

# Continental Law and the Global Financial Crisis

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Round table 1 - 9:00 a.m.

## **What kind of system offers the best security of ownership at reasonable cost? (Land Registration vs. Recording & Insurance)**

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The global financial crisis has thrown into question many legal and regulatory institutions in the United States and other nations of the developed world. Systems and practices which seemed to suffice for decades have exhibited flaws and limitations. Jurists in every nation are casting critical looks at their own legal institutions and comparing them with those of other modern democracies - sometimes for the first time.

In preparing for this panel, we fashioned three questions to focus our discussion.

- Question 1:** Could some institution of preventive justice, such as a civil law notary help prevent consumers from entering to improvident and excessive mortgage transaction?
- Question 2:** Are there practical ways to provide consumers in residential real estate transactions with independent and impartial legal advice and guidance?
- Question 3:** What is the most cost effective means of effectuating residential real estate transactions with a high degree of efficiency and legal certainty?

Maitre Pourciel has addressed [will be addressing] these questions from the standpoint of the civil notary as an institution of preventative civil justice. My remarks will address these three questions collectively in the context of title insurance versus title registration.

Fundamental to the successful functioning of any market for real estate is the system by which ownership and mortgage lien rights in real estate are legally secured. The economic importance of ownership and security interests in real estate is obvious. Systems which provide a high degree of security combined with transparency and responsiveness all at modest cost better further solid economic activity than systems which are less than certain, which are opaque, or which impose unnecessary delay and cost on transaction participants.

Most of the Member States of the European Union maintain land register systems by which title to and liens on real estate can be registered in a public register which then serves as more or less conclusive proof of title. These registers allow an interested party to determine the state of title and any encumbrances on any parcel of real estate rapidly and with a high degree of certainty. In some countries, such as Germany, the entry of a transfer or lien in the land register is constitutive, and actually accomplishes the transfer. In other jurisdictions, such as France, the entry in the register is declarative of a conveyance that has taken place by an instrument prepared prior to re-registration. In either case, once title registered in the name of a particular owner it is practically indefeasible against all persons.

In the various United States the predominant system for securing titles to real estate is by recording instruments of conveyance in local registries of deeds. These registries merely contain indexed copies of the conveyance instruments. There is no registration of ownership as such. One can infer ownership of real estate by examining a chain of conveyances to the person in possession of the property that appear to refer to the same parcel back for a period of 40 or 60 years.

Traditionally, when ownership and financing of real estate was a local affair, purchasers and banks would rely on reports of the state of title by local attorneys who had examined relevant instruments in the local registry of deeds. In recent years the widespread practice of bundling, selling and securitizing residential and other mortgages has generated a need to standardize title risks in large numbers of individual loans. This has made the use of title insurance, by which an insurance company contracts to indemnify an owner or mortgagee against most defects of title to a particular parcel of real estate, practically universal. Title insurance is typically purchased by the purchaser or borrower at the time of a real estate transaction for his own protection or the protection of his mortgagee.

It should be noted that some American states have adopted title registration systems similar to those in Europe. In Massachusetts, for example, more than 20% of the land area of the state is registered. There are nine other states which currently provide the option of land registration.

Conveyance of parcels which have been registered does not require a title examination or title insurance from the standpoint of risk, although curiously enough, the secondary market for mortgages requires that even registered titles be insured in the interest of providing a uniform product.

It is safe to say that for the last 100 years every serious analysis of land title registration versus conveyance recording with title insurance has found that land registration provides much greater security, transparency and flexibility of function at a lower cost to transaction participants than the title insurance system. This has been confirmed both theoretically and by empirical studies, the latter most recently in 2007. The theoretical superiority of registration of ownership interests in land, as is the case with ships, aircraft and other kinds of valuable personal property, is patent. The practical difference between consulting a one-page listing in a land register and laboriously searching for back conveyances over a period of time without logical certainty of ownership is also obvious.

Title insurance provides only financial indemnity in a specified amount in the case of title defect. Registration guarantees ownership, usually with a right of recourse against the state if the registration is defective. Buyers and mortgagors in countries with registered titles need not and do not pay title insurance premiums at all.

Not only is title insurance an inferior substitute for a system that provides positive proof of title, but the widespread use of title insurance in the United States has generated serious abuses which have resulted in unnecessary costs and risks to real estate transaction participants.

Although title insurance is provided by private insurers, there is no competitive market for title insurance products. Because a title insurance policy is typically provided by the person or firm which handles the underlying real estate conveyance, there is no real opportunity for consumers - home buyers in particular - to shop around for the cheapest rates. In fact, there is what is called reverse competition, since the title insurers pay commissions on the title policies to the lawyers or title companies which issue them in connection with transactions they are handling. The competition among the companies is to provide the largest "commission" to these middlemen, sometimes as high as 80% of the premium paid, thus driving up the rates rather than reducing them.

Title insurance policies only indemnify the identified policy holder against failures or defects in title in the insured real estate and only up to a given maximum amount of loss. There is no indemnity for incidental losses in connection with title defects such as moving expenses, business interruption, or the like. Nor can title insurance policies be passed on from one owner to another. Each time a property is sold a new policy has to be issued. The mortgagee always

requires a new title policy made payable to it. If the owner wishes to be protected to the extent of his own investment in the property, he must obtain his own "owner's policy" and pay a premium therefor. It is easy to see that this can and does result in redundant coverage, particularly if the land is heavily mortgaged, and a duplication of costs..

