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# THE Billion-Dollar Opportunity

BY STEPHEN CRAWFORD

**I**n these challenging times, banks, life insurers, pension funds and other mortgage lenders looking for revenue should search no further than their existing commercial lending groups. Settlement services tied to U.S. commercial mortgage loan closings constitute a multibillion-dollar sub-industry. By creating joint-venture title insurance agencies and using affiliated and preferred vendors, commercial lenders could net significant additional revenue without increasing loan production. ■ The bulk of this revenue would come from capturing title insurance premiums on commercial refinance transactions. Additional revenue could result from mortgage lenders offering customers an optional, all-inclusive price for lender-required settlement services, which would include a reasonable profit for the lender. The Real Estate Settlement Procedures Act (RESPA) is inapplicable to commercial transactions, but lenders would still need to comply with anti-tying regulations and applicable state law.

**Commercial mortgage lenders may be overlooking a revenue opportunity right under their noses. Capturing the income from settlement services associated with their own commercial mortgage closings could be a significant new opportunity.**

## Where's the money?

Banks and other residential mortgage lenders have been selling title insurance through affiliates and joint ventures for years. In fact, many of the nation's largest residential lenders already have affiliated vendor-management companies (VMCs) or joint-venture title agencies that service a large percentage of U.S. residential refinances.

To date, VMCs and other lender-affiliated settlement-service providers have focused their efforts on capturing residential transactions. There is a growing awareness, however, that commercial settlement services are an untapped market for lenders and offer a higher profit margin than residential settlement services.

According to a November 2006 report by Oldwick, New Jersey-based A.M. Best Co. Inc., the leading insurance industry rating agency, underwriting commercial transactions represents the highest profit-margin activity for title insurers.

Only 2 percent to 5 percent of insured transactions produce 20 percent to 25 percent of all title insurance premiums written. (This estimate is based on the 2006 *Pennsylvania Title Insurance Statistical Report* [revised], published by the Title Insurance Rating Bureau of Pennsylvania [TIRBOP], Wayne, Pennsylvania). Between 2 percent and 5 percent of all policy types written in Pennsylvania in 2006 were for insured amounts equal to or greater than \$500,000; these transactions are assumed to involve commercial property and accounted for between 20 percent and 25 percent of title insurance premiums earned in Pennsylvania. Pennsylvania statistics have been extrapolated to estimate total premiums earned on all U.S. commercial transactions, both purchase and refinance. It is likely that similar ratios hold true for other settlement products, including residential vs. commercial appraisals, surveys and property inspections.

In 2007, title insurance premiums earned on U.S. residential and commercial real estate transactions were \$13.9 billion, according to the Washington, D.C.-based American Land Title Association (ALTA). (This amount does not include premiums earned in Canada, Mexico, Guam, Puerto Rico, U.S. Virgin Islands, American Samoa or "aggregate/other" jurisdictions.) Approximately 20 percent to 25 percent—or \$2.8 billion to \$3.5 billion—resulted from commercial transactions. (This estimate is based on the 2006 Pennsylvania Title Insurance Statistical Report.)

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But how much of this potential revenue could mortgage lenders capture? Excluding purchase transactions, which are notoriously difficult to control, U.S. commercial refinance transactions generate approximately \$1.5 billion in title insurance premiums annually, according to an estimate based on the 2006 *Pennsylvania Title Insurance Statistical Report*.

By implementing some or all of the strategies outlined in this article, lender-owned title insurance agencies and VMCs could conceivably capture a large percentage of these premium dollars. Commercial lenders could also earn additional fee income by offering customers one-stop shopping for all other settlement services required to close commercial loans.

## Six ways for lenders to capture commercial settlement fees

Lenders have several options for driving commercial settlement services to affiliates and preferred vendors without violating anti-tying laws. Under anti-tying restrictions, it is illegal for a bank to extend credit on the "condition or requirement" that customers obtain some additional product or service (such as title insurance) from the bank or its affiliates. Nevertheless, there are important exceptions to anti-tying restrictions and powers granted in the Gramm-Leach-Bliley Act (GLBA) that are effective in winning business.

The fact that RESPA is inapplicable to commercial mortgage loan settlements should be a significant source of

comfort to commercial mortgage lenders concerned about compliance. Commercial settlement services are largely unregulated at the federal and state levels. Further, this author knows of no significant federal or state investigation involving lender-referred commercial settlement services.

