

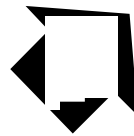


The Secret Story Behind New Mexico's Title Insurance Law,
How it Harms Working Families, and How We Can Fix It

Cover Art: Greg Tucker
Design: Kristina Gray Fisher
Design Consultant: Arlyn Eve Nathan
Mailing Coordinator: Frank E. Gonzales
Pre-Press: Peter Ellzey
Printer: Starline Printing
Production Manager: Lynne Loucks Buchen
Researched by: Kristina Gray Fisher, Fred Nathan, Grant Taylor
and Maclovia Quintana
Written by: Fred Nathan and Kristina Gray Fisher

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THINK NEW MEXICO
A Results-Oriented Think Tank Serving New Mexicans



Address: 1227 Paseo de Peralta
Santa Fe, New Mexico 87501

Telephone: 505. 992.1315

Fax: 505. 992.1314

Email: info@thinknewmexico.org

Web: www.thinknewmexico.org

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About Think New Mexico

Think New Mexico is a results-oriented think tank serving the citizens of New Mexico. Our mission is to improve the quality of life for all New Mexicans, especially working low and middle-income families. We fulfill this mission by educating the public, the media and policymakers about some of the most serious problems facing New Mexico and by developing effective, comprehensive, sustainable solutions to those problems.

Our approach is to perform and publish sound, nonpartisan, independent research. Unlike many think tanks, Think New Mexico does not subscribe to any particular ideology. Instead, because New Mexico is at or near the bottom of so many national rankings, our focus is on promoting workable solutions. We use advocacy and, as a last resort, legal action in accordance with federal tax law.

Consistent with our nonpartisan approach, Think New Mexico's board is composed of Democrats, Independents and Republicans. They are statesmen and stateswomen, who have no agenda other than to see New Mexico succeed. They are also the brain trust of this think tank.

Think New Mexico began its operations on January 1, 1999. It is a tax-exempt organization under section 501 (c) (3) of the Internal Revenue Code. In order to maintain its independence, Think New Mexico does not accept government money. However, contributions from individuals, businesses and foundations are welcomed, encouraged and tax-deductible.

Results

As a results-oriented think tank, Think New Mexico measures its success in changes we help to achieve in law or policy, such as:

- making full-day kindergarten accessible to every child in New Mexico
- repealing the state's regressive tax on food
- creating a Strategic River Reserve to protect and restore New Mexico's rivers
- enacting the Family Opportunity Accounts Act to alleviate New Mexico's persistent poverty
- reforming the state lottery to reduce its excessive operating costs and redirect the savings to full-tuition college scholarships

Think New Mexico's Board of Directors



Edward Archuleta, a 13th generation New Mexican, is a consultant and activist on issues including responsible land-use planning, growth management, and sustainable development. Edward previously served as the top assistant to former New Mexico Secretary of State Stephanie Gonzales.



Paul Bardacke served as Attorney General of New Mexico from 1983–1986. Paul was Chairman of Bill Richardson's successful 2002 gubernatorial campaign. He is a Fellow in the American College of Trial Lawyers. Paul currently handles complex commercial litigation and mediation with the firm of Sutin, Thayer, and Browne. *Paul abstained from consideration of this report due to a possible conflict of interest.*



David Buchholtz has advised more than a dozen Governors and Cabinet Secretaries of Economic Development on fiscal matters. David recently served as Chairman of the Association of Commerce and Industry. He is the senior member of the New Mexico office of Brownstein, Hyatt, Farber, & Schreck.



Garrey Carruthers served as Governor of New Mexico from 1987–1990. Garrey is Dean of New Mexico State University's College of Business, and was formerly President and CEO of Cimarron Health Plan. He is a member of the Board of Directors of the U.S. Chamber of Commerce.



Dr. F. Chris Garcia is a former President of the University of New Mexico and is currently a Distinguished Professor Emeritus of Political Science. He is the co-author of, among other books, *Hispanics and the U.S. Political System* and *Governing New Mexico*. Dr. Garcia recently received the Governor's Distinguished Public Service Award.



Elizabeth Gutierrez is the Director of Policy and Program Development for the New Mexico Higher Education Department. She holds a PhD in educational leadership and public policy. Liz was a marketing executive with IBM for nearly two decades. *She is on leave from Think New Mexico's Board while she works for the state.*

LaDonna Harris is an enrolled member of the Comanche Nation. LaDonna is Chairman of the Board and Founder of Americans for Indian Opportunity. She is also a founder of the National Women's Political Caucus. LaDonna was a leader in the effort to return the Taos Blue Lake to Taos Pueblo.



Rebecca Koch is the owner of Rebecca Koch & Associates which provides management consulting services, development, and strategic planning for local and national nonprofits. Rebecca was the organizational development consultant for the Santa Fe Business Incubator, Inc. She is a former President of the Board of New Mexico Literary Arts.



Edward Lujan is the former CEO of Manuel Lujan Agencies, the largest privately owned insurance agency in New Mexico. Ed is a former Chairman of the National Hispanic Cultural Center of New Mexico, the Republican Party of New Mexico and the New Mexico Economic Development Commission.



Fred Nathan founded Think New Mexico and is its Executive Director. Fred served as Special Counsel to New Mexico Attorney General Tom Udall. In that capacity, he was the architect of several successful legislative initiatives and was in charge of New Mexico's lawsuit against the tobacco industry.



Roberta Cooper Ramo is the first woman elected President of the American Bar Association. Roberta serves on the State Board of Finance and is a former President of the Board of Regents of the University of New Mexico. She is a shareholder with the Modrall law firm and serves on many national boards. *Roberta abstained from consideration of this report due to a possible conflict of interest.*



Stewart Udall served as Secretary of the Interior under Presidents Kennedy and Johnson. Prior to that, Stewart served three terms in Congress. He is the author of *The Quiet Crisis* (1963), which tells the story of human-kind's stewardship over the planet's resources, and *To the Inland Empire: Coronado and Our Spanish Legacy* (1987), which celebrates Hispanic contributions to our history.



Dear New Mexican:

This report is really about Diana Akins, her family, and the many other families like hers across New Mexico.

Diana is saving to buy a first home. Alan, her husband, is disabled and cannot work. They have two children, Jed and Cheyenne. Diana owns a small business, Eagle Custom Signs, in which she is the sole employee. Jed and Cheyenne work there part-time. The business helps to meet their modest living expenses, but does not generate much cash beyond that.

