Title Insurance: An Overlooked Insurance Market

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Consumers often participate in a marketplace without having perfect information about the best price offered. Sometimes this is because consumers enter the particular market occasionally, or because the organization of the marketplace makes it difficult to acquire information about the best price. One such example is the marketplace for title insurance, a purchase that the majority of consumers make only a few times in their lifetimes.

Title insurance protects those who buy real estate from losses due to pre-existing title liabilities that are not discovered until after the purchase. Title insurance commonly includes a title search to discover whether the title is "clear" (without problems). The insurance component pays the legal costs if a covered claim to the property occurs after the purchase. Title insurance plays the same role when property is refinanced.

Although a decision about title insurance is a part of most home-buying decisions, very little is known about how that choice is made. This study used data from the National Survey of Mortgage Originations to examine what types of consumers are more likely to shop for title insurance. More specifically, we studied the influence of financial knowledge and risk tolerance on the decision to shop for title insurance.

Literature Review

Both mortgage lenders and property owners use title insurance to protect themselves from future claims against property titles. Property owners buy title insurance policies called owner's policies; financial services firms that issue mortgages buy policies called lender's policies. Homebuyers typically pay the premium for both types of policies as an up-front payment. Both policies protect the beneficiary against losses that could be caused by title issues identified after the purchase. Possible title issues include errors in deeds, forgery, and undisclosed liens, among others. Owner's policies remain in place until the property is sold, while lender's policies remain in place until the associated mortgage is paid off or refinanced.

In 2019, Value Penguin estimated the average cost of title insurance for a home with the national median value to be about $1,375 -- $544 for the lender's policy and $830 for the homeowner's policy (Ceizyk, 2020). This is a small outlay relative to other closing costs as well as the annual cost of homeowner's insurance.

Unlike competitive insurance markets where there are incentives for consumers to seek information prior to purchasing, the title insurance market is relatively different. There is a significant degree of concentration in the market; there are only four national title insurance companies (Fidelity National, Financial First American Corporation, Old Republic National Title Insurance Company, and Stewart Title Guaranty Company) and several regional independent companies (https://www.investopedia.com/terms/t/title_insurance.asp). In addition, by state regulation there is no price competition in title insurance in three states (Texas, Florida, and New Mexico) (Nielsen, 2018). Rates may vary significantly from year to year or from state to state, but not typically within a state (Nielsen, 2018).

Another disincentive for consumers to seek information about title insurance options is that they buy this type of insurance only when they buy a home. Home purchase is a seldom occasion, so the returns from search for title insurance are limited to a single transaction. Of course, home purchases often involve mortgages as well. However, there are far greater financial returns to searching for a mortgage

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than searching for title insurance. For example, in June 2020, the Consumer Financial Protection Bureau's interest rate tool indicated that most lenders offered a rate of 3.125% or lower in Georgia (https://www.consumerfinance.gov/owning-a-home/explore-rates/), However, the rate with at least one lender was 4.275%, a difference that would amount to $35,000 more paid as interest over the life of a 30 year mortgage, compared to a one-time outlay of about $1,375 (the median value) for title insurance.

As a matter of fact, consumers typically buy title insurance based on the recommendation of the professional who manages the closing, which is different in different parts of the country – a settlement agent from the title insurance company in most parts of the country, an escrow agent in the West, and a closing attorney in the South and Northeast (CFPB, n.d.). In a 2014 survey by the American Land Title Association (ALTA, 2014), 42% of respondents said they used the title insurance company recommended by their real estate agent. Another 25% followed the recommendation of their lender.

Given the importance of home purchases in the average American family investment portfolio and the lack of competition in title insurance markets, it is important to understand how consumers select their title insurance. It also is important to understand the predictors of consumer shopping for title insurance.

Methodology

Our data came from The National Mortgage Database (NMDB®) program. The NMDB is a de-identified loan-level database of closed-end first-lien residential mortgages. It has three primary components: the National Mortgage Database (NMDB); the quarterly National Survey of Mortgage Originations (NSMO); and the annual American Survey of Mortgage Borrowers (ASMB). The data contain detailed, loan-level information about the terms and performance of mortgages, as well as characteristics of the associated borrowers and properties. The NSMO focuses on topics such as mortgage shopping behavior, mortgage closing experiences, and other information that cannot be obtained from other sources, such as borrowers' expectations regarding house price appreciation and experiencing critical household financial events (Avery et al. 2017).

We used the first NSMO public use file that is based on waves 11-15 of the survey. We limited our analysis to respondents who were identified as homeowners and those who have answered all of the survey questions needed to construct our variables of interest. Our final data set contains 11,934 observations. The dependent variable, *Searched for Title Insurance*, was based on responses to the following question: "Which one best describes how you picked the title insurance?" Answer choices were "Reissued previous title insurance," "Used title insurance recommended by lender/mortgage broker or settlement agent," and "Shopped around." The answer choices were coded as one if the respondent chose "shopped around" and zero otherwise.