(RESPA only applies to "federally related mortgage loans," which are secured by a mortgage on a one-to-four-family residence, including a condominium or a cooperative, and that is either 1) made by a lender insured or regulated by the federal government; 2) made, insured, guaranteed or supplemented by an officer or agency of the federal government or connected to a housing program administered by an officer or agency of the federal government; or 3) made by a lender intending to sell it to Fannie Mae, Freddie Mac or Ginnie Mae.)

### METHOD ONE: Opt-out/bank-approved provider

The Federal Reserve has approved the use of opt-out language where a bank lists its affiliate as the "default" or "pre-approved" provider of services required in connection with a

mortgage loan. An opt-out provision should be used in the earliest paperwork signed by the borrower, normally a mortgage loan application or commitment, and it should include language similar to the following:

*[Lender] has pre-approved the following vendors (the "approved providers") to provide title insurance and escrow services for the subject loan: [list affiliated vendors] . . . Alternative title insurance and escrow vendors must be licensed, insured and qualified to issue title insurance in accordance with the requirements attached hereto. To engage an alternative title insurance or escrow agent, borrower and applicant must, upon submission of this application, request approval of the vendor and certify that it has no direct or indirect financial interest in the vendor.*

A lender can individually qualify third-party vendors chosen by a borrower as long as the lender applies objective and reasonable criteria in doing so (and applies the same criteria to all third-party vendors on a non-discriminatory basis, including its affiliated vendors). In implementing an opt-out program, banks should provide a mechanism for customers to choose an alternative provider, be highly reasonable in their approval of non-affiliated vendors and promulgate objective standards for approval of these vendors.

The use of affiliated or preferred vendors can also significantly decrease the time to closing, because they are much more familiar with the lender's underwriting policy than borrower-chosen vendors.

#### METHOD TWO: *Opt-in/packaged products discount*

Offering commercial mortgage loan customers an all-inclusive, one-charge settlement package can be an effective means of streamlining the closing process and earning additional fees. Settlement services can be made available separately or be aggregated by lenders as part of a discounted package. This forward-looking practice, known as "packaging" or "bundling" settlement services, was first introduced in the residential real estate market following the Department of Housing and Urban Development's (HUD's) 2002 proposed revisions to RESPA regulations.

Packages can be offered at a guaranteed price (including a reasonable profit for the lender) and at a discount from the cost of purchasing settlement services separately. But how can lenders offer a discounted package and still increase revenue? This result can be achieved because some or all of the

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underlying services are being provided by affiliated or preferred vendors.

EXAMPLE: A lender originates a \$10 million mortgage loan for sale to a conduit, and requests a loan policy of title insurance with all required secondary market endorsements. The loan is secured by real estate located in Ohio. Without a commercial joint-venture title agency, the title insurance underwriter would earn approximately \$33,000 in title insurance premiums. If the lender has a joint-venture title agency managed by a 50 percent partner, the lender (through its affiliate) could capture \$14,000 of that premium.

Assume further that the cost of all required settlement services—including title insurance, appraisal, survey and environmental site assessment—is \$63,000. Because the package includes the use of the lender's joint-venture title agency, the package is offered to the borrower for \$58,000. By choosing the package, the borrower is achieving a cost savings of \$5,000 and the lender has increased its overall fee income by \$9,000 (\$14,000 in title insurance premiums earned through its affiliate less \$5,000 package discount to the borrower, not allocated to any product).

VARIATION NO. 1: The lender offers the package at its retail price of \$63,000 but discounts its loan origination fee by \$5,000.

VARIATION NO. 2: The lender offers the package for \$69,300 (\$63,000 plus an additional fee of \$6,300). The additional fee is 10 percent of the underlying cost of third-party charges and is earned for vendor-management services and/or underwriting a guaranteed price on the package on the package.

Lenders can also use their buying leverage to obtain cost savings from third-party providers. These savings can either be passed on to the customers or retained as profit, as in the following example:

VARIATION NO. 3: The lender's counsel offers to document and close the loan for a fixed fee of \$6,000 where the lender purchases the loan policy of title insurance from the attorney's affiliated title insurance agency. The market rate for legal fees on a loan of this size and complexity is normally \$7,500. The lender includes the lender counsel legal fees in the package, and either reduces the overall price of the package by \$1,500 or increases its own discretionary fees by \$1,500 (for specified services rendered) to bring the cost of the package up to retail or market price.

