

# Effects of market concentration on U.S. title insurance premiums

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## **Extended Abstract**

Real estate conveyancing in U.S. relies on a mixture of private and public intermediaries to clear land title and protect real estate buyers. On the one hand, private conveyancers produce information on land title by searching and examining available information about past events that can be affecting land title. They usually compile and store this information in title plants. On the other, public institutions give constructive notice of any recorded private agreement that may affect or burden the land –in most states in the U.S. usually is the Recorder of deeds. However, and despite conveyancers' professional due diligence, unknown risks may remain and still cloud land title.

Title insurance was born precisely to protect real estate buyers against these risks (Palomar, 2017 §1:3). It is a peculiar product among the insurance lines in the industry. It has a preventive function –to indemnify the insured if he suffers losses because of unknown or uncovered pre-existing title defects, is issued and paid once –when the insured real estate transaction takes place– and its coverage extends to perpetuity. Conversely to the rest of insurance lines that cover against future events and coverage is limited to a before-hand time-paid period (Arruñada, 2002).

Hence, title insurers can minimize risks and, thus, prevent future losses if efficient and good quality title search and examination is performed, allowing them assessing risks before issuing a policy. However title search and examination is usually conducted by lawyers, especially wherever they hold exclusive competency by law. Consequently, title insurers and lawyers are not only the main players in the title insurance industry but are also entangled in an interdependent relationship that may affect both the quality and the price of the title insurance (Arruñada, 2007; Palomar, 1998).

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This paper studies if and how title insurance premiums are affected either by the interdependent relationship title insurers and lawyers have or by changes in the insurers' market concentration levels. Firstly, I discuss who and to what extent have an effect on title insurance premiums, insurers or lawyers, in a context of a bilateral monopoly given the insurers' oligopolistic power over underwriting title insurance policies and lawyers' monopolistic competencies over title search and examination services—and the relevance of such services for assessing and purging title defects and estimating the residual risk left to be insured. Results suggest that premiums are higher in a situation of bilateral monopoly than in one of vertical integration, but they are inconclusive as to whether a double markup problem could be at play. Further analysis suggests that, in a situation of bilateral monopoly, the title premium would be influenced by lawyers' monopolistic power when title insurers' market concentration levels are low. However, once title insurers' market concentration increases and reaches a certain level, the lawyers' monopoly matters no more.

Secondly, I focus on title insurers and their market concentration levels. I analyze whether concentration and price are positively related as the classic oligopoly theory has stated (Stigler, 1964; Weiss, 1989). Employing the methodology of natural experiments, I test whether an increase in the title insurers' market concentration levels—due to the bankruptcy of Land America, and its merger with Fidelity National in 2008—increases title insurance premiums. Results suggest that premiums have increased because of higher market concentration levels. This is supported by the most restrictive robustness checks.

Most previous work on title insurance is theoretical, consisting of either discussions about the nature, configuration or economic implications of title insurance in conveyancing transactions. Nyce and Boyer (1998) provide a descriptive analysis of the structure, performance and problems of the suppliers of title insurance from an industrial organization approach. Arruñada (2002) analyzes the role of title insurance from a transaction cost view in U.S and its applicability to other markets where a registry system, instead of a recording one, is in place.

Little empirical work has been done on the title insurance industry, mainly due to the lack of suitable data. Arruñada (2007) studies the involvement of legal specialists in land transactions under different land title regimes. Considering the shifts in characteristics produced over time in both the market and institutions, he concludes the

demand for legal specialists in conveyancing services has decreased. Results from the empirical study show that lawyers' involvement in the U.S. market adds little value. Nyce and Boyer (2010) combine a theoretical approach with an empirical one. They present four different competing industrial organization models (Cournot, Salop's circular city, the Monopolistic competition and the Blockaded entry models) to see which one fits the title insurance industry best. Their empirical results suggest that the Salop circular city model would be the one. This result implies that insurers compete in prices and consumers perceive differences in products as the distance between two firms located around a circle. Feinberg et al. (2015) develop empirical models to study how closing costs vary within five metropolitan areas using as explanatory variables house, buyer and real estate broker characteristics. Results suggest variation in closing fees charged depend on the settlement agents and advise shopping around for a service provider and comparing rates. Lastly, Palomar (1998) discusses differences in quality of real estate conveyancing services based on whether they are provided by lay conveyancers or lawyers, considering the long-lasting battle between these two types of professionals based on the concept of the "unauthorized practice of law". Results suggest differences in quality are not significant enough to determine that consumers actually face a higher amount of risk if they hire lay conveyancers and, therefore, do not constitute grounds for keeping other service providers but lawyers from performing those services.

The main contribution of the paper is to provide a better understanding of how title insurance is priced and, more specifically who holds a higher say on that. Its most relevant novelty is the empirical study on the effects on premiums considering two different factors: one is the presence of a bilateral monopoly—consisting of an insurers' oligopoly and lawyers' monopolistic competencies—and two the change in title insurers' market concentration levels that took place because of Land America's bankruptcy in 2008—due to exogenous circumstances. Moreover it contributes to the heated debate on price setting practices in the title insurance industry and related closing costs in real estate conveyancing operations. Social concerns reached their peak in the years after subprime crisis, 2006-07, to the point that the Federal and States Governments conducted a series of investigations into title insurers' practices; resulting in changes in title insurance legislation and fines (DasGupta & Hernick, 2007).

Although results are inconclusive for who, insurers or lawyers, holds higher power over setting prices, concentration levels in the title insurers' market seem to have increased prices. Title insurers seem to not only be profiting from oligopolistic rents but have increased prices due solely to their market's higher concentration levels.

*Keywords:* lawyers, title insurers, real estate, property rights, bilateral monopoly, concentration-price relationship.

*JEL:* L85, L11, G22, K23.

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