

AFFILIATED BUSINESS ARRANGEMENTS
AND THEIR EFFECTS ON
RESIDENTIAL REAL ESTATE
SETTLEMENT COSTS:
AN ECONOMIC ANALYSIS

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CAP ANALYSIS

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I. INTRODUCTION and CONCLUSIONS

Transfers of residential property between two parties that necessitate the use of real estate settlement services are sometimes made by providers engaged in *affiliated business arrangements* (“ABAs”).¹ These arrangements are relationships in which a person in a position to refer business to a provider of real estate settlement services has an indirect or direct ownership interest in that provider, and refers business to that provider (either directly or indirectly).²

The manner in which the market for residential real estate settlement services to homebuyers and sellers should be regulated has been debated by policymakers for well over 30 years. One of the issues that periodically receives attention in such debates is the role played by ABAs in this market and the economic impact of such arrangements on the consumer.

CapAnalysis Group LLC (“CapAnalysis”) has been asked by the Real Estate Services Providers Council, Inc. (RESPRO)³ to examine the economic impact of affiliated business arrangements on consumers by means of an original study of settlement services charges to them. Our findings, presented in detail below, are based on a statistical analysis of data from 2,236

¹ The term “affiliated business arrangements” or “ABAs” is the term for such arrangements under the Real Estate Settlement Procedures Act (RESPA) (12 U.S.C. 2601 et. seq.), which was passed in 1974 to enhance disclosure to consumers about the cost of settlement services and to eliminate certain abusive practices such as kickbacks and referral fees that were viewed as likely to increase the cost of real estate settlement services (12 U.S.C. 2601). Note that affiliated business arrangements are sometimes also referred to as “**ABAs**.” Under some state laws, these arrangements are also known as “controlled business arrangements.”

² In residential real estate transactions, the business being referred is that of the homebuyer or home seller. The “person in a position to refer” that business could be a real estate broker or agent, mortgage lender, mortgage broker, attorney, home builder, or other person who has contact with the home buyer or seller. A “provider of real estate settlement services” could be a title insurer, title agent, mortgage lender, mortgage broker, or any other provider of “settlement services” as defined by RESPA.

³ RESPRO[®] is a national non-profit trade association of settlement service providers, including real estate broker-owners, real estate franchisers, mortgage lenders/brokers, title insurers/agents, home builders, and home warranty companies. Many of its members offer affiliated services through subsidiaries, joint ventures, and partnerships.

HUD-1 forms that report the cost of settlement services to consumers in actual residential property transactions in 2003 and 2005.

The results of our analysis show ABAs are pro-competitive and do not harm consumers. Specifically, title premiums and other title-related settlement costs⁴ are not higher when ABAs are involved in the transaction compared to when they are not. Moreover, this has remained true from 2003 to 2005 despite an 18% increase in the share of total title-related settlement costs associated with firms that have affiliated business arrangements. As we discuss below, this suggests that the growth of ABAs has been able to provide pro-competitive non-monetary benefits, such as the convenience of one-stop shopping, while not increasing settlement costs to consumers.

II. THE CURRENT REGULATORY ENVIRONMENT OF AFFILIATED BUSINESSES

The Real Estate Settlement Procedures Act (RESPA) regulates affiliated business arrangements at the federal level. RESPA requires that a person who refers business to an affiliated settlement service provider (1) disclose in writing the nature of its financial interest in that provider to the person being referred (and include an estimate of the provider's usual charge); (2) not require the consumer to use an affiliated provider, and (3) receive no other pecuniary benefit from the arrangement than a return on the ownership interest or franchise interest.⁵ The Department of Housing and Urban Development (HUD), which is the primary

⁴ Settlement costs include those related to the mortgage loan, real estate broker commissions, government charges and title-related charges. Our study focuses on the price of title insurance and other title-related settlement costs because the HUD-1s lack complete information about the mortgage loan and because this promotes comparability with prior studies, which similarly examined title-related charges.

⁵ 12 USC 2607(c)(4).

regulator under RESPA, also has issued guidelines to identify RESPA-compliant affiliated business arrangements from “shams”.⁶

Prior to the Congressional passage of RESPA statutory provisions governing affiliated business arrangements,⁷ many state legislatures enacted highly restrictive laws that either precluded certain ABAs from operating or limited the amount of business which providers could obtain from affiliates.⁸ Many but not all of these laws are still in effect. Recently, state regulators’ concerns over the presence of certain “sham” affiliated businesses in the form of joint ventures in certain marketplaces have raised questions as to whether they should regulate affiliated businesses in a manner beyond what RESPA and its regulations provide.