Package or preferred vendor discounts should not be allocated to any product or combination of products in the pack-

**Figure 1**

**Sample Form:  
Opt-In/Packaged Products**

<b>Please choose one option for lender-related services connected to your mortgage loan:</b>	
<input type="checkbox"/>	I wish to purchase <i>lender-related services</i> required in connection with the loan in a package at a [guaranteed or firm estimate (within 10 percent) or discounted] cost of \$____.* This price includes the following products and services: <ul style="list-style-type: none"> <li>• Application</li> <li>• Origination</li> <li>• Underwriting</li> <li>• Appraisal</li> <li>• Credit report</li> <li>• Document preparation</li> <li>• Lender's attorneys' fees</li> </ul>
<input type="checkbox"/>	I wish to purchase <i>lender-related services</i> separately.
<input type="checkbox"/>	The cost of these services will be charged at the time of settlement.**
<b>Please choose one option for real estate-related services connected to your mortgage loan:</b>	
<input type="checkbox"/>	I wish to purchase <i>real estate-related services</i> required in connection with the loan in a package at a [guaranteed or firm estimate (within 10 percent) or discounted] cost of \$____.* This price includes the following products and services: <ul style="list-style-type: none"> <li>• Survey</li> <li>• Zoning report</li> <li>• Loan policy of title insurance</li> <li>• Escrow services</li> <li>• Environmental site assessment</li> <li>• Flood determination</li> <li>• Property inspection</li> </ul>
<input type="checkbox"/>	I wish to purchase <i>real estate-related services</i> separately.
<input type="checkbox"/>	The cost of these services will be charged at the time of settlement.**
<p>*If discounted, add: "This represents an approximate savings of \$____. Lender has obtained this price on my behalf from lender, lender's affiliates and/or lender's pre-approved vendors."</p> <p>**If discounted, add: "I understand that these services may cost approximately \$____ more when purchased separately, and that use of alternative vendors for any of the above products or services may extend the time to closing."</p>	
SOURCE: CRAWFORD LAW CO. LPA	

insurance). The sale of multiple bundled products to a customer does not, however, violate anti-tying laws if the customer voluntarily decides to purchase the package.

To simplify pricing, lenders may wish to offer two separate price quotes: one for *lender-related services* (e.g., application, origination, underwriting, appraisal, credit report, document preparation and lender's attorneys' fees) and another for *real estate-related services* (e.g., survey, zoning report, loan policy of title insurance, escrow services, environmental site assessment, flood determination, property inspection and so on).

See Figure 1 for sample opt-in language for a commercial loan application or commitment.

Mortgage lenders should identify any affiliated vendors providing services for the package on a written disclosure statement presented to the borrower with the application. The disclosure should be signed by the borrower and maintained in the loan file.

Choosing a package of settlement services relieves borrowers of the increasingly burdensome task of delivering third-party reports that comply with the lender's underwriting guidelines (especially for conduit, Fannie Mae or other loans destined for the secondary market). In exchange for their increased responsibility over vendors, lenders can include a reasonable charge to borrowers for transaction-management services. This fee can be justified, even to cost-conscious clients, as simplifying and shortening the closing process. The charge could be separately disclosed or, more typically, embedded in the price of the package.

Banks wishing to offer a guaranteed price or a discount on bundled products should obtain regulatory approval from the Office of the Comptroller of the Currency (OCC) (national charters), Office of Thrift Supervision (OTS) (savings-and-loans and savings banks), the Federal Reserve (state-chartered Federal Reserve members) or Federal Deposit Insurance Corporation (FDIC) (national banks).

**METHOD THREE: Paying cross-sell/referral fees**

A bank may pay a referral fee to an employee for referring title insurance business to its affiliate as long as the employee does not counsel customers in insurance matters and the referral fee is not conditioned on the actual purchase of insurance by the customer (i.e., the referral fee is paid regardless of whether the deal closes or title insurance is actually purchased), according to GLBA. (State laws that contradict this principle are pre-empted by federal law.)

Referral-fee payments should come from bank funds designated for incentive-based payments to employees—not from title agency funds. State laws purporting to prohibit banks from paying employees for making referrals to insurance affiliates are pre-empted by GLBA, and unenforceable. Lender-employed commercial closing personnel, often ineligible for other incentives, may be highly motivated to cross-sell bank products by a well-structured referral-fee program.

In recent years, federal and state investigations of the title insurance industry have focused on alleged violations of RESPA by title insurance underwriters, agents and other real estate market participants. These investigations have unnerved many lenders unnecessarily. Regulation X, implementing RESPA, states unequivocally that Section 8 of RESPA (prohibiting kick-

age, and the customer should be free to accept or reject the package. These types of arrangements are common in relationship banking and are not prohibited by anti-tying restrictions.

For a tying violation to occur, a bank must impose a condition or requirement that a customer buy the desired product (e.g., mortgage loan), as well as another product (e.g., title

backs and referral fees) permits “an employer’s payment to its own employees for any referral activities.”

Banks and other residential mortgage lenders reluctant to implement a referral-fee program should consider doing so with regulatory approval from the supervisory agencies listed earlier. A program of this kind could significantly increase the percentage of bank-originated transactions captured by affiliated VMCs or joint-venture title agencies.

A referral-fee program for commercial title insurance can be implemented without regulatory approval. Commercial lenders should take additional comfort that referral-fee programs are expressly permitted even under RESPA, which is wholly inapplicable to commercial transactions.

**METHOD FOUR: *Fee-income credit***

Giving commercial loan officers and loan groups “credit” for the fee income generated from cross-selling bank products is an important incentive. Getting credit for the fee income generated by their sale will help achieve “buy in” from loan officers and loan groups, many of whom have relationships with title insurance agents.

**EXAMPLE:** Using the example here, the lender (through its affiliate) has increased revenue by \$14,000 (or \$9,000 if a discounted package is offered). This additional revenue is then “credited” toward the originating loan officer’s annual fee-income goal.

**EXAMPLE:** If a referral-fee program (Method Three) were also in place, the bank’s closing coordinator would earn a cross-sell fee in accordance with a program schedule (say, \$500 for the referral of a \$10 million loan policy of title insurance to a bank affiliate). This referral fee would reduce the lender’s net fee income, but increase its “capture rate”—the percentage of transactions serviced by the bank joint-venture title agency—by generating more referrals to its affiliate.

**METHOD FIVE: *Mixed-product arrangement***

Here, the customer seeks a bank product such as a commercial loan, but the bank determines that offering the loan

as a stand-alone product is not sufficiently profitable to justify committing its capital. Rather than simply decline to extend the loan, however, the bank offers the customer a choice of other products offered by the bank and/or its affiliates, and informs the customer that if he or she chooses an additional product from the menu of choices, the relationship would be sufficiently profitable to allow the bank to make the loan.

The menu of choices offered to borrowers would include traditional bank products such as treasury-management services, and non-traditional bank products such as title insurance. So long as customers have a meaningful choice of traditional bank products, then an arrangement allowing the customer to choose from the bank’s menu of products in order to meet a profitability hurdle is permissible under anti-tying laws.

Figure 2 shows a sample mixed-product arrangement.

**METHOD SIX: *Required use***

With prior regulatory approval, commercial lenders should consider requiring the use of affiliated settlement-service providers. There is good reason to believe that regulators would approve this approach for commercial refinances.

Currently, most commercial lenders allow borrowers to choose the bank’s title insurance provider. This practice is understandable in purchase transactions where there is a separate, distinct consumer demand for owner’s policies of title insurance. A commitment for an owner’s policy is usually commissioned immediately by the borrower, primarily for the borrower’s protection. The lender’s policy, insuring the priority of the mortgage, is customarily issued simultaneously with the owner’s policy and at a nominal additional cost.

In commercial refinance transactions, however, where a loan policy is the only policy to be issued, commercial lenders may not violate anti-tying laws by requiring the use of affiliated title insurance agents. The reason for this is that a tying violation must involve two or more separate products (i.e., the customer’s desired product and one or more separately tied products). In refinances, a loan policy of title insurance is probably not sufficiently separate from the mortgage loan to be considered a distinct product. This conclusion is supported by federal court decisions involving appraisals and other bank-controlled settlement services.

In *McGee vs. First Federal Savings and Loan Association of Brunswick* (Georgia), the plaintiff alleged that a bank violated tying laws by referring appraisal work almost exclusively to its wholly owned appraisal subsidiary. The Eleventh Circuit Court of Appeals found that: “An appraisal is performed for the benefit of the lending institution. [The bank] is the ‘consumer’ of the appraisal product. There is no legitimate consumer demand by a borrower to purchase loan-related appraisal services separate from the purchase of the loan itself.”

