

If Title Insurance Didn't Exist Today We'd Have to Invent It

*It's the fastest most efficient system
in the world*

Adding billions to the value of U.S. real estate

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It's fashionable these days to be critical of title insurance.

This criticism originates mainly with the media, which believes it too expensive and unnecessary. Regulators, Congress, and certain trade groups have expressed displeasure with it too.

These critics say it's costs too much, has too few claims, and is behind the times technologically. They say it shouldn't be necessary in the age of the internet, electronic commerce, and an environment with few real problems. They say mortgage lenders are learning to live without it, and it's working. Title insurance will be replaced, soon, these people believe, or perhaps simply go away and be replaced by nothing.

Don't believe all this. Title insurance is one of the great unsung heroes of our age, a swift and efficient free market solution to a bureaucratic nightmare, a sound and effective marketplace miracle that has added untold billions to the value of real estate in this country. It developed quietly and efficiently in the hands of a nationwide community of concerned land title companies in what has been, and continues to be, a remarkable effort.

If there weren't such a thing as title insurance available today we'd have to develop it, or something like it, right away. It's had a profound effect both on the speed and efficiency of the real estate market and on the value of the real estate that makes up that market. Those who believe it can safely be ignored are deceiving themselves.

A little history might be helpful. Title insurance came into use in the latter part of the Nineteenth Century when it began to dawn on a fast-developing real estate market in a fast-developing nation that there was too much uncertainty, too much harum-scarum, too much fraud and deception, and far too many mistakes made in moving real estate from person to person. When problems occurred there was no one to turn to, no one to stand behind the exchange of papers and say it was right. No one with respectability, expertise, deep pockets, and a sense of responsibility for the correctness of things.

What was needed was solid assurance that real estate was being correctly transferred and secured. So a new kind of *insurance* was invented to answer this demand for *assurance*.

Title insurance became a type of protection buyers and mortgage lenders could obtain that protects them against defects in their legal ownership. With the birth of standardized title insurance forms during World War II, it quickly became used in a majority of transactions. Its use became virtually universal in the 1980s when the secondary market came into being. Well-advised purchasers insist on it. Mortgage lenders like it because of its comprehensiveness and uniformity. The secondary market, in spite of its recent attempts to denigrate it, is hooked on it. It makes mortgages marketable and their securitization swiftly possible.

What instead?

Some critics say the U.S. should do what other countries do: “Let the government handle real estate titles. It’s just an administrative thing. We need to register land titles like we register car titles.”

What one title company will insure another will not. It’s a free market competitive system, and it works.

Others say that instead of title insurance lenders should use ‘credit scoring.’ “If the borrower has a good job and has paid his bills in the past, he will in the future. That’s all you need to know, ” say its proponents. Lenders are looking at the need for title protection in just this way.

Others argue for the casualty approach. They say title problems are infrequent and unimportant and can be ignored. Just write policies and if title problems begin to increase, raise premium rates. That’s what other lines of insurance do.

What’s so wonderful about it?

Although the basic concept behind title insurance has not changed, those who produce it have come a long way since its introduction in 1871. Today’s title company takes advantage of the legal rationale underlying title insurance: it doesn’t guarantee that title is perfect, or what the courts call *good title* or *legal title*, terms used to describe title with no defects of any kind.

No, title insurance defines insurable title as being *marketable title*, another legal standard based on a title having no *significant* defect, a title good enough that a reasonable buyer would accept it. Rather than *good title* this might be called *good enough title*. A *good title* standard says a deed recorded in 1903 without a notary seal is flawed and void and passes no title, because that is what the law strictly says. A *marketable title* standard permits a considered weighing of the likelihood there will be a challenge to that deed, and decides whether to accept or reject that risk. It thereby moves real estate, flawed by traditional standards, back into the marketplace, quickly and efficiently.

There is more. As was said, title insurance is a free market solution. Title companies are very competitive. Different firms view title defects in different ways, and what one will not insure another will. This means that in this country, unlike any other in the world, the marketability of real estate is *negotiated*. Difficult cases are bargained from title company to title company. Risks are effectively bid upon by firms whose experience gives them a feel for what is risky and what is not. Title companies dislike this process but they all use it. The result is an even speedier and more efficient marketplace.

Difficulties of some kind crop up in a small but significant number of transactions. Some problems are mended, some are looked at and accepted as non-risks, and others will have eluded discovery entirely. All can be insured against. Title insurers pay out hundreds of millions annually to settle claims against their policies.

Even here, quick settlement has become the style, another example of swiftly returning defective properties to the marketplace, a major plus.

Speed of service is an extremely important competitive advantage and it is also put out for bids. The title firm that can make, and keep, service guarantees will get the work.