Nevertheless, with the help of the Santa Fe Housing Trust (SFHT), a well-respected affordable housing group, Diana is hoping to purchase a home for approximately \$220,000, which is about the cost of a typical home in New Mexico. In order to finance the home, Diana is planning on taking out a first mortgage with a local bank for about \$140,000, and the equivalent of a second mortgage of about \$70,000 from the City of Santa Fe.

SFHT calculates that Diana can expect to pay an additional \$6,000 in closing costs. One of the biggest components of that cost is her title insurance premium, which will be \$1,022 plus \$100 for title policy endorsements and \$50 for a title insurance binder. That's about \$457 more than she would have to pay for title insurance on a \$220,000 home in North Carolina.

This report explains how New Mexico's title insurance law hurts families like Diana's by locking in high title insurance prices and locking out free market competition that would reduce those prices. The report also describes a series of reforms that would save homebuyers in New Mexico approximately \$40 million each year. This would lower closing costs and make home ownership that much more affordable for hundreds of thousands of New Mexicans.

At Think New Mexico, we focus on policy reforms that expand opportunities for all New Mexicans. Historically, homeownership has been the surest ticket out of poverty and into the middle class. For that reason, reducing closing costs for homes by reducing the cost of title insurance holds enormous appeal to us.

The themes of expanding opportunities and broadening the middle class also tie this initiative to our previous initiatives, which include making full-day kindergarten accessible to every child in New Mexico, repealing New Mexico's regressive food tax, and reforming the state lottery to reduce its excessive operating costs and redirect the savings to full-tuition college scholarships.

No doubt title insurance reform is not quite as exciting as some of those topics, even to policy wonks like us, but the entertaining story of how New Mexico's title insurance law came about in 1985 and how it has driven up our title insurance premiums ever since, should be of interest to all students of the political process, as well as anyone who has bought or plans to buy a home in New Mexico.

Special thanks, once again, to my hard-working and talented colleagues at Think New Mexico, who are pictured at right. Our efforts on this report were greatly enhanced by the contributions of Think New Mexico's intern, Maclovía Quintana who, sadly for us, will be leaving to enter Yale University this fall.

If you would like to join us and become part of this initiative to reduce title insurance costs and make homes more affordable for Diana and other working New Mexico families, then I encourage you to send in a contribution in the conveniently enclosed reply envelope. In addition, our website at www.thinknewmexico.org provides other ways to get involved.

Fred Nathan

Founder and Executive Director

Think New Mexico STAFF



Lynne Loucks Buchen
Business Manager



Kristina Gray Fisher
Research Director



Fred Nathan
Executive Director



Maclovía Quintana
Intern



Grant Taylor
Field Director

HOME OWNERSHIP AND TITLE INSURANCE

“Dad began construction of our home on West Houghton Street in 1930, shaped from thousands of adobes that he and Grandpa Albert and two of his brothers, Rudy and Willie, made from mud mixed with straw...Uncle Frank Rivera helped to dig the foundation, which was filled with cement mixed in a wheelbarrow. The adobes were then stacked one on top of the other with a thick layer of mud in between...When I think about my home I feel a steady warmth in my heart...”

MARIE ROMERO CASH

Tortilla Chronicles: Growing Up in Santa Fe

When a young family moves into its first home, it achieves one of the key milestones of the American Dream. Owning a house means owning a valuable, appreciating asset that is a working low-income family's best opportunity for moving into the middle class.

The economic benefits of homeownership are matched by its social benefits. A 2001 study by Harvard's Joint Center for Housing Studies found that children of homeowners score 9% higher in math achievement and 7% higher in reading achievement than children of the same socioeconomic background living in rented homes. Similarly, children in families that own their homes experience a 9% lower high school dropout rate and up to a 4% lower teen pregnancy rate than children of renters with identical socioeconomic characteristics, according to a 1997 national study conducted by economists at the University of Michigan.

Given all the positive effects of homeownership, it is imperative that we make homeownership as attractive and affordable as possible. At first glance,

it would appear that New Mexico is doing a pretty good job: according to the US Census Bureau, in 2006, 72% of New Mexico families owned their own homes, compared to 68.8% nationally. Unfortunately, that statistic is somewhat misleading, as it includes mobile homes. New Mexico ranks second in the nation for the percentage of its homes that are mobile homes: 18.6%, more than twice the national average of 7.6%.

Mobile homes do not provide families with the same social and economic benefits as permanent homes, according to a comprehensive 2006 study by researchers at Oregon State University. While permanent homes *appreciate*, becoming more valuable over time, mobile homes *depreciate*, losing value over time just like automobiles. After three years, the typical mobile home has a wholesale value equal to only half of its original price. In addition, the living and maintenance costs of mobile homes are generally higher than those of permanent homes.

Excessive closing costs are a serious obstacle to permanent homeownership for New Mexico's working families. As the mortgage market tightens, families must come up with cash for not only a substantial down payment, but also all the other costs associated with closing a real estate deal.

According to a 2006 report in Money Magazine, closing costs today are eight times higher than they were 40 years ago. New Mexico families face the eighth highest costs in the country—in a state that ranks 43rd in median income. High closing costs are especially burdensome for young families striving to purchase their first home—precisely the families who benefit the most from homeownership.



Plastering a home in Llano Quemado, south of Taos, New Mexico, 1966. Photo by Mildred T. Crews, Courtesy Palace of the Governors (MNM/DCA), #066644.

There are many fees and other costs that are incurred at the time of a home purchase. After the down payment and real estate agent commission, the most expensive cost is generally title insurance.

Title insurance is intended to provide a guarantee to buyers that the seller is giving them good title to the property – in other words, that the seller is truly the owner of the property, and that there are no other claims against the property such as mortgages, liens, building restrictions, or other encumbrances. The title insurance company's role is to search the public record for any such problems with the property, and ensure that the title is good.

Most lenders require a buyer to have title insurance before they will approve a mortgage on the property, in order to guarantee that they will have clear title to the property if the borrower defaults.¹ However, these lenders only require the buyer to purchase a "lender's policy," which covers the

amount of the mortgage but does not protect the equity the buyer has invested in the home. (Many New Mexicans choose to purchase a separate owner's policy.)