For example, some states have prohibited lending institutions from operating or acting as a title insurance producer or agent or from conditioning a mortgage loan on the use of a particular title insurance company.⁹ Other states have limited the percentage of revenues that a provider may receive from an affiliated business. Currently, these limits range from 10 percent to no more

⁶ In 1996, HUD issued guidelines under RESPA which set forth various factors which will tend to show that the ABAs are not merely Limited Liability Corporations or Partnerships (LLCs or LLPs) in name only, but have adequate capital, real employees performing the settlement service that the joint venture was created to do, separate offices, phones and signage, and in short are genuine businesses. This study could not and did not seek to determine whether the affiliated business arrangements we reviewed complied with RESPA and its sham joint venture guidelines. We assumed that they did, but we did not have the resources to make that actual determination. To the extent that some of the ABAs were structured or operated inconsistently with RESPA, we believe that our findings are only made stronger because it is RESPA’s and HUD’s premise that ABAs that do not comply with RESPA will involve higher settlement service prices.

⁷ The requirements imposed on affiliated business arrangements under RESPA were passed by Congress as an amendment to RESPA in 1983 and are commonly known as RESPA’s “affiliated business exemption”. Congress adopted the exemption after rejecting an alternative amendment that would place a percentage cap on the amount of settlement service business a provider could receive from an affiliate.

⁸ Approximately 19 states have such highly restrictive laws while another 12 states have some form of restrictive legislation. See “2005 Survey of State Affiliated Business Laws”, RESPRO, 2005 edition.

⁹ RESPRO® Survey of State Affiliated Business Laws, 2005 Edition, p.1.

than 50 percent of total gross operating revenues.¹⁰ Limits as low as 20 percent would likely deter or prevent the formation of and/or continued operation of affiliated business arrangements. However, even a 50 percent limitation would be unnecessary if ABAs do not result in higher prices and are already regulated adequately under federal law.

Those that support restrictions on ABAs beyond those provided under RESPA claim that home buyers and sellers who purchase real estate settlement services through affiliated businesses may be “steered” toward more costly settlement services, which could result in inadequate service and/or higher costs. Similarly, concerns that so-called *reverse competition*¹¹ will jack up the title and title-related costs that consumers pay have been used to defend and promote laws that restrict ABAs beyond RESPA.

The results of the analysis presented below are consistent with the learning of earlier studies and reinforce conclusions that should call into question the social benefits claimed to justify these state laws that would preclude affiliated business arrangements or limit the amount of business done by them.¹² Indeed, limiting or precluding ABAs appears to be based on faulty theoretical assumptions and an absence of sound empirical evidence.

¹⁰ Ibid., pp. 2-7. Not all restrictions use as a base aggregate “gross operating revenues.” Some restrictions are based on other criteria. For example, Kansas recently adopted “the insurer’s or agent’s closed title orders in the preceding twelve months” and limited permissible controlled business to 70 percent of the figure, p. 4.

¹¹ Reverse competition is a term describing competition among title and/or closing service providers for customer referrals, whether or not they are part of an affiliated business arrangement. Persons in a position to refer business (e.g., real estate brokers and agents, home builders, title agents, or lawyers, who are intimately associated with settlement services, normally), refer potential purchasers of title and closing services to providers who often do not market their services to the consumer but instead market their services to the person in the position to refer business. Critics of affiliated businesses argue that although direct payment for referrals are outlawed under RESPA, indirect compensation may flow through affiliated business arrangements so that the alleged effects of reverse competition would extend to consumers purchasing under such arrangements.

¹² See “Economic Issues Relating to the Title Insurance Industry in Minnesota: Would Further Regulation Be Helpful? February, 1992, Prepared by Paul A. Anton, Anton Financial Economic Inc. (hereafter “The Anton Study”); “Economic Analysis of Restrictions on Diversified Real Estate Services Providers,” Comments in Response to the Proposed Regulation Published by the U.S. Department of Housing and Urban Development, on July 21,

III. THEORETICAL ISSUES

A. Critics' Claims Regarding the Economic Impact of ABAs on Consumers

Before testing for the economic impact of affiliated business arrangements on consumers, it is worthwhile to examine closely the hypothesis that underlies claims by critics of ABAs that they are disadvantageous to the consumer. Actually, there are two alternative hypotheses that are most associated with this allegation. However, they have a common thread. Both hypotheses assume widespread consumer ignorance of market relevant information about settlement services (particularly title and closing services that the consumer usually does not shop for directly) and also assume that this ignorance gives rise to opportunities for exploitation by suppliers of these services.

The critics' first hypothesis can be expressed as follows:

(H₁) Those with access to consumers of settlement services have an opportunity to (and given the right incentive will) steer (refer) ignorant consumers to the higher priced title and title related settlement services providers. As a result, affiliated business arrangements disadvantage consumers.

This hypothesis assumes that ABAs provide the incentive to steer, because by definition there is an ownership interest or business arrangement between the referring party and the party providing the settlement service, such as the title insurer.¹³ For example, it is alleged that title

1994, Regarding the Real Estate Settlement Procedures Act, Lexecon Inc. January 3, 1995 (hereafter "The Lexecon Study"). The results of these two studies are summarized on page 11 of this report. See also HUD Economic analysis of F.R. 3638, p. 18.

