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## Real Estate *Update*

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### Calls for State Insurance Threaten Property Transfers

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Currently before the State Legislature are two bills, each jointly introduced in both houses, that would inject the state in the business of title insurance, damaging New York's standing as the capital of real estate transactions. One would broaden the power of the State Insurance Fund to provide a State alternative to the current private system of title insurance.<sup>1</sup> The other would create a new state title authority for the same purpose.<sup>2</sup> The latter also earmarks the presumed profits of the new system for certain favored public projects, such as affordable housing and road construction. Neither bill sets forth how and where offices would be set up or what standards would be used to insure title. Both bills leave those details to the respective agencies administering the program. We deal with the two sets of bills as a unitary concept, State Title Insurance (STI).

After a number of highly controversial recent enactments, many real estate attorneys have come to understand that any bill may become law no matter how devastating the significance or ill thought out the consequences. Many of these attorneys see these bills as a threat, both to the heart of the safe transfer of real estate and to the capitalist system itself. They fear both government competition against a healthy private industry and the extensive and expensive investment and undertaking such a new enterprise would require. Finally, they doubt that New York State is either qualified to undertake these tasks or can afford to administer them.

#### A Faulty Analysis

STI already appears to have substantial support in the Legislature and is championed by various lobbies, including the New York AFL-CIO, NYC Partnership, and Consumers Union. While the title industry opposes this legislation for its own profit-based reasons, their points are nonetheless valid and actually pro-taxpayer and pro-consumer. This is why numerous bar associations, including The New York State Bar Association and The New York City Bar, commissioned task forces to study and ultimately went on record opposing the legislation.<sup>3</sup>

STI's sponsors do not point to anything supposedly wrong with the current system except that the industry is presumably profitable. They



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claim that STI would eliminate some of that profitability and put the rest for state-sponsored public works. Among other things, this analysis ignores that the premium rates are set by law, that the only cost of business the sponsors' analysis allows for is payment on claims, and that the snapshot period of the sponsors' analysis was an extraordinary time very different from the conditions that prevail now.

While STI's sponsors say that it is modeled on Iowa's STI, unique in this nation, that is not strictly true. STI is a state monopoly in Iowa.<sup>4</sup> The proposals for STI in New York are unclear about whether STI would only compete with private insurance, or if under the regulations, privately issued title insurance would become impossible to achieve, effectively outlawing private companies without doing so explicitly. While STI's advocates claim it would be like Iowa—one version of the proposal copies the Iowa statute nearly verbatim<sup>5</sup>—it would nonetheless be like no other American system.

Neither New York proposal addresses STI's start-up costs, such as how many STI branch offices would have to be opened or what that would entail. While one of the bills allows the state authority to issue bonds,<sup>6</sup> these bonds would likely outlive the office equipment they fund.

Information acquisition accounts for a major percentage of where current premiums go, but it is the private companies' ability to add to their already existing base of knowledge that helps make the private industry profitable. Only confiscation could give this to STI also.

The bill calling for the creation of a new state authority also provides that its presumed profits are to be spent in particular dollar amounts

although in its first years, it would run at an enormous loss.

#### Iowa State Involvement

While the proposals purport to mimic the Iowa system, Iowa's needs are very different from New York's. Title insurance became state-run in Iowa as a result of the bankruptcy of two title insurance companies, leaving a void and a need for the government to step in to protect and secure real estate transfers.<sup>7</sup> In 1947, the Iowa legislature banned the sale of commercial title insurance within the state.<sup>8</sup> In that year, the state recorded some 115 land transactions,<sup>9</sup> as compared to New York's current 65,000 per year.<sup>10</sup> After 38 years without title insurance in Iowa, the Iowa State Title Guaranty was created in 1985 to assist and open the Iowa mortgage market to encourage more loans to Iowa citizenry.<sup>11</sup>

As, John Eisenman, the president of the Iowa Land Title Association, noted:

This, in my opinion, is the most significant fact in the national discussion of the "Iowa System": Title Guaranty, a public entity, was sought by the private sector to fill a void that had existed for 38 years! This would obviously not be the case in New York, where the bill would put the state in direct (and most likely unfair) competition with its own citizens and taxpayers (emphasis in original).<sup>12</sup>

Notably, title insurance companies based in adjoining states such as Nebraska, where the selling of title insurance is not prohibited by the state, insure many Iowa titles.

Title insurance in New York is much more important than in Iowa. While Iowa had relatively few fraud claims during the last decade,<sup>13</sup> New York consistently ranked among the top six states. Outside of Iowa, mortgage fraud has taken the lead as the fastest growing white collar crime in the country, accounting for more than 20 percent of all fraud in the United States. In 2007, the title industry paid

fraud-based claims just under \$1.3 billion. In New York City alone, the FBI, two U.S. Attorney's branch offices and the Manhattan District Attorney's Office have all restructured to open specialized mortgage fraud bureaus.<sup>14</sup>

### Unjustified Criticism

STI's sponsors do not claim the title industry serves the public badly, only purportedly very profitably. Instead of proposing a law allowing industry to charge less, the sponsors argue that the state needs to balance its own budget by destroying this particular industry. Passage of this legislation could place any number of other businesses in fear that they may be the next subject of state takeover or competition.

That the industry pays relatively few claims stands not as a critique of the industry but rather as a testament to just how well insurers are doing their job of preventing problems. Those who criticize the low payout-to-premium ratio fail to realize two fundamental facts.

First, title insurance is the only form of insurance designed to prevent loss rather than to compensate for it. The compensation, in fact, is just the visible safety net in real estate transactions. Title companies' research and advice constitute an invisible protection that prevents problems.

Homeowners policies compensate those who fall on a broken sidewalk; metaphorically speaking, title policies discover the crack in the sidewalk and recommend the repairs to prevent the fall from happening. If a fall still occurs, the title company will cover it.