In addition, most mortgage lenders require that a new title insurance policy be purchased every time a mortgage is refinanced. The number of refinancings has grown rapidly in recent years.

Because the price of title insurance is tied to the value of the home, that price has soared as home values have increased. Meanwhile, the actual cost of conducting a search of the public records has fallen dramatically due to computerization, according to the November 2006 *Forbes Magazine* cover story, *Inside America's Richest Insurance Racket*.

Today, New Mexicans pay some of the highest title insurance costs in the nation. If we are to make homeownership more attractive, and ensure that more New Mexicans have access to all the social and economic benefits of a permanent home, we must begin by reducing excessive costs that stand in the way of homeownership. The most troubling of these is title insurance.

¹ *Protection against title defects is even required for mortgages and home rehabilitation loans on New Mexico's Indian reservations, where most of the land is held in trust by the federal government. Traditionally, the Bureau of Indian Affairs has been responsible for conducting a title search and issuing a Title Status Report (equivalent to a title insurance policy) for tribal properties. However, inefficiencies at the BIA have led to a push for reform, and during the past decade, title insurance policies written by private title insurers have become increasingly common in Indian country.*

THE STORY BEHIND NEW MEXICO'S COSTLY TITLE INSURANCE LAW

It is highly unusual for an industry to ask to be regulated, but that is exactly what happened in March of 1985, when the New Mexico legislature passed a bill regulating title insurance in New Mexico at the behest of the industry.

The story of how this law came about actually began two months earlier, on January 7, 1985, when President Ronald Reagan's Federal Trade Commission (FTC) filed price-fixing charges against six major title insurance companies. The FTC alleged that the price fixing had occurred in 13 states, including New Mexico, and sought to prevent them from engaging in such practices in the future.

An industry spokesman responded at the time by stating, "We believe that our activities are exempt from [federal] antitrust laws because [we] are regulated by the states."

Indeed, since the 1945 passage of the federal McCarran-Ferguson Act, insurance companies have been exempt from federal antitrust laws and the states have had the authority to regulate the entire insurance industry. That authority to regulate is known as the "state action doctrine," which exempts certain anti-competitive activities within a state from federal antitrust laws if the state has authorized the activity and actively supervises it.

However, because New Mexico did not have its own law regulating the title insurance industry in January of 1985, the FTC challenged whether the McCarran-Ferguson Act could protect the title

insurance industry in New Mexico against the price fixing charges.

Within two weeks of the FTC filing its price fixing charges, the title insurance industry in New Mexico had drafted a bill innocuously titled the "New Mexico Title Insurance Law." The bill stated at the outset that "[t]he purpose of the New Mexico Title Insurance Law is to provide a comprehensive body of law for the effective regulation and active supervision of the business of title insurance transacted within this state in response to the McCarran-Ferguson Act."

The industry took its bill to the Senate Majority Floor Leader, who introduced it as Senate Bill 52. The bill passed the Senate 20-7 and the House 46-6 without any substantive amendments. Within two months of introduction, the bill was law. It remains on the books today.

The law had its desired effect for the title insurance industry. The fact that the legislature had passed a bill that would regulate the industry constituted state action sufficient to satisfy the McCarran-Ferguson Act, and the FTC was forced to drop New Mexico from its enforcement action.

Unfortunately, Senate Bill 52 went beyond merely exempting the title insurance industry from federal antitrust laws and the price fixing allegations confronting the industry at that time. Buried in the New Mexico Title Insurance Law is a small provision which states: "The [insurance] superintendent shall promulgate such laws and regulations as are neces-



Working on a home in New Mexico, circa 1910. Photo by Henry Dorman, Courtesy Palace of the Governors (MNM/DCA), #397.

sary to carry out the provisions of the New Mexico Title Insurance Law, including rules and regulations requiring **uniform forms of policies and uniform premiums.**" (*emphasis added*)

To legislators wading through hundreds of complicated bills, this particular provision could easily have been missed, since there was no active public opposition and no media coverage of Senate Bill 52. The bill may have appeared to simply regulate an unregulated insurance industry.

However, the result of this seemingly minor provision was that when the law went into effect on July 1, 1985, the free market in New Mexico stopped setting the price of title insurance. Rather, the Superintendent of Insurance (an employee of the Public Regulation Commission) sets a single rate schedule of "uniform premiums" that determines the price that all title insurance companies must charge. Therefore, no matter which title insurance company a New Mexico family purchases a policy from, they will pay the exact same price for title insurance. In addition, the superintendent, not the

free market, decides which types of title insurance policies may be offered to consumers.²

The Aftermath of the New Law

Only three states in the country allow the government to set prices for the title insurance industry: New Mexico, Texas, and Florida. As of 2006, all three states were in the top five for the price of title insurance, according to a 50-state comparison performed by Bankrate.com.

Although the Public Regulation Commission (PRC) commendably lowered New Mexico's title insurance rates by approximately 6.3% in 2007, New Mexico remains in the top third among states for title insurance costs, even though New Mexico is in the bottom fifth for income.

In addition to ranking eighth highest among the 50 states for closing costs, New Mexico also ranks eighth highest for the cost of title insurance relative to income, as shown in the chart on the following page. The cost of a title insurance policy for a \$200,000 home mortgage is nearly a quarter of the median monthly income for a New Mexico family. By comparison, even though North Carolina ranks 39th for per capita income and New Mexico ranks 44th, homebuyers in New Mexico pay 81%

² After the bill's passage, the title insurance industry moved quickly to control the rulemaking process. Bob Philo, a member of the New Mexico and Texas Land Title associations (industry trade groups), was hired by the Public Regulation Commission's predecessor, the State Corporation Commission, to draft the regulations. The regulations and the published ratemaking schedule clarified that there would be no price competition for title insurance in New Mexico.