Since failures of title to real estate are extremely rare, and even claims on title policies are not frequent, the loss ratio on title policies extremely low. Reports and studies indicate that title insurance companies pay out in losses and claims expense, on the average, no more than 3-5% of the amounts collected as premiums. This low loss ratio has led some insurers to treat title insurance purely as insurance and to issue policies on properties without doing any investigation as to the actual state of title. This has meant that purchasers could not rely on the issuance of a title insurance policy as confirmation of the quality of the underlying title that they were acquiring. All that they were getting was whatever the seller could give them plus a policy of insurance that would indemnify them or their lender in case the title failed.

These and other abuses in the title insurance industry have led to regulation by the various American states. Some states require that a title insurance company actually perform a title examination or have other evidence of good title before issuing a title insurance policy. Many states require that if a title insurance company issues a policy protecting a mortgagee on a particular property, it make an additional policy available to protect the owner at modest additional cost. Most states regulate the maximum premium that can be charged for title insurance. It is significant, though, that in every state the amount of the premium that may be paid in "commissions" to lawyers or other title insurance originators is still very generous, in many states up to 70% or even 80% of the total premium.

From the standpoint of contribution to total transaction costs, systems of land registration appear to be a lower cost solution than the American system of deed recordation and title insurance. An investigation of land transfer transaction costs was undertaken by your speaker in 2006-2008 involving 5 European Union Member States as well as two states of the United States. All of the European countries, namely England, Estonia, France, Germany, and Sweden had land registration systems. Both of the American states, New York and Maine, had deed recordation and title insurance systems.

The study showed that although recording fees in the European countries were generally significantly higher than deed recording fees in the American states, the cost of title insurance in the American states more than made up for the difference and ultimately meant that the American states had the high-cost solution. To give you an order of magnitude, the investigation disclosed that the fee for registering a contract for the purchase of a house for

250,000 Euros in France was 250 Euros. The fee for recording a deed to a house of the same cost in New York was only 27 Euros. However the cost of procuring a insurance policy covering this property in the amount of the purchase price was 853 Euros. So we can see that the American deed recording - title insurance system provides American real estate purchasers less protection at a considerably greater costs than does the land registration system in France. I should add, however, that this comparison includes only the fees to register the transfer of title and not taxes or costs of professional services in connection with the transfer.

The advantage of a land registration system over the American title insurance model will become even greater as electronic submission of documents evolves into the ability to effect re-registration of title by remote access to land registers. In December 2006 your speaker witnessed how a French notary both discharged an existing mortgage and registered a new mortgage on an apartment in Paris all in real time from his office by sophisticated and secure electronic access to the relevant registers. In the words of the English Land Registrar, the ability to effectuate changes to registered title to real estate instantaneously at the time a transaction closes is the "gold standard" in the real estate economy. This is within reach in jurisdictions with modern land register systems. It is impossible, both logically and practically, under the American system.

Why don't we Americans follow the lead of the rest of the modern world and implement land registration? As mentioned above, there was, starting in the 1890's a movement toward land registration in many states. It ultimately never took hold, and in the succeeding decades several states that had introduced land registration gave it up. In others it continues on the books, but is of no practical significance.

The likely answer to this question has three parts. The first is that the model of land registration that was introduced in the US was a judicial model. In order to obtain registration of a parcel the asserted owner had to initiate an expensive judicial proceeding against everyone who could claim any kind of potential interest in the real estate and obtain a court judgment confirming his claim of title. That created a clear cost and expense hurdle to land registration. European countries such as France have had land registration for a long time so that obtaining initial registration of parcels is simply not an issue. In England, where land registration was more or less completed in the 1990s, the registration process was simplified and made administrative, not judicial, in order to spur registrations. Although the result may be that the English land register, particularly with respect to property boundaries, may not be perfect, virtually all the private land is registered.

A second reason why land registration has failed to take root in the US is the fact that it has not been mandatory, but has been offered as an intelligent option for the landowner. However the typical landowner buys or sells a particular parcel only once in a lifetime. No one wants to go to the expense of registering for a single transaction. Again in England, land registration lagged for nearly a century until it was made mandatory on the sale, gift, or inheritance of any piece of property. Once registration became compulsory on all dispositions the volume of registrations greatly increased and almost all remaining unregistered land became registered in a couple of decades.

Finally, a land registration system involves a significant investment of public resources and a cadre of competent civil servants to create and maintain the register as a living public record. Americans are notoriously stingy with public expenditures outside the military. Simply filing away deeds and mortgages, or even scanning them into an electronic database does not require the same kind of effort and expertise as does the maintenance of a comprehensive land register and the effectuation of transfers to change registered ownership. In a sense Americans seem more willing to pay almost 900 Euros to a private insurance company to give partial protection than they would be to pay 223 Euros in public registration fees.

While it is unlikely that the cumbersomeness and high cost of the American land title transfer system have significantly contributed to the subprime mortgage crisis, two things are clear. First is that the many people who paid too much for their houses and borrowed too much to finance them, also paid too much to insure the titles that they were obtaining. Lawyers, title companies, and title insurance companies were among those who profited handsomely from the real estate excesses that led to the downfall of our entire economy. Second, if the United States wishes to be in the forefront of modern real estate economies it is high time that the states or the federal government adopt comprehensive land registration that will guarantee titles and expedite transactions without imposing unnecessary costs on the transacting parties. The rest of the world offers us many excellent examples of how it works and how the transition can be done. It is time that we get going.