Second, in New York, the premiums are set in a schedule in the State Insurance Department below which title companies are not permitted to charge.

### Incalculable Harm

The proposed legislation does not acknowledge how the New York title system works nor the differences between ours and Iowa's.

Only title insurers start by investigating problems and proactively proposing solutions to them, backing their proposed solutions with their own financial resources, and assuming the risk that there was nothing else lurking. Title companies use their own resources to clear a home buyer's path of financial problems. When a fraud, forgery, stolen identification, missed mortgage or other problems surface, the title company both defends the home, and indemnifies any loss. It is the company's willingness to guaranty this work—whether or not its fault—that provides lenders the confidence to release funds once the title guarantee is present.

At the outset, a state system would create a shortage of staff at the private insurers. STI

would have to employ staff wooed from private agencies. But for perhaps six months, the new public employees would not be available to issue title policies. Instead, they would be busy opening offices, establishing procedures and training. Meanwhile, private employees who do not join the state enterprise would simply look for work in 48 other states, fearing that their private sector jobs were about to vanish. The unavailability of these title experts in both the public and private insurance systems during this transitional period would likely make title insurance of any kind effectively unavailable in parts of the state until STI came fully up to speed.

Private title serves the real estate community by its quick turnaround of title reports, by being available outside normal business hours, by being available to handle escrow transactions, by their wiring funds and making closing disbursements, by their handling of documents to be recorded, and by their transmittal to government of various taxes. Delays in the title process will impair the efficient closing of real estate transactions in New York. The effect on New York's status as capital of real estate will be immense.

Title companies do a full search of title, tax and judicial records to remove any judgment or liens against the property. Title insurers underwrite and provide risk analysis in many areas, including land under water, building loans, and foreclosures. Title insurers advise counsel on how to clear title issues and determine whether to write over open but paid off mortgages. Title companies pay transfer taxes within statutory periods to avoid the imposition of interest and penalties. These tasks prevent a buyer from losing or encumbering the property being purchased.

State programs would be unable or unwilling to perform all these functions.

Currently, New York based title insurance companies handle multi-state transactions through a network of contacts in the various states to clear title and prepare the policies to be issued based on local laws, and to record closing documents. The proposals do not envision STI duplicating this network.

Because of the dual nature of the title industry—research to prevent problems and defense when problems do occur—it is particularly vulnerable to politicization. Under STI, if a seller of property with bad title can convince the right politician, STI's commissioner would be under irresistible pressure to allow a deal to go forward. If the title proved bad, not only would the taxpayers be out the price of the home, but the home purchaser would be without housing.

Each underwriter employs a claims administration staff and engages private attorneys. The title company must, as a matter of com-

mon law, administer claims in "good faith." STI would likely administer claims with private counsel selected for political considerations, putting STI at risk for damages based on allegations that claims are not being administered in "good faith" and putting the public at risk that claims are processed by a law firm selected only for cronyism and nepotism.

There is a serious problem intrinsic in the selection of the very industry with which STI proposes to compete. New York is the great world dynamo of real estate transactions, largely owing to substantial consistency in both statutes and decisions that set a very high priority on stability and dependability in all questions affecting real property. New York shies away from changing the rules, even when there can be better rules out there. STI promises changes in the rules so fundamental that calculating both their direct and indirect harm is absolutely impossible.

### Conclusion

While the State Legislature should be applauded for attempting to find ways to balance the budget, it should avoid molesting the very industry that provides the lubrication and safety net to facilitate the secure transfer of real property. Attorneys on both sides of the issue must hold their breath until the bills go up or down in the Legislature.

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### Endnotes:

1. A9441/S6288.
2. A9445/S6290.
3. On March 26, 2010, The New York City Bar released its report opposing the legislation which can be found at <http://www.nycbar.org/pdf/report/uploads/20071884-CommentonLegislationReState-RunTitleInsuranceSysteminNY.pdf>. On April 9, 2010, the executive committee of The New York State Bar Association unanimously approved a report prepared for it opposing STI.
4. Iowa Code §515.48 (2010); Id.
5. A9445/S6290.
6. A9445/S6290.
7. See Joseph B. Treaster, "Iowa Cuts Added Costs in Title Insurance Policies," *N.Y. TIMES*, July 6, 2005, at C3.
8. Iowa Code § 515.48 (2010); Id.
9. <https://iowalandrecords.org/portal/clris/ShowHomePage> (last visited Feb. 17, 2010).

10. <http://www.nyslta.org/news.htm> (last visited Feb. 17, 2010). This is the bulletin of the New York State Land Title Association. It shows a current slump in the deeds and mortgages recorded per annum to approximately 65,000. At the height of the real estate boom, it was 152,000 deeds and mortgages per year.
11. Title Guaranty Division, Manual, (2009), [http://www.iowafinanceauthority.gov/documents/filelibrary/tgd/forms\\_and\\_documents/TitleGuarantyManual.pdf](http://www.iowafinanceauthority.gov/documents/filelibrary/tgd/forms_and_documents/TitleGuarantyManual.pdf); See Iowa Code §16.91 (2010).
12. E-mail from John Eisenman to Andrea Golby, editor of “The Legal Description”, dated 11/16/2009. Mr. Eisenman adds, “The ‘Iowa System’ works for us, but it cannot successfully be replicated anywhere else.”
13. Dr. Nelson R. Lipshutz, Economic Benefits of Permitting Title Insurance Sales in Iowa (Report to The Iowa Title Insurance Coalition), Aug. 16, 2004.
14. Adam Leitman Bailey, “Title Litigation, Expense of Theft Prevention Dwarfed by Cost of Fraud,” 4/8/2009 NYLJ, 5 (col. 2).