Title Insurance as Percentage of Median Monthly Income

STATE	PERCENT	STATE	PERCENT
Pennsylvania	37 %	U.S. Median	17 %
Texas	34 %	South Dakota	17 %
Florida	30 %	Alaska	17 %
New York	30 %	Michigan	17 %
Mississippi	30 %	South Carolina	17 %
Arkansas	27 %	Wisconsin	17 %
Louisiana	25 %	Georgia	16 %
New Mexico	24 %	Connecticut	16 %
Tennessee	24 %	Virginia	16 %
Ohio	23 %	Massachusetts	16 %
West Virginia	22 %	Minnesota	15 %
Oklahoma	21 %	Missouri	15 %
Alabama	21 %	California	15 %
Kentucky	20 %	Nebraska	15 %
New Jersey	20 %	Kansas	15 %
D.C.	19 %	Iowa	14 %
Colorado	19 %	Oregon	14 %
Montana	19 %	Maryland	14 %
Utah	19 %	Hawaii	13 %
Vermont	18 %	Nevada	13 %
Maine	18 %	New Hampshire	13 %
Arizona	18 %	North Carolina	12 %
Delaware	17 %	Wyoming	12 %
Idaho	17 %	Washington	12 %
North Dakota	17 %	Indiana	12 %
Rhode Island	17 %	Illinois	11 %

The one-time title insurance costs for a \$200,000 house, increasingly required in cash at closing, total nearly a quarter of the average New Mexican's monthly paycheck.

Source: Median income information taken from the U.S. Census Bureau's 2005 American Community Survey. Title insurance information taken from Bankrate.com's 2007 Closing Costs Survey, which gathered data from at least eight lenders in the zip code of the largest urban center in each state. Compiled by Think New Mexico.

more than homebuyers in North Carolina for title insurance on a \$200,000 home mortgage, according to Bankrate.com.

This huge price difference cannot be explained by the loss ratio for title insurance (the percentage of premiums that are paid out as claims), which is 8.5% in North Carolina and only 5.1% in New Mexico, according to the most recent 50-state study performed in 2001 by Lawrence Kirwin, an independent researcher and expert in the field of insurance loss ratios. (The title industry nationally faces loss ratios that are far smaller than those of most other insurance industries.) Nebraska's loss ratio is the highest in the nation at 12.3%, more than double New Mexico's ratio, yet homebuyers in New Mexico still pay 36% more than Nebraska homebuyers.

Because all title insurers in New Mexico charge the same rate, it would be pointless for a homebuyer to shop around for title insurance. For example, if a New Mexico family were to purchase a \$300,000 home anywhere in the state, that family would pay \$1,248 for their title insurance because that is the rate promulgated by the Insurance Department in 2007 (effective September 1).

Not only does current New Mexico law prohibit the title insurance companies from competing on price, it also stifles innovation and the development of new products. In many cases, the very products that consumers most want are illegal, and the entrepreneurs who want to offer those products are frozen out of the market.

For example, many consumers who refinance a mortgage would like to have the option of purchasing a pared down "lien protection" policy in lieu of the new title insurance policy that is generally required. Under those circumstances, paying for a whole new title policy seems unjust when the probability that the title has acquired new

defects since the homeowner bought it is miniscule.

Since March of 2006, homeowners in Iowa have been able to purchase this type of streamlined refinancing policy for a mere \$90. Unfortunately, there is no “uniform policy” for a pared down “lien protection” in New Mexico, and it is, therefore, illegal to sell such a policy, although it could save New Mexico homebuyers millions of dollars annually. ³

Perhaps the only one burdened more by this absurd law than homebuyers is the Superintendent of In-

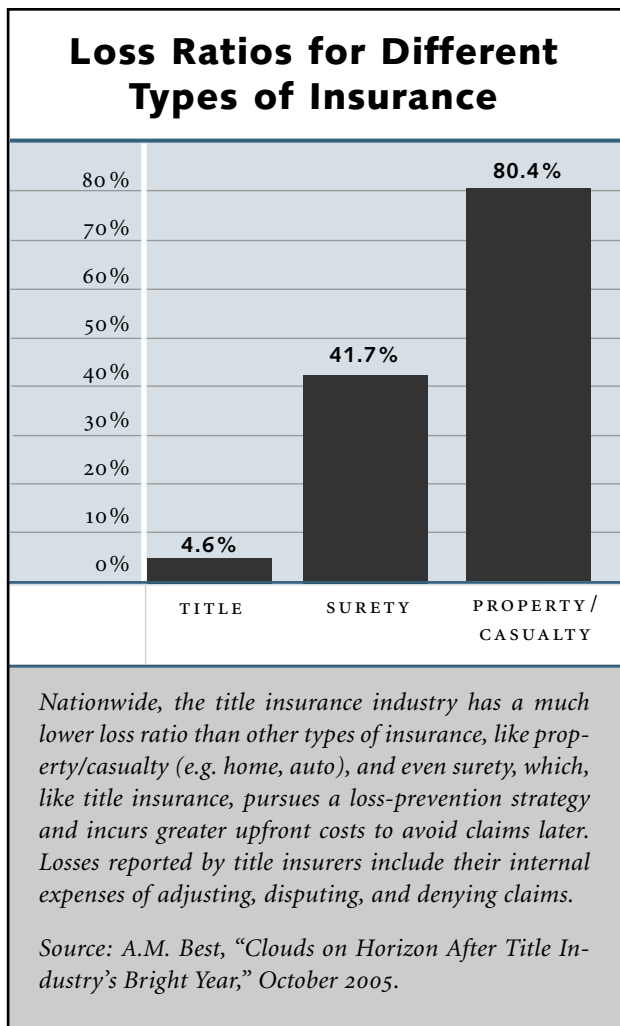
surance. After all, the law requires the Superintendent to undertake the Herculean task of centrally managing the title insurance market in New Mexico. In effect, the Superintendent must set the price of title insurance prospectively for the next year without a crystal ball to reveal what sort of economic conditions will prevail. By contrast, businesses that adhere to America’s free market system set their own prices and can adjust those prices in response to changing market conditions.

Indeed, for the Superintendent of Insurance, it is the classic no-win situation. Set the price too high and the Superintendent is accused of gouging the consumer. Set the price too low and the Superintendent is accused of engaging in price controls. (The annual rate hearings themselves cost homebuyers \$250,000 a year, paid for through a tax on their title policy premiums.)

Since the Title Insurance Law was passed in 1985, Superintendents under both the PRC and its predecessor, the State Corporation Commission, have generally sided with the industry on price. However, the current PRC, led by Ben Ray Lujan Jr. and Superintendent Mo Chavez, has cut the price of title insurance and is genuinely attempting to strike a balance between the needs of consumers and industry when setting the price.

Their efforts have met with fierce resistance. When the Superintendent recently cut the price of title insurance premiums by 6.3%, instead of the 1.4%

³] New Mexico’s uniform price schedule does provide customers a 0-60% discount for refinancings completed within 10 years after the original mortgage. This discount rate is arbitrary and would be better left to the market to determine.



reduction that the industry had proposed, the New Mexico Land Title Association strenuously objected and appealed the action in court. This underscores the need for a new approach.