The primary independent variables of interest were financial knowledge and risk tolerance. The dataset did not include any objective measures of financial knowledge. Although early financial literacy research focused on objective measures of financial knowledge, more recent research has demonstrated that one's subjective financial knowledge – how much one thinks he or she knows – often is more significantly related to financial decisions than one's objective financial knowledge (see, for example, Barbiarz & Robb, 2014). Thus, this study used responses to the two multi-part questions that asked respondents about their assessment of their subjective knowledge related to the home-buying process, including one item specific to title insurance.

- "When you began the process of getting this mortgage, how familiar were you (and any co-signers) with each of the following" (seven aspects of home buying: mortgage interest rates at the time, different types of mortgages available, mortgage process, down payment needed to qualify for a mortgage, income needed to qualify or a mortgage, credit history or credit score, money needed at closing)?
- "How well could you explain to someone the" (nine aspects of home buying)?" One of the nine items was specific to title insurance – "How well could you explain to someone the difference between lender's and owner's title insurance?" The others were process of taking out a mortgage, difference between fixed- and adjustable-rate mortgage, difference between a prime and subprime loan, difference between a mortgage's interest rate and its APR, amortization of a loan, consequences of not making required mortgage payments, relationship between discount points and interest rate, reason payments into an escrow account can change.

A single item in the survey measured financial risk tolerance: "Which one of the following statements best describes the amount of financial risk you are willing to take when you save or make investments?" The response choices (and coding) were "Take substantial financial risks expecting to earn substantial returns" (4), "Take above-average financial risks expecting to earn above-average returns" (3), "Take average financial risks expecting to earn average returns" (2), and "Not willing to take any financial risks" (1). Two dummy variables were created – High Risk Tolerance (=1 if Risk Tolerance was 3 or 4; Reference group was average risk coded as 2) and Low Risk Tolerance (=1 if Risk Tolerance was 1; Reference group was average risk coded as 2). Other variables in our analysis controlled for financial resiliency (an index created based on responses to four items asking how likely (on a 3-point Likert scale) a household would be to pay bills without borrowing, get significant financial help from family or friends, borrow a significant amount from a bank or credit union, and significantly increase income if faced with an unexpected personal financial crisis), demographic factors, employment, and income.

After examining descriptive relationships between our variables of interest and others in our model, we estimated a standard probit specification that an individual shopped for title insurance.

Results

Our final data set contained 11,934 observations. Of those, 6,712 reported having title insurance. Of those, 1,136 reported their title insurance was "Reissued previous title insurance." The overwhelming majority (5,221) had "Used title insurance recommended by lender/mortgage broker or settlement agent," and a very small number of consumers, 355, reported having "Shopped around." Of those who had shopped around for their title insurance, 80% were white and more than 50% had completed college or graduate education. Younger people and those with greater financial resiliency said they had shopped around for title insurance.

Results from our probit model suggested that general financial knowledge, measured by the financial knowledge index, did not increase the probability of shopping around for title insurance. However, specific knowledge of the two types of title insurance appears to have significantly increased the probability of shopping for title insurance. As for risk tolerance, it appears that both consumers who had low and high-risk tolerance were more likely to shop around than those with average risk tolerance.

Conclusions

This research provides the first academic research-based insights into consumer experiences with title insurance. The results suggest that specific knowledge about title insurance is relevant to shopping for title insurance while general financial knowledge is not. However, both measures are subjective. Future research is needed with valid objective measures of financial knowledge as well as a larger sample of home buyers who shopped for title insurance, ideally segmented by state.

It is, however, unclear whether consumers should even be encouraged to shop for title insurance. One perspective is that the costs are fairly similar across title insurance companies and, as a result, the returns to shopping are limited. From this perspective, one strategy to select a title insurance company is to choose the same company as one's lender uses. An owner's policy may cost less following this strategy. After all, while consumers only buy title insurance when they buy a home, lenders buy title insurance several times a day (Zillow, n.d.).

In contrast, the Consumer Financial Protection Bureau (CFPB, 2017) provides a qualified recommendation to shop for title insurance: "If you shop for title insurance, you may be able to save money." The CFPB has emphasized disclosure of Affiliated Business Arrangements – when a real estate agent or broker is compensated to refer a buyer to a specific mortgage financing or title insurance company (Real Estate Settlement Procedures Act, 2017).

Regardless, researchers should have a better understanding of what consumers know and do related to title insurance – and of the product itself. Lindamood's (2003) legal analysis of the title insurance market is informative and still relevant, as the title insurance market has changed little in the years since she wrote the article. Educators also need to be more informed about title insurance. In fact, title insurance may not even be mentioned in home buyer education curricula. For example, the description of HUD-approved housing counseling, education, and outreach topics for pre-purchase/home buying does not mention any form of insurance, including title insurance.

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