Monoline Insurance**

Monoline refers to the statutory restriction of companies writing a particular line of insurance to writing only that line. Enforced at the state level, monoline restrictions currently apply to title insurance, mortgage guaranty insurance and financial guaranty insurance.

Monoline restrictions allow an insurer to isolate its surplus for the protection of its policyholders. This is important because the term covered by the single premium collected for a title insurance policy is the duration of property ownership or the term of the real estate loan. The failure of a title insurance company would affect all title insurance customers for decades past.

The experience of the 1980s shows that periods of financial instability and plunging real estate prices were not a one-time Depression-Era occurrence. Writing title

insurance in conjunction with mortgage guaranty insurance would put title insurers and their policyholders at risk.

Non-title insurance companies have attempted to offer title insurance products – companies which specialize in other high-risk lines. These companies have no title insurance underwriting experience, and have a much lower aggregate surplus than the title insurance industry. They are unable to assure the policyholders' safety, nor deliver the same quality of product as a title insurer.

ALTA believes the monoline restriction for title insurance continues to constitute sound economic and regulatory policy.

### **VIII-C. RESPA Reform**

Congress passed the Real Estate Settlement Procedures Act (RESPA) in 1974 to provide consumers with greater understanding of the home-buying settlement process. In July 2002, the Department of Housing and Urban Development (HUD) issued proposed revisions to its RESPA regulations that would have made significant changes to the disclosure and anti-kickback regimes established by Congress. In particular, HUD would have encouraged mortgage lenders to provide a Guaranteed Mortgage Package that would include the loan and all charges relating to the closing of the loan.

Due to intense opposition from industry and consumer groups alike, HUD withdrew its proposal in March 2004 from the White House Office of Management and Budget. A new reform proposal is currently underway and, according to HUD, will be submitted to Congress for input in the Spring/Summer of 2005.

ALTA fully supports the goals of HUD to simplify the closing process for consumers, and to make closing costs more transparent. The association was encouraged by HUD Secretary Alphonso Jackson's commitment (quoted in Inman News, March 17, 2005) to strive for a "consensus of 75 to 80 percent of the people in the industry," and will actively participate in this process.

## **IX. ALTA UNIFORM POLICIES**

In the beginning, there was no uniformity of policy certificate coverage. Each title company issued its own form of policy, guarantee or certificate. This created many problems for insureds, particularly lenders who desired the same coverage in all parts of the country and did not want to review each policy from each company to make sure the desired coverage was present.

Since the ALTA membership included a great majority of title insurers in business at the time, lenders were able to persuade the association to develop the 1929 lender policy that was responsive to their needs. Over the years, an extensive array of additional forms has been developed through the association.

Presently, there are six basic ALTA policies of title insurance. These include Lenders, Lenders Leasehold, Owners, Owners Leasehold, Residential (plain language), and Construction Loan policies. Additionally, a special policy has been designed for use by the United States Government in its purchases and condemnations.

Major revisions of the ALTA policy forms are made every few years, usually as a result of either a lender's request, a perceived ambiguity in existing language, or as an answer to a court whose decision interpreted a policy in a different manner that deemed proper within the title industry.

ALTA policy forms provide coverage for the usual or standard type of real estate transaction, and can be used in such transactions without a need for change or addition. However, with the development of the real estate industry, and the increasing complexity of both the conveyancing and the financing in transactions, there are situations not applicable to the ALTA forms. In an effort to help the title industry tailor the ALTA forms so they are even more useful in larger transactions, ALTA has created various endorsements or groups of endorsements for the market.

These ALTA endorsements include, but are not limited to, coverage for zoning, condominiums and planned unit developments, variable rate mortgages, residential environment liens, and special restriction, easement and mineral problems.

In addition to its regular title policies, ALTA also created short form and master mortgage policies, which have been approved by Federal National Mortgage Association (Fannie Mae) for use in all its residential loan packages.

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Even though national title insurance companies offer their product across the country, each state determines the rules and regulations that must be followed to do business within its borders. The American Land Title Association, in conjunction with the national law firm of Kirkpatrick & Lockhart LLP, has assembled all the pertinent information on how the title business is conducted in each state and the District of Columbia. ALTA's Title Insurance Regulatory Survey is the most comprehensive collection of regulatory information and practices of the title industry available. Those looking to expand their knowledge of the industry, should contact ALTA at 800.787.ALTA about obtaining a copy of this resource.