Reforming the Title Insurance Law

The vast majority of businesses in America would never willingly give government the power to set the price of their products. However, the title insurance industry claims that if they were made to compete in the free market, then some title insurance companies might go bankrupt.

The industry argues in effect that the Superintendent of Insurance must set the price of title insurance high enough in New Mexico so the least efficient title insurance company does not go out of business. Otherwise, the industry contends, title agency bankruptcies in some parts of the state would leave prospective homebuyers without anyone to purchase title insurance from.

Here, the solution is not government imposed price fixing. Instead, the Legislature could simply repeal section 59A-12-13C of the Title Insurance Law, which requires homebuyers to purchase title insurance in the county in which the property to be purchased resides. If this requirement (apparently unique to New Mexico) were removed, homebuyers could utilize any of the title firms across the state.

The title industry also argues that bankruptcies by any of its firms would ultimately harm existing customers because it would leave them with no one to collect from if a title defect was later discovered.

Here it is important to understand that title insurance duties and premiums are split between a

local title agent, who performs the title search and the escrow functions, and a national title insurance underwriter, who ultimately insures the risk and is liable if there is a title claim. Nationwide, five title insurance underwriting companies control 93% of the market. They are multi-billion dollar corporations that have been consistently profitable and enjoy financial strength ratings ranging from AA- to A-, according to Fitch Ratings. They are unlikely to go bankrupt any time soon.

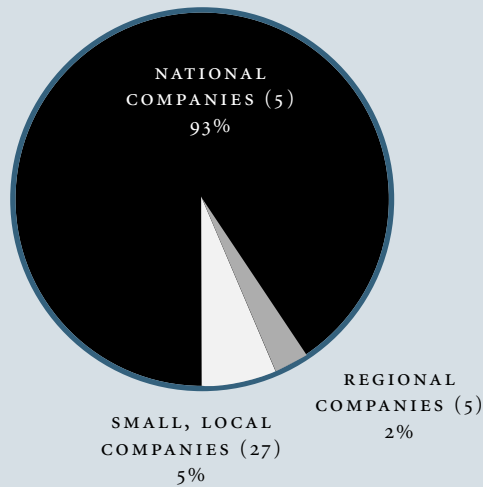
This financial stability is confirmed by Greg Stephens, President of the New Mexico Land Title Association, who wrote in a fall 2006 private letter to the national title insurance underwriters: "the state's methodology of rate making that we've had established for many years...you know full well has been **EXTREMELY** profitable for your companies." (*emphasis in original*)

Even if any title insurance companies were to go bankrupt, consumers would be protected by New Mexico's Title Insurance Guaranty Fund. Safeguarding this fund is a much more appropriate regulatory function for government than setting



A mother and child outside their home in Questa, New Mexico, 1939. Photo by Russell Lee, Courtesy Library of Congress, #LC-USF34-034242-D.

Concentration of the Title Insurance Industry



The percentage of total title insurance industry income earned by the five large national title insurers (Fidelity National, First American, LandAmerica, Old Republic and Stewart Title) in 2006, compared to the 32 regional and small title insurers.

Source: Fitch Ratings, "Review & Outlook 2005–2006: U.S. Title Insurance," December 2005.

prices for the industry. (Only a modest fund is required since the industry's loss ratio is only 5.1%.)

The argument against competition in the title insurance industry is clearly contradicted by the experience of the rest of the insurance industry in America. They set prices for their own policies and products and have earned healthy profits. In fact, the title industry itself has prospered in the free market both in other states (e.g. Illinois, Indiana, and Hawaii) and Canada. If free enterprise already works for the rest of the insurance industry across America, surely it can work for the title insurance industry here in New Mexico.

Thus, the first step in making title insurance more affordable for New Mexico homebuyers is to end government rate setting and allow the free market to determine prices. The title insurance industry in New Mexico should be regulated just like other lines of insurance, where the government's involvement is limited to licensing industry employees, providing oversight of industry practices, and managing the Title Insurance Guaranty Fund.

How much money might this save for New Mexico homebuyers who are currently overpaying for title insurance? Professors Joseph & David Eaton, authors of *The American Title Insurance Industry: How a Cartel Fleeces the American Consumer* (NYU Press, 2007), conclude that "deregulation would probably reduce the rates by a good deal more than 30.6%."

Their calculation is supported by the history of deregulation in the airline and long-distance phone service markets, where prices fell 37% and 73% respectively, according to Consumer Reports.

In 2006, the title insurance industry collected \$133,583,787 in premiums in New Mexico, according to Chuck Denton, the Title Insurance Bureau Chief at the PRC. If the free market reduced title insurance prices by just 30% in New Mexico, homebuyers would save at least \$40 million annually.

These savings would reduce closing costs and put money back in the pockets of homebuyers who could then invest it in new appliances like refrigerators, washers, and dryers, and repairs on their new homes. That, in turn, would strengthen the economy and create jobs for New Mexico carpenters, electricians, and roofers, among others.

SOLVING MARKET FAILURE: LEVERAGING LENDERS' KNOWLEDGE AND PURCHASING POWER

Abolishing New Mexico's monopoly pricing scheme is only the first step to solving the problem of high title insurance costs. As Professors Joseph & David Eaton have documented in their comprehensive study, even in states that permit market competition, title insurers engage in collusive and cartel-like practices to keep the prices high.

The reason they are able to do so is that the title insurance market suffers from a severe market failure: the people who buy it know almost nothing about it.

Homebuyers purchase title insurance only a handful of times in their lives – when they buy a new home or refinance a mortgage – and they almost never focus on title insurance before closing. Syndicated real estate columnist Kenneth Harney quotes one mortgage broker as describing homebuyers at closing as “in a total daze – they are signing everything you put in front of them.” To the extent homebuyers ever focus on title insurance, it appears to be a relatively small expense compared to the total cost of the home or mortgage – even though it represents nearly a quarter of an average New Mexican's monthly paycheck.

As a result, title insurers view their true clients not as the homebuyers who pay for the policies, but rather as the realtors, bankers, mortgage brokers, and homebuilders (the “producers” in title insurance lingo), whose recommendations homebuyers are almost certain to follow.