Adding value to real estate

So the entire system encourages speed and efficiency, and, like all commodities, as real estate becomes more marketable it becomes more valuable. Without any question, real property in America is more valuable -- that is, it sells for higher prices -- because of the efficiency of its marketplace. As a big contributor to this marketplace title insurance adds value to real estate in an amount no one can estimate, but is certainly many billions of dollars.

Third world nations find that merely installing a basic government land records system often doubles or triples the value of its real estate. We can only guess at the value our unique system adds to real estate in the U.S., the only nation in the world that uses title insurance.

The courthouse: unchanged since 1871

As with everything else in a free market environment, entrepreneurs work with what they're given. The title industry accepts what it did not create and cannot change: fifty states with fifty sets of real estate laws, and more than 3,000 counties, each with its own notion of how to store and index property records. Title companies take those records as they find them, then create a marketplace solution to fit the needs of commerce.

Few lay people realize how difficult it is to search a title or make sense of what a title search finds, whether that search is manual or computerized. Yes, courthouse records are becoming computerized and some are posted on the internet. But although the technology is new the role and responsibility of the courthouse is no different than it was in 1871. The environment that made title insurance necessary still exists today.

What about the alternatives?

What about making real estate title registration a government thing? Consider that in the rest of the world the job of moving a piece of real estate from seller to buyer is a lengthy dogged bureaucratic process presided over by civil servants. There are government offices to visit, forms, rules, regulations, hoops to jump through, fees to pay, waits to endure. In some countries bribes are necessary.

When irregularities occur there is no negotiation. Problems will be fixed in accordance with the wishes of bureaucrats. Exposing themselves to risk is not something bureaucrats, virtually all of whom are well-intentioned, will do easily or often. Even the most inconsequential error has to be fixed. The public servant hasn't been born that wants to be accused of an error, departing from the rules, cutting corners, or overlooking minor problems.

America had its fling with government registration of land. It was called the Torrens system and it failed. Go ask the real estate people in Illinois, who became so infuriated with it they finally abandoned it altogether. Another example, also a disaster, is the federal government's registration of Indian tribal lands. Critics say no matter how much is spent on that system it will never be fixed.

As sure as the sun rises in the morning, lenders will find themselves explaining what in the world they could have had in mind. It will not be pleasant.

What about credit scoring?

In mortgage lending, why not forget the real estate and look exclusively to the borrower, thereby making loans solely on the basis of creditworthiness?

The world has now had a major and disastrous experience with this approach. Those should have been called personal loans instead of mortgages. No, lenders now understand that, once again, a mortgage isn't a mortgage unless and until its title policy says it is. It's a chance, a gamble, a hope. It's a stab at a mortgage. Lenders who believe otherwise will, as sure as the sun rises in the morning, find themselves explaining to their superiors, to judges and juries, to regulators and legislators, what in the world they could have had in mind. It will not be pleasant.

Furthermore, credit scoring may be some kind of option for lenders, but what about buyers? No mortgage lender, no attorney, no escrow closer, should let buyers invest in real estate without title protection. That is just plain foolishness.

Why not casualty?

Finally, what about the much talked about 'casualty' approach. Why don't title companies stop doing all that analyzing and automatically insure everything? Problems can be fixed if they pop up later.

There are two answers here. First, if title people didn't work hard all day every day preventing mistakes from occurring and fixing small errors, titles would erode in a hurry. We would soon be a third world country when it comes to real estate titles. The second answer is that title companies have been using an intelligent casualty approach for many years. Policy protection against forgeries, fraud, unknown heirs, and, more recently, survey problems, are all casualty in nature. Many of the industry's newest automated systems are programmed to take calculated, casualty-type risks. Additional risks are being accepted every day.

The one thing title firms are not likely to do is write policies without inquiry of any kind. Again, they know titles erode in quality quickly and with every transaction unless watched carefully. They would not relish fixing all those erosions later – or charging consumers to do so.

Nevertheless, improvements are needed

It is true, and title people must admit, that title insurance has remained stubbornly expensive. They also must admit that its processes, although much faster today than ever before -- and faster than any alternative -- are still too slow. And they must admit that its delivery systems are out of date and need modernization.

Progress is being made on all these fronts. Major improvement is just around the corner – probably within the next few years. The answer for today isn't to do away with title insurance. It's to help open the way for those improvements in every possible way.

Main tool and centerpiece

The question was asked at a recent conference what the consequences would be if everyone in the settlement services industry were to take the same month off. This is not an amusing thought but the purpose in posing it was clear to all: Neither the real estate marketplace nor the nation's economy as a whole fully understands the critical importance of this small and obscure corner of the financial services universe.

Title insurance is that industry's main tool and centerpiece. ♣

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