The plaintiff could, therefore, not meet the threshold requirement of a tying claim—proving that there are two separate products.

Likewise, in commercial refinances, there is no legitimate consumer demand by a borrower to purchase a loan policy of title insurance separate from the purchase of the loan itself. While the loan is a service to the borrower, the title insurance policy is commissioned by the bank for the bank’s protection

**Figure 2 Sample Form: Mixed-Product Arrangement**

<p><b>Underwriting of the requested loan requires that the borrower or its affiliates obtain at least one of the following additional products or services from the lender or its affiliates. Obtaining any one of the following additional products or services from the lender or its affiliates will satisfy this condition. Please check your preference:</b></p>	
<input type="checkbox"/>	Title insurance and escrow services for the subject transaction; or
<input type="checkbox"/>	Treasury-management services for property operating account; or
<input type="checkbox"/>	Primary deposit account for the borrower’s parent or guarantor.
<p>SOURCE: CRAWFORD LAW CO. LPA</p>	

(as an additional means of insuring the security of its loan). It is the bank that is asked to lend against the security of the property, so it is the bank that has the paramount interest in insuring the accuracy of the loan policy. Should not the bank, then, be permitted to require the use of an affiliated or preferred title insurance provider?

Because bank holding companies and other lenders are permitted to own and operate title insurance agencies, there is no obvious reason why they should not also be permitted to require the use of an affiliated title insurance provider. This point becomes undeniable when it is understood that the use of lender-affiliated title insurance agencies will generally not increase borrower costs.

While states have different methods of regulating the price of title insurance, a majority of states require insurers to establish rates by filing them with the applicable state Department of Insurance. These filed rates are typically identical among underwriters and adhered to by title insurance agents, whether affiliated with a lender or not.

But even if affiliated providers were more expensive, borrowers would not have a better case for controlling the issuing agent. Banks do not generally allow clients to control vendors of other lender-related services, such as legal counsel or appraisers, for any reason, including cost. Lenders self-regulate in this regard, choosing vendors that provide adequate service but whose cost structure will not injure the customer relationship.

Another important consideration for lenders should be that borrower-chosen title agents often do not have adequate experience in commercial transactions, and tend to increase lender counsel fees and time to closing.

To avoid conflicts of interest, lenders that allow borrowers to choose the bank's title insurance provider should, at a minimum, require their clients to certify that they have no direct or indirect financial interest in the vendor. This is important for bank safety and soundness, as many title insurance agencies are now owned, or partially owned, by developers, real estate investment trusts (REITs) and other institutional real estate owners.

#### **Organizing a joint-venture title agency or VMC**

The Gramm-Leach-Bliley Act permits bank holding companies to broker and sell title insurance and provide real estate settlement services. Before engaging in title insurance activities, a bank holding company must 1) file a declaration

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with the Federal Reserve Board (FRB) electing to be a financial holding company, 2) file a certification with the FRB affirming that all of its subsidiary banks and thrifts are well-capitalized and well-managed, and 3) ensure that all of the company's subsidiary banks and thrifts have a satisfactory Community Reinvestment Act (CRA) rating.

After meeting any applicable federal requirements, mortgage lenders must obtain a state business entity title insurance license. The agency should be organized in a state with a friendly regulatory environment offering licensing reciprocity with states in which the mortgage lender is doing business. State laws that seek to prevent or significantly interfere with the power of a bank or its affiliates from engaging in title insurance sales are pre-empted by federal law.

For lenders that already have affiliated VMCs or title insurance agencies, adopting policies directed at winning commercial business is all that's needed to create a new source of revenue. Lenders without an existing settlement-services affiliate must obtain appropriate regulatory approval and any necessary state licenses.

#### **Choose the right partner**

Choosing the right industry partner is a big consideration in forming a title insurance joint venture. A partner must be capable of delivering accurate and responsive service. Lenders should also be aware of the strengths and weaknesses of

underwriters and independent agents as joint-venture partners.

Title insurance underwriters can deliver financial strength to a joint venture, but may have financial and underwriting conflicts of interest or expose the bank to class actions. Agents can create competition among underwriters to maximize operating profits, but may lack sophisticated in-house title expertise.

Mortgage loans are originated by almost every area of a bank, including syndications, small business, wealth management and corporate. Because a joint-venture title agency generates fee income from the lender's entire enterprise, the loan group, bank division or line of business willing to take the lead in organizing and managing a joint venture could add a significant revenue component to its profit center. **MB**

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