J. Summary of Borrower's Transaction

J. Summary of Borrower's Transaction	
100. Gross Amount Due from	I.. Settlement Charges
101. Contract Sales Price	700. Total Sales/Broker's Commission based
102. Personal Property	Division of Commission (line 700) as
103. Settlement Charges to B	701.
104.	702.
105.	703. Commission Paid at Settlement
Adjustments for items paid	704. 1/2 Gross Receipts tax on commission
106. City property taxes	705. 1/2 Gross Receipts tax on commission
107. County property taxes	706.
108. Assessment Taxes	800. Items Payable in Connection with Loan
109. School property taxes	801. Loan Origination Fee %
110. Other	802. Loan Discount %
111. Other taxes	803. Appraisal Fee
112.	804. Credit Report
113.	805. Lender's Inspection Fee
114.	806. Mortgage Insurance Application
115.	807. Assumption Fee
116.	808. Per Premium(PUC)by Lender
120. Gross Amount Due From	809. Funding Fee/UPMIP
200. Amounts Paid By Or for	810. Tax Service Fee
201. Deposit or earnest mon	811. Lender's Administration
202. Principal amount of new	1100. Title Charges
203. Existing loan(s) taken s	1101. Settlement or closing fee
204. Commitment fee	1102. Power of Attorney
205. Broker Credit for Closi	1103. Title examination
206.	1104. Title insurance binder
207.	1105. Document retrieval E-docs fee
208.	1106. Notary fees
209.	1107. Attorney's fees
Adjustments for items unpa	(includes above items numbers:
210. City property taxes	1108. Title insurance
211. County property taxes	(includes above items numbers:
212. Assessment Taxes	1109. Lender's coverage
213. School property taxes	1110. Owner's coverage
214. Other	1111. Escrow fee
215. Other taxes	1112. Commitment/Binder
216.	1113. Mech Lien- w/ evidence priorit
217.	1114. Envir Prot Lien Endorsement
218.	1115. Named Insured Endorsement
219.	1300. Additional Settlement Charges
220. Total Paid By/For Borr	1301. Improvement Location Report
300. Cash At Settlement Fr	1302. Pest Inspection
301. Gross Amount due from	1303. FedEx Fees
302. Less amounts paid by/fo	1304. Cashier's check for payoff
303. Cash From Borrower	1400. Total Settlement Charges (enter on line
Section 5 of the Real Estate	I have carefully reviewed the HUD-1 Settlement
following: • HUD must deve	disbursements made on my account or by me in
borrowing money to financ	
understand the nature and co	

Excerpt of HUD Settlement Statement

Title insurance is just one in a long and complex list of charges homebuyers face at closing.

This creates a mismatch between the parties who are choosing the title insurer (producers) and the parties who are actually paying for the insurance (homebuyers). Title insurers therefore have a perverse incentive to market themselves to producers. In some states they have done so by paying direct rebates to producers or by picking up the tab for office parties, open houses, and even ski trips, according to a 2005 article in Kiplinger's Personal Finance Magazine.

Because homebuyers ultimately bear the cost of these marketing practices, both federal and state laws have attempted to limit or prohibit them.

In 1974, Congress passed the Real Estate Settlement Procedures Act (RESPA), which made it illegal for title insurers to pay referral fees. States were permitted to supplement RESPA with their own, tougher measures, and many states chose to do so, enacting regulations that range from additional disclosure requirements to outright prohibitions on payments of any sort between title insurers and lenders.

New Mexico's own regulations currently limit monetary and in-kind payments from title insurers to producers, and restrict title insurers' ability to pay for open houses, meals, or company parties, engage in joint advertising, or provide below-cost continuing education courses for realtors or builders.

Despite the federal and state regulations, title insurance agencies in various states have developed and exploited one loophole after another, such as establishing "affiliated business arrangements" with lenders (because "in-house" referrals are exempted from RESPA), or engaging in "captive reinsurance," where the title companies return as much as half



A couple on the porch of their home in Colfax County, New Mexico. Photo courtesy Palace of the Governors (MNM/DCA), #015125.

of the insurance premium to homebuilders to "reinsure" the policies. One strategy targeted by California reformers is the practice of title insurers renting office space from the builders and bankers that refer business to them, often at above-market prices.

The federal fine of \$10,000 per violation has not deterred such abuses, in part because the Department of Housing & Urban Development (HUD) has never had the resources to properly enforce the law, and in part because violating the law is so lucrative. According to Norman Williams, spokesman for the California Department of Insurance, title insurers view a fine as "the cost of doing business, and it's minuscule compared to what they bring in."

As of 2005, HUD had over 60 active investigations into RESPA violations by title insurance companies, and nearly every state in the country was pursuing its own independent investigation. Recent major enforcement actions against the five largest title insurance companies have included:

- In 2005, Colorado insurance commissioners levied \$24 million in fines against First American Title Insurance Company for illegal rebates to builders who referred buyers to the company. New Mexico homebuyers received \$635,123 of that nationwide settlement. (First American's chief regulatory attorney characterized the payment not as a fine, but rather as a "voluntary disgorgement of profits" which "happens all the time in the insurance industry.")
- That same year, Old Republic Title Company paid \$50 million to the City and County of San Francisco to settle a civil suit alleging the company had charged fees for services that were never performed (consumers received \$14.8 million in refunds).
- Also in 2005, Fidelity National Title Insurance Company paid \$3.2 million in fines and refunds to 10,000 Florida residents, while Stewart Title of California was fined \$750,000 for illegal rebating activity.
- In 2006, LandAmerica agreed to pay \$4.5 million to settle charges of illegal kickbacks to lenders in California (\$2.6 million was refunded to customers) and \$3 million to settle similar charges in Nevada.

Tough enforcement measures alone will never eliminate these practices in the title insurance industry, because enforcement does not address the root cause of the problem: the wrong party is being forced to buy title insurance.

The solution is to convince lenders, rather than homebuyers, to purchase lender's title insurance policies. At the most basic level, this reform is a



Lydia Trujillo and her son in front of their home in Nambe, New Mexico, 2007.

matter of common sense and fairness, since it is the lender's investment that is being protected by the policy, not the homebuyer's.

Lenders are also much more knowledgeable about title insurance than homebuyers. They participate in thousands of transactions each year, which provides them with the information and experience needed to compare different policies and find the best possible deal (once price competition is legal). In addition, lenders can negotiate to purchase policies in bulk for their many clients, further lowering the costs.

Lenders will, of course, ultimately pass along the cost of title insurance to homebuyers. However, lenders have a powerful incentive to keep those costs as low as possible. The lower the closing costs, the easier it is for buyers to afford that new house or mortgage refinancing. This could induce

lenders to leverage their purchasing power and provide less expensive title insurance policies as an incentive for homebuyers to take out mortgages with them.

In 1971, U.S. Senator William Proxmire introduced the Title Charge Reduction Act, which would have required lenders to purchase their own title insurance policies. Business experts such as Jack Guttentag, Professor Emeritus of Finance at the Wharton School of Business at the University of Pennsylvania, have spent many years championing this reform. Unfortunately, neither the states nor the federal government have yet been able to overcome the political force of the title insurance companies and enact this crucial consumer protection measure.

As a result, it is impossible to determine exactly how much this reform will save New Mexico homebuyers. However, as Professor Guttentag notes, the fact that title insurers have routinely paid as much as 50% of their premiums to producers indicates that the savings will be substantial. Persuading lenders to buy lender's policies will end the severe market failure in the title insurance industry and save homebuyers millions of dollars in excessive closing costs.



Family with horses outside their adobe home in New Mexico. Photo by Iona McCullough, Courtesy Palace of the Governors (MNM/DCA), #138851.

ENDING TITLE INSURERS' IMMUNITY FROM NEGLIGENCE LIABILITY

Beyond the high price of title insurance in New Mexico, there are serious questions about how much protection it actually affords homebuyers and business owners.

In 1999, Senate Bill 297 was enacted establishing the Title Insurance Guaranty Fund. Buried in the 15 pages of technical language was a small provision that, like the “uniform premiums” in the original Title Insurance Law, went largely unnoticed by the media and legislators. The provision read:

“The New Mexico Title Insurance Law is not intended and should not be construed to create any duty to search and examine that runs to the benefit of, or to create any right or cause of action in favor of, any person other than a title insurer.”

Translated from the legalese, this provision meant that title insurers could not be sued for failing to perform a reasonable search of the public record to look for problems with the title – the very service they are paid to perform.

Kurt Faust was one of the first to discover how harmful this new law could be. Faust and his business partners had bought a piece of land on Pacheco Street in Santa Fe to build office space for Tierra Concepts Inc., their architecture and construction firm. However, their title insurance company failed to reveal a height restriction that had been imposed upon the lot, and Faust's office building was 10 feet too tall. Halfway through the project, the city halted construction, and Tierra Concepts teetered on the edge of bankruptcy until



Women plastering an adobe home in Paguete, New Mexico, near Laguna Pueblo, 1925. Photo by Edward S. Curtis, Courtesy Library of Congress, #LC-USZ62-80166.

Faust negotiated a settlement with the neighborhood association in return for an exception to the height restriction. By then, the title insurer's error had cost Faust more than \$140,000, and he sued the company to recover those damages.

Before the enactment of Senate Bill 297, New Mexico courts had upheld the title insurers' responsibility for protecting homebuyers from title defects – a policy embraced by courts in many

other states. In *Ruiz v. Garcia*, a 1993 case, the New Mexico Supreme Court ruled that title insurance companies owed a duty to both the buyers and sellers of property to perform a reasonable search of the title and communicate any defects it found. If the insurer failed to do so, the buyer or seller had a legal right to recover any damages caused by the title insurer's error.

However, with the amended law in place, Santa Fe District Judge James Hall was forced to throw out Faust's case. He stated that, "were it not for this statutory provision, I think the claim would be a valid one, but I believe that the statute precludes it."

Title insurers have defended the amended law, arguing that it is needed to prevent homebuyers from "double dipping"—receiving a payout under the insurance policy and then recovering damages as well.

However, as Faust's attorney puts it, "the way the statute reads now, the claimant doesn't get a first dip." The standard policies offered by the title insurers are rife with exclusions—title problems ranging from easements to unpatented mining claims to boundary conflicts with neighboring properties are not covered. Only those homebuyers savvy enough to request a policy with better coverage (and pay a slightly higher premium) receive a policy that actually insures against these common title defects.

In addition, very few title insurance policies actually insure the full market value of a home or business, since the policies cover only the sales price of the property, and most properties increase in

value over time. This means that even if the policy pays out to its full extent, some of the loss will fall on the homebuyer.

Finally, in those cases where only a lender's policy, not an owner's policy, is purchased, the buyer receives no protection at all.

Since the full ramifications of the title insurers' negligence immunity have come to light, several reform-minded members of the state legislature have introduced legislation to repeal it. In 2005, bills to restore title insurers' liability for negligent searches were introduced by Representative Mimi Stewart (D-Bernalillo), Senator Carroll Leavell (R-Eddy & Lea), and Representative Debbie Rodella (D-Rio Arriba, Sandoval & Taos). In 2007, legislation was introduced by Representative Stewart and Senator Cisco McSorley (D-Bernalillo) seeking to accomplish the same goal. Unfortunately, none of these bills managed to pass either chamber of the legislature, demonstrating the enormous political power of the title insurance industry in New Mexico.

As long as the law continues to exempt title insurers from their own negligence, homebuyers will pay the price if their insurer misses a glaring and costly title defect. To ensure that New Mexico homebuyers receive the protection they are paying for, this immunity should be repealed, and title insurers should be required to take responsibility for their negligent errors just like other businesses.

THE \$40 MILLION OPPORTUNITY

Homeownership is out of the reach of too many average New Mexicans who work hard and play by the rules. In 2005, the cost of housing (e.g. mortgage payments) in New Mexico totaled nearly a third of a homeowner's monthly income, according to the U.S. Census Bureau. More than 12% of New Mexico families spent over half of their incomes on housing costs. Making homeownership more accessible to working families benefits all New Mexicans by creating a better environment for children, a more engaged citizenry, less crime, and a broader middle class.

The high cost of title insurance is one of the largest obstacles to the hundreds of thousands of New Mexicans who are striving to become homeowners. In many cases, these are the same young, working families who have to overcome numerous other challenges in purchasing a home.

Excessive title insurance costs also harm New Mexico's business environment. A company seeking to purchase a \$10 million office park, for example, must pay more than \$21,000 for title insurance under the state's current rate schedule, even though the risk faced by the title insurer is extremely low.

The Legislature, Governor Bill Richardson and the New Mexico Mortgage Finance Authority, among others, understand the urgency of promoting economic development in New Mexico and making homes more affordable. They have taken significant steps to address these challenges by enacting policies like the 2005 Housing Trust Fund Act.

Another big step toward maximizing homeownership and spurring economic development in New



Mabel & Herman Johnson with their children outside the family farmhouse in Lake Arthur, New Mexico, 1951. Photo courtesy of the Johnson family.

Mexico would be to significantly reduce the excessive cost of title insurance. Our proposal would: **1)** allow the market, instead of the government, to set the price of title insurance; **2)** limit regulation to licensing title professionals, administering the Title Insurance Guaranty Fund, and policing abusive practices; **3)** correct the title insurance market failure by encouraging lenders to leverage their market clout and purchase title insurance policies on behalf of their consumers; and **4)** end the title insurers' immunity from negligence liability.

Together, we call these four recommendations "the \$40 million opportunity" because of the savings they would produce for New Mexico homebuyers. Such an approach is certainly better for New Mexicans than the status quo, yet at the same time is more moderate than the radical reform approach of Iowa, the only state to have succeeded in keeping title insurance affordable.

Since there is no economic or public policy basis on which to continue to exempt the title insurance premiums from free market competition, some might wonder why it has not been reformed before in New Mexico.

The answer has to do with the nature of title insurance and the enormous disparity between the resources of the industry and those of consumers. For the homebuyer, title insurance is complicated, mandatory (with a mortgage), and while expensive, it appears small relative to the cost of the real estate transaction.

Meanwhile, the industry, its trade group (the New Mexico Land Title Association), and its lobbyists understand the system and focus their enormous resources and political firepower on maintaining the status quo.

In 1999, Superintendent of Insurance Don Letherer came in with a reform agenda and 36 years of experience in the insurance industry. He reduced title insurance rates his first year in office and proposed to reduce them again the following year. He also prepared a legislative memorial calling for a study of title insurance reforms. One week before the 2001 legislative session convened, Letherer was forced to resign.

Letherer was succeeded in the Superintendent's position by Eric Serna, who increased title insurance premiums. Serna left the position after questions were raised about some of his dealings, including the fact that the title industry lavished \$47,950 on the Con Alma Foundation while Serna was in charge of both the foundation and the title rate schedule.

Not surprisingly, New Mexico's title insurance law is the envy of the title industry in other states.

THE IOWA ALTERNATIVE

In 1947, the Iowa legislature passed a law banning the sale of title insurance in the state. Rather than trying to reform the private system, Iowa went into the title guarantee business itself.

Today, the Iowa Title Guaranty system is widely lauded for its efficiency and low costs. As of 2006, any property valued up to \$500,000 can receive a title guarantee for \$110. For more expensive properties, additional coverage costs \$1 for every \$1,000 of value. Policies for mortgage refinancings are \$90.

Iowa manages to keep its prices so low by basing its premiums on the actual administrative costs of checking for title defects. Its claim ratio has been similar to that faced by private insurers elsewhere: of the approximately 500,000 titles the state has insured, only 28 have generated losses.

By 2006, Iowa's state-run program had not only saved Iowa homebuyers hundreds of millions of dollars in closing costs, compared to buyers in other states, but had also generated \$35 million in profits that have gone to the Iowa Housing Trust Fund, which provides financial support for first-time and low-income homebuyers.

Think New Mexico believes that it would be preferable to reform New Mexico's title insurance system with free market competition rather than increased state involvement, and that the modest proposals we present in this report will successfully lower title insurance costs and make homeownership more attractive and affordable for New Mexico families. However, the Iowa system presents a promising, if more radical, alternative reform.

This past year, the title industry in Missouri sought to pass a law modeled on New Mexico's.

Their effort was ultimately defeated, in part due to the strong opposition of realtors and home builders. Sam Licklider, a lobbyist for the Missouri Association of Realtors described their position as "one of fairly healthy skepticism that rate setting is the only way to travel." Pat Sullivan, Executive Vice President of the Home Builders Association of Greater St. Louis added that, "Anyone can look at the states that have put in place a state-fixed title insurance rate, and those rates are substantially higher to the consumer."

As Missourians recognized, New Mexico's excessive title costs slow real estate activity and harm the lending, real estate, and home building communities.

Champions of reform are emerging in New Mexico as well, such as the legislators mentioned in the previous section of this report. Another courageous example is Ben Ray Lujan Jr., the new Chair of the Public Regulation Commission. In a May 2, 2007 article about title insurance rates in New Mexico, he told the *Santa Fe New Mexican*, "I'm tired of the industry setting policy....I'm tired of the industry mandating to us what we are going to do."

Though not yet successful, the work of these reformers underscores the bipartisan appeal of this solution. Republicans particularly favor a free market solution, while Democrats are particularly supportive of protecting consumers.

For example, in 2002 Senator Phil Gramm (R-Texas) said: "I know how we can cut the initial, up-front cost of buying a house by between a quarter and a third. The way to do it is to do something about title insurance. We could probably do more to promote home ownership by fixing this problem than by any increase in appropriations for housing." Meanwhile, California Democratic Lt. Governor and former state Insurance Commissioner John Garamendi states, "Nothing less than the American Dream is at stake here. For most of us, home ownership is the key to our financial security. Increasing the middleman costs of home acquisition [like title insurance] exacts a toll on home ownership."

The battle over title insurance reform ultimately pits an idea whose time has come against a very powerful special interest with lots of money, lobbyists, and political connections. Hopefully, traditional New Mexico values like integrity, self-reliance, and fairness will prevail.

TAKE ACTION!

Want to join Think New Mexico's efforts to reform title insurance? Visit our website at www.thinknewmexico.org and sign up for email action alerts to find out how you can help!

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“Dad began construction of our home on West Houghton Street in 1930, shaped from thousands of adobes that he and Grandpa Albert and two of his brothers, Rudy and Willie, made from mud mixed with straw...Uncle Frank Rivera helped to dig the foundation, which was filled with cement mixed in a wheelbarrow. The adobes were then stacked one on top of the other with a thick layer of mud in between....When I think about my home I feel a steady warmth in my heart.”

– Marie Romero Cash, *Tortilla Chronicles: Growing Up in Santa Fe*