¹³ Consumer protections for the overall home buying and financing process were thought necessary when Congress enacted RESPA in 1974 because the purchase of a home (and the purchase of a mortgage and title and other settlement services) was considered a very infrequent occurrence for the average homeowner. It was alleged that as a result, consumers with such limited experience have accumulated very little market information about the providers of these services, including where to find them and what they charge. It was argued that this was especially the case with a service such as title insurance and title-related services, which the consumer usually does not shop for directly. Critics of affiliated title business arrangements, therefore, argue that real estate brokers and agents, mortgage lenders/brokers, home builders and attorneys are in a strategic position to "steer" consumers to title insurance providers that would not have been chosen had consumers been armed with information about the services available to them.

insurers with higher premiums per dollar of coverage find their clients not through direct competition with lower- priced competitors but by referrals from parties in which they have an ownership interest or other business arrangement.

The critics' second hypothesis makes a similar prediction and thus is empirically indistinguishable from the first. Nevertheless:

(H₂) Competition by settlement service providers for referrals, from parties with access to consumers, raises their costs that are then passed on to consumers in the form of higher settlement charges, as in higher title insurance premiums or higher fees for title searches, etc. As a result, affiliated business arrangements between settlement service providers and those with access to consumers will disadvantage consumers.

This hypothesis assumes that it is so called "reverse competition" that would be responsible for the higher settlement charges that critics claim consumers may suffer under affiliated business regimes. That is, the privileged access to consumers represents a scarce asset that commands a price in the form of a return to the referrer's ownership interest, if not a specific fee per referral. This cost in turn, it is assumed, is reflected in the settlement charges that consumers will pay, including the title insurance premium and/or the charges for the other generally unregulated closing services.

Finally, it should be noted that the hypotheses described above both implicitly assume that affiliated business arrangements provide no tangible benefits to consumers that might warrant a higher price or otherwise qualify their prediction. We will address this assumption below.

B. Critique and an Alternative View

As a matter of economic theory, we think the above hypotheses are fundamentally wrong. They fail to recognize or acknowledge distinguishing features of ABAs that give them the capacity to benefit competition and consumers. As a result, they exclude the possibility that

consumers may be worse off if ABAs were limited or prohibited.¹⁴ Indeed, the critics' hypotheses imply that if affiliated business arrangements were limited or prohibited that settlement services costs would be lower. The evidence contradicts this implication.

Affiliated business arrangements are a specific example of a type of business organization economists call vertical integration. The production and distribution of a good or service involves several successive stages. In the first stage, the inputs or resources used to produce the good or service are acquired, in the second stage the good or service is produced and in the last stage it is distributed to consumers. Firms that participate in more than one stage are called vertically integrated. For example, a coal-fired power plant is vertically integrated when it owns the coal mines which supply its coal input. Nonvertically integrated firms buy the inputs or services they need for their production or distribution processes from other firms. In our example, the power plant would buy its coal in the marketplace. Partial vertical integration results when the vertical ownership interest is less than 100% ownership, e.g., the power plant owns only 60% of the coal mine.

A firm may also be vertically integrated in the marketing of its products or services to customers. In the wholesale food distribution business, for example, some firms market their services through their own salespersons. Such firms are vertically integrated with respect to this sales function. Nonvertically integrated firms, on the other hand, market their services through third-party brokers, with established customer relationships, from whom they purchase marketing services. Partially integrated firms employ some salespeople and also use brokers. That is, they

¹⁴ That is, the critics hypothesize a cause and effect relationship between the existence of affiliated business arrangements and the level of title related charges, i.e., that affiliated business arrangements facilitate higher title related settlement charges. As we show below, the evidence from our study rejects such a causal relationship and is consistent with the results of earlier studies by other researchers, suggesting that ABAs benefit competition and competitors.

may market to large accounts through their internal sales force and purchase marketing services from brokers to solicit smaller accounts.

In the case of real estate settlement services supplied by providers engaged in affiliated business arrangements, the situation is analogous. The service produced is real estate settlement services and the vertically integrated inputs are entities with existing customer relationships and or complimentary services. When the service provider owns the entity (with customer relationships), the vertical integration is complete or 100 percent, e.g., when a settlement services company and real estate broker or mortgage lender are owned by the same firm. Other affiliated business arrangements involve partial vertical integration where those with customer relationships have a partial ownership interest in the settlement service provider. Thus affiliated business arrangements are simply a form of vertical integration that are commonly used throughout the economy.

There are three major reasons why a firm might vertically integrate that apply in the case of affiliated business arrangements involving real estate settlement services: 1) to lower the provider's transaction costs related to producing settlement services, 2) to lower the consumer's transaction costs related to purchasing the settlement services, and 3) to create or enhance market power by reducing competition. Only the third reason can result in harm to consumers.¹⁵

Vertical integration may lower the provider's transaction costs related to settlement services through several means. First, it may eliminate duplicative services, such as recording applicant information once instead of several times, as would be required if a separate firm performed the settlement and real estate brokerage services. Second, it may increase the

¹⁵ For a general discussion of the economic reasons for vertical integration see, Dennis W. Carlton and Jeffery M. Perloff, Modern Industrial Organization, 2nd Ed., HarperCollins College Publishers, New York, NY, pp. 501-520.

provider's quality assurance through internalized checks and balances among the integrated firms which decreases transaction costs related to costly mistakes. Such checks and balances would be much more difficult if not impossible to perform among separate nonintegrated firms.

Third, vertical integration reduces the provider's transaction costs associated with marketing their settlement services to consumers. Several methods are available, each a substitute for the other - advertising, use of a sales force, and referrals. Advertising, marketing and other sales efforts all have high transaction costs (high promotional expense relative to number of the sales realized) because very few consumers are in the market for settlement services at any time since the purchase of a home is very infrequent. To be cost effective, the sales effort must be targeted at home buyers. Thus, the emphasis is on entities that can identify the home buyers. These entities include real estate brokers, agents, mortgage lenders and others.

Finally, affiliated business arrangements may produce "economies of scope" or efficiencies derived from the provision of multiple services (in this case complementary services) that employ common resources, as in common facilities or the sharing of information, management, technology, or equipment which would not be otherwise available. The existence of such economies and/or transaction cost savings from vertical integration may result in some of these efficiencies and/or cost savings being passed on to the consumer in the form of either price or non price benefits.

Benefits from ABAs are not limited to the firms that are parties to them. ABAs also may reduce transaction costs and the cost of information and search to consumers. That is, consumers may benefit from "one stop shopping" which would include the greater convenience, accountability, and quality assurance of complementary settlement services including title insurance, title searching, the closing, etc. Lower transaction and/or search costs and greater

certainty reduces the *effective price*¹⁶ a consumer pays for settlement services purchased from vertically integrated providers, even if the actual dollar amount paid does not decrease.

On the other hand, the market power enhancing motivation for vertical integration likely does not apply in the case of ABAs in the real estate services industry. A necessary condition for firms to engage in vertical integration to enhance their market power is that they already possess market power in either real estate services or consumer referrals. In most geographic markets, this is very unlikely, given the intensity of competition and large number of firms providing real estate services. This is particularly true regarding title related settlement services.¹⁷

Thus, economic theory suggests a competing hypothesis to the two described above.

(H₃) In the provision of settlement services, affiliated business arrangements will produce title and title-related settlement costs that are equal to or less than those associated with non-affiliated business arrangements.¹⁸

Using quantitative economic analysis, a failure to reject this hypothesis would mean that the existence of affiliated business arrangements do not cause higher title-related settlement costs for consumers.

¹⁶ Economists use the concept of *effective price* in distinguishing between products or services of different qualities but having the same observable dollar prices. Two similar services can have different effective prices if, at the same observable dollar price, one service offers greater quality or more features than the other.

¹⁷ Although there are a small number of firms that provide title insurance underwriting, there are a large number of firms that serve as agents for these underwriters. It is generally the numerous local title insurance agencies, not the underwriters, who have affiliated business arrangements with entities that refer consumers to them, e.g., real estate brokers, mortgage lenders, home builders, etc. The large number of title insurance agencies in most geographic markets renders it unlikely that the affiliated business arrangement was for the purpose of enhancing market power.

¹⁸ This hypothesis allows for the possibility that, to the extent that affiliated business arrangements produce economies of scope (efficiencies generated from the bundling of several complementary consumer oriented services), closing costs could be less than those incurred under conditions where settlement services are supplied without the benefit of affiliated business arrangements.

IV. AN EMPIRICAL ANALYSIS OF THE IMPACT OF ABAS ON THE COST OF SETTLEMENT SERVICES

A. Overview

The CapAnalysis study examines over 2,200 actual real estate transactions in nine states. We find that consumers do not pay higher prices for title related settlement services, provided by firms with affiliated business arrangements compared to non-affiliated providers of these same services.¹⁹ Therefore, the evidence rejects the contention that ABAs harm consumers. Rather, our empirical study should be interpreted as indicating that ABAs benefit consumers and are pro-competitive. More specifically, the data show that the share of total title related settlement costs provided by affiliated firms grew by 18% from 2003 to 2005.²⁰ Yet, as we demonstrate, this revenue growth occurred in the absence of higher consumer prices associated with affiliated arrangements. This suggests that affiliation arrangements enable firms to grow by providing greater benefits to consumers compared to non-affiliated firms.

These empirical results are consistent with those found in two previous studies of affiliated business arrangements. The Anton Study found price quotes for title related services were somewhat lower for affiliated versus non-affiliated firms in the Minneapolis-St. Paul area in 1992 and that title related settlement prices increased in one major county in Kansas after a new state law forced affiliated title services companies out of business in 1991.²¹ The Lexecon study

¹⁹ These charges included title premiums and charges for “other” title related services. The charges for “other” title related settlement services included title searches and examinations, closing fees, document preparation fees, courier fees, attorney fees and miscellaneous others.

²⁰ Specifically, the share of total title related closing costs associated with affiliated providers increased from 22.3% in 2003 to 26.3% in 2005. This measure holds constant the sample respondents in each year. Two respondents did not provide data for 2003.

²¹ “Economic Issues Relating to the Title Insurance Industry in Minnesota: Would Further Regulation Be Helpful? February, 1992, Prepared by Paul A. Anton, Anton Financial Economic Inc.

was a more systematic analysis of affiliated business arrangements and examined 1000 real estate transactions in seven states. It found that the price of title related services was the same, whether provided by affiliated or non-affiliated firms.²²

The CapAnalysis study updates and expands the Lexecon study and controls for more factors that might influence settlement costs, independent of affiliation status, such as local supply and demand conditions and cost differences across providers. It examines 2,236 real estate transactions covering nine states in two different years – 2003 and 2005. This enabled us to determine that affiliated relationships have grown over time, but that this growth has not harmed consumers. Affiliated providers’ prices for settlement services do not differ from those of unaffiliated firms. Our results are more robust than earlier studies and at the same time confirm their major findings. We more comprehensively control for factors unrelated to affiliation that affect the price of title related services.

B. Data Sample

As mentioned above, the data for our study was drawn from HUD-1 Settlement Statements (HUD-1s) that report the cost of settlement services to consumers for actual residential property transactions in 2003 and 2005.²³ The 2,236 HUD-1s were collected from sixteen RESPRO members operating in nine states. These particular states were selected because they met the criteria of having no binding statutes or rules that restricted affiliated business arrangements for firms involved in title related settlement services, during the time period of the

²² “Economic Analysis of Restrictions on Diversified Real Estate Services Providers,” Comments in Response to the Proposed Regulation Published by the U.S. Department of Housing and Urban Development, on July 21, 1994.

²³ Specifically, the HUD-1s collected represented real estate transactions that occurred during the second week of June in 2003 and 2005. Some HUD-1s were also provided for the last week of June 2005.

study, 2003 and 2005.²⁴ Table 1 below shows the number of HUD-1s included in the sample from each state.

TABLE 1
Number of Real Estate Transactions Analyzed

State	Number of HUD-1s in Sample	
	2005	2003
AL	139	42
IL	125	113
MD	159	94
MI	151	102
MN	83	---
NC	147	88
OH	221	285
SC	174	21
VA	159	133
TOTAL	1358	878

This sample actually biases the study, in 3 separate ways, toward finding consumer harm from affiliated business arrangements, if indeed such harm exists as critics allege. That is, the data make it more difficult to show no harm. First, because the providers of the sample data have affiliated relationships, it means for most of the HUD-1s there was likely an attempt to refer the consumer to an affiliated provider of title related services. Consumers who instead used independent providers likely had a greater propensity to price shop compared to those who preferred the one-stop convenience of using an affiliated provider. Price shoppers generally will find the lowest price among a distribution of prices in the marketplace, in this case among the

²⁴ Approximately 19 states have no binding restrictions on ABAs. See Survey of State Affiliated Business Laws, 2005 Edition. Although Ohio limited financial institution's and real estate company's ownership interest in a title agency to less than 50%, several Ohio real estate brokers were able to form and participated in ABAs notwithstanding this 50% ownership limit. The study also excluded states which restrict settlement services providers to only attorneys. The sample was drawn from the remaining states, without ABA or attorney restrictions, where a reasonable sample size could be collected from RESPRO members.

independents. Thus, the price of independent providers in the sample is likely biased downward below the actual average market price for independents because the independents in the sample likely are patronized mostly by price shoppers.²⁵

Second, the data sample further biases the study toward finding consumer harm from affiliated business arrangements, if it exists, because the data do not measure or capture non-monetary transaction cost savings that consumers receive from patronizing real estate settlement providers with affiliated business arrangements, for example, the time saved from one-stop shopping. Finally, the sample also draws its data from states where ABAs are unfettered by regulations. Thus, if ABAs harm consumers, the harm would be most pronounced in the states of our sample.

The HUD-1 itemizes each settlement charge showing the firm that provided the service and the price paid for the service by the seller and buyer of the property. The charges include real estate broker's commissions, mortgage loan related fees and deposits, government transfer and recording charges, title premiums and "other" title related charges. The "other" title related charges include closing fees, title search and examination fees, document preparation, attorney's fees and miscellaneous others. Because HUD-1s lack complete information about the mortgage loan,²⁶ our study focuses on a) the price of title insurance and b) total title related settlement services. The latter includes title insurance premiums plus charges for "other" title related

²⁵ A HUD comment in its Economic Analysis that accompanied a final RESPA regulation made the same point concerning the Lexecon Study, which also collected its sample from RESPRO members. See HUD Economic Analysis of F.R. 3638, pp. 18.

²⁶ For example, the HUD-1's do not reflect the interest rate of the loan, the credit score of the applicant, and other related information that would be required to perform a valid comparison of loan costs on an apples to apples basis across consumers in the sample.

services. This focus also promotes comparability with the prior studies, which similarly examined title related charges.

C. Econometric Model

We perform multiple regression analyses to determine whether affiliated business arrangements affect title premiums and the price of total title related settlement services, respectively. Multiple regression analysis enables us to isolate the affect of affiliation from other factors that might influence title related settlement charges independently.²⁷ We measure the affiliation effect separately for title premiums and total title related charges. Each individual HUD-1 has one entry for the title insurance provider. If the provider engages in affiliated business arrangements, we code it as being affiliated. However, the other title related services listed on a HUD-1 typically are provided by multiple firms, each of which may or may not engage in affiliated business arrangements. To accurately control for this mixed affiliation effect, when we examine total title related charges, we compute the share of total title related settlements charges provided by affiliated providers for each HUD-1 and use this as our measure of the extent to which affiliated relationships affect total title related settlement charges.²⁸ We calculate a similar affiliated share measure based on just the “other” charges (total charges less

²⁷ Multiple regression analysis is a statistical estimation technique that is widely used by economists as an aid in helping to isolate and measure the effect (if any) of each hypothesized independent influence allegedly determining the movement in and values of some specified dependent variable, such as a price or a cost. The formulations and interpretation or data using multiple regression analysis is within the field known as econometrics. An accessible discussion of multiple regression analysis, as used in the economics profession, may be found in [A Guide to Econometrics](#), by Peter Kennedy, 5th Edition (MIT Press, Cambridge MA) 2003.

²⁸ A small number of HUD-1s list two to three providers of a single title related service, including title insurance. If any of these providers had affiliated business arrangements, we coded the service as being associated with an affiliated provider. The HUD-1s provide no information that would enable us to apportion the charge for the service among the multiple providers.

title premiums) when we study the “other” title related charges separately. Table 2 reports the extent of affiliations present in the sample HUD-1s by year.

TABLE 2
Extent of ABAs in the Data

Year	Portion of Title Insurers with ABAs	Share of Non-Title Insurance Title Related Closing Costs Provided by Firms with ABAs	Share of Total Title Related Closing Costs Provided by Firms with ABAs
2005	37.0%	28.1%	27.2%
2003	24.7%	25.1%	22.3%

Besides affiliation, there are also other factors that may influence title premiums and total title related settlement charges. These include the purchase price of the home, the demand conditions and competitiveness of each local market for title related services and the pricing characteristics of individual providers. Holding other things constant, the average price of title related services will be influenced by market driven supply and demand forces, the competitive dynamic of local geographic markets and firm specific characteristics. When firms are differentiated in terms of service quality or other characteristics, as is the case in the title related services industry, prices will vary across the individual firms who have the same affiliation status within a market. Without controlling for these other factors, the independent effect of affiliation as estimated by our regression model might be biased by their influence.²⁹

Our study differs significantly from the Lexecon Study in terms of the detail to which it controls for these other factors. We model the market for title related services as individual counties and control for local market conditions with county-specific control variables called dummy variables. We control for individual differentiated firm characteristics by including a

²⁹ Formally, econometrics describes this as omitted variable bias.

control variable for each major title related settlement services provider within a state.³⁰ Finally, we control for the effect of the house price using a quadratic function that allows the title premium to vary non-linearly with the house price, e.g., title insurance might be less costly per \$1,000 of coverage for more versus less expensive homes.

D. Results

The CapAnalysis econometric model does a very good job of explaining the variation in title premiums and total title related settlement costs across the 1,358 HUD-1s in the 2005 sample. Specifically, it explains 87% to 81% of the variation in title premiums and total title related settlement charges, respectively, as captured in the statistic known as R-Squared.³¹ For the 2003 data, the model has a similarly high explanatory power, with an R-squared of 0.85 to 0.83 for the title premiums and total title related settlement costs equations, respectively.

Before discussing the statistical results associated with the affiliated business arrangements variable in our model, it is important to report on the variables that would provide an independent influence on title related settlement costs. The complete statistical results from the multiple regression analysis can be found in the Appendix.

³⁰ Specifically, due to the large number of firms providing “other” title related settlement services, for each year of the sample we ranked title related settlement services firms within a state from largest to smallest in terms of their total title related settlement services charges and created individual control variables for the firms accounting for a cumulative share of 70%. The remaining firms were aggregated into an “other” category, which was assigned its own control variable within the state. Each control variable equals the provider’s share of a HUD-1’s total title related settlement charges. These firm-specific control variables were used for the regressions involving total title related settlement charges as the dependent variable. For the regressions explaining “other” title related settlement charges, the firm-specific control variables represent a firm’s share of the total “other” title related settlement charges on a HUD-1. In the title premium dependent variable regressions, the firm-specific control variables reduce to a dummy variable for each title insurance provider since there is one title insurance provider per HUD-1. The number of title insurance providers in the sample is far less than the number of “other” title related settlement services providers.

³¹ R-squared is a statistic that measures how well a regression model approximates the relationship present in real data. It represents the fraction of the variance in the data that is explained by a regression and ranges between 0 and 1. The higher the R-squared, the more confidence one can have in the regression model.

The local demand and competitive conditions controlled for by the county dummy variables are jointly statistically significant to a very high degree as are the variables that control for the individual firm effects.³² This means these factors have an important influence on title premiums and total title related settlement charges. Therefore, it was critical that our regression model take account of and control for these influences. Had it not, the effect of affiliation estimated by the regression would be biased by the influence of these other factors.

The house price effect is also highly statistically significant. Total title related charges initially rise on average about \$111 for each \$50,000 increase in the house price, but this effect diminishes slightly as the price of the house increases – the increment equaling only \$94 for a \$900,000 house compared to \$128 for a \$200,000 house.

Finally, the model clearly accepts the hypothesis of no consumer harm related to affiliated business arrangements:

(H₃) In the provision of settlement services, affiliated business arrangements will produce title insurance related closing costs that are equal to or less than those associated with non-affiliated business arrangements.

The estimated coefficient for the effect of affiliations on title premiums is highly statistically insignificant in both 2005 and 2003. This means that the estimated difference in title premiums between affiliated and non-affiliated providers is \$0. The data, therefore, provide no empirical support for the notion that affiliated business arrangements increase title premiums paid by consumers. That is, the data clearly reject the two anticompetitive hypotheses H₁ and H₂. By way of appreciating the force of our results, assume that a coin flip (i.e. a chance event) could predict whether affiliations affected premiums, in place of our regression model. The probability of no

³² An effect is typically considered statistically significant only if it has a p-value of 0.05 or less, meaning that there is only a 5% probability or less that the effect has no influence on the variable under study.

effect would approximate 50 percent. By comparison, the estimated probabilities of no effect, from our regression model, exceed by a wide margin, that associated with a chance event.³³ This means the data strongly supports the conclusion that affiliations do not increase insurance title premiums.

The data also finds that affiliations do not increase total title related settlement charges. The affiliation effect is highly statistically insignificant in both the 2005 and 2003 data samples.³⁴ The high statistical insignificance indicates a \$0 difference between total title related closing charges at affiliated versus non-affiliated providers. It does not matter what portion of the total title related services are provided by affiliated providers, even if 100 percent, consumers still do not pay more compared to if 100 percent was provided by non-affiliated providers. The estimated difference in cost to the consumer is \$0, i.e., none. Thus, our empirical analysis demonstrates clearly that affiliated business arrangements do not harm consumers.^{35 36}

³³ In our study, the estimated p-values indicate there is a 62% and 82% probability that affiliations had no effect on title insurance premiums in 2005 and 2003, respectively.

³⁴ Based on the estimated p-values, the probability that affiliations do not increase total title related settlement charges is 95% and 66% in 2005 and 2003, respectively.

³⁵ We also studied “other” title related charges (total charges less title premiums). In 2005, we find firms with affiliated business arrangements charge no more for these “other” services than non-affiliated firms – the difference in charges between the two types of firms was highly statistically insignificant. In 2003, affiliated firms charged \$2.26 less on average than non-affiliated firms for each one percentage point increase in affiliated firms' share of the total "other" title related settlement charges on a HUD-1 and the effect was statistically significant.

³⁶ The statistically insignificant estimates for the affiliation variable in our various regressions mean that there is no dollar difference in the relevant title related settlement charges between affiliated and non-affiliated firms, i.e., the difference is \$0. Nevertheless, one can calculate the average difference. The estimated effect of ABAs on total title related charges was not statistically different from zero for the point estimates which show that a one percentage point increase in affiliated firms' share of the total title related settlement charges on a HUD-1 changes total title related settlement charges by $-\$0.07$ and $\$0.61$ in 2005 and 2003, respectively. Though statistically not different from zero, the point estimates of the effect of ABAs on title insurance premiums were \$18 and $-\$10$ in 2005 and 2003, respectively. In 2005 for "other" title related settlement charges, the point estimate, though statistically not different from zero, indicates affiliated firms charged \$0.23 less on average than non-affiliated firms for each one percentage point increase in affiliated firms' share of the total "other" title related settlement charges on a HUD-1.

V. CONCLUSION

We conducted an empirical analysis to study the economic impact of *affiliated business arrangements* in the market for residential real estate settlement services to homebuyers and sellers. Using a large database of more than 2200 HUD-1s that report the cost of settlement services to consumers in actual residential property transactions in nine states in 2003 and 2005, our econometric analysis shows that title premiums and title related settlement closing charges are not higher when affiliated business arrangements are involved compared to when they are not. Moreover, this has remained true from 2003 to 2005 despite an 18% increase in the share of total title-related settlement costs associated with firms that have ABAs. This suggests that the growth of ABAs has provided pro-competitive non-pecuniary benefits to consumers, such as the convenience of one-stop shopping and all of the enhanced consumer services associated with it.

Ours is the third empirical study that concludes that affiliated business arrangements do not harm consumers. However, our study differs significantly from these prior analyses in terms of the breadth of time it covers (two different years) and the detail to which it controls for other factors that affect title premiums and title related charges, such as local market conditions and individual differentiated firm characteristics. We find that these other factors strongly influence the price of title related services. By controlling for these factors in the regression analysis, we ensure that our estimate of the effect of affiliated business arrangements on the price of title related services is not biased by the influence of these other factors.

In summary, the mounting empirical evidence, where each new study involves a larger sample and more sophisticated analysis than the prior,³⁷ should strongly call into question the social benefits claimed for various state regulations of affiliated business arrangements, beyond those found in RESPA. Indeed, this additional regulation of affiliate business arrangements appears to be based on an absence of sound empirical evidence, such as that presented in this study.

³⁷ See *infra* note 12.

APPENDIX I: REGRESSION RESULTS

Year:	2005				2005				2005			
Dependent Variable:	<u>Title Premium</u>				<u>Total Title Related Settlement Charges</u>				<u>Other Title Related Settlement Charges</u>			
<u>Parameter</u>	<u>Estimate</u>	<u>Error</u>	<u>t Value</u>	<u>Pr> t </u>	<u>Estimate</u>	<u>Error</u>	<u>t Value</u>	<u>Pr> t </u>	<u>Estimate</u>	<u>Error</u>	<u>t Value</u>	<u>Pr> t </u>
Intercept	575.633	264.909	2.17	0.0300	1643.290	948.422	1.73	0.0835	888.687	711.509	1.25	0.2119
Home Price (\$10,000)	27.239	1.447	18.82	<.0001	28.609	2.5135	11.38	<.0001	-0.355	1.8868	-0.19	0.8509
Home Price Squared	-0.049	0.015	-3.29	0.0010	-0.049	0.026	-1.92	0.0548	0.026	0.019	1.33	0.1831
ABA ¹	18.041	36.307	0.50	0.6194								
ABA Share of Total Charges ²					-0.074	1.090	-0.07	0.9460				
ABA Share of Other Charges ³									-0.229	0.593	-0.39	0.6994
Joint Significance Tests:												
<u>Parameter</u>	<u>F Value</u>	<u>Pr>F</u>			<u>F Value</u>	<u>Pr>F</u>			<u>F Value</u>	<u>Pr>F</u>		
County-Specific Effects	7.22	<.0001			1.32	0.0307			1.17	0.1462		
Firm-Specific Effects	2.19	<.0001			1.81	<.0001			2.46	<.0001		
Number observations	1357				1358				1358			
R-Squared	0.866				0.813				0.582507			
F-Value	34.24				13.42				4.31			
Pr>F	<.0001				<.0001				<.0001			

Year:	2003				2003				2003			
Dependent Variable:	<u>Title Premium</u>				<u>Total Title Related Settlement Charges</u>				<u>Other Title Related Settlement Charges</u>			
	Standard				Standard				Standard			
<u>Parameter</u>	<u>Estimate</u>	<u>Error</u>	<u>t Value</u>	<u>Pr> t </u>	<u>Estimate</u>	<u>Error</u>	<u>t Value</u>	<u>Pr> t </u>	<u>Estimate</u>	<u>Error</u>	<u>t Value</u>	<u>Pr> t </u>
Intercept	183.763	77.3156	2.38	0.0177	2620.278	665.074	3.94	<.0001	2448.951	516.397	4.74	<.0001
Home Price (\$10,000)	30.895	2.141	14.43	<.0001	41.633	3.5509	11.72	<.0001	7.240	2.75715	2.63	0.0089
Home Price Squared	-0.040	0.026	-1.54	0.1230	-0.017	0.043	-3.81	0.0002	-0.060	0.034	-1.78	0.075
ABA ¹	-9.766	43.514	-0.22	0.8225								
ABA Share of Total Charges ²					0.613	1.390	0.44	0.6597				
ABA Share of Other Charges ³									-2.258	0.886	-2.55	0.0111
Joint Significance Tests:												
<u>Parameter</u>	<u>F Value</u>	<u>Pr>F</u>			<u>F Value</u>	<u>Pr>F</u>			<u>F Value</u>	<u>Pr>F</u>		
County-Specific Effects	5.19	<.0001			1.81	0.0003			1.69	0.0013		
Firm-Specific Effects	2.39	<.0001			2.99	<.0001			3.90	<.0001		
Number observations	878				878				878			
R-Squared	0.846				0.828				0.675			
F-Value	23.45				11.79				5.09			
Pr>F	<.0001				<.0001				<.0001			

APPENDIX II

About the Authors:

Dr. Donald L. Martin is Chairman of CapAnalysis, Group LLC. He has a PhD in economics from UCLA and has been consulting on antitrust and regulatory matters for the past 25 years. He has testified before federal and state courts, the United States Court of International Trade, and the European Commission covering a wide variety of industries and markets including residential real estate. He has also appeared before regulatory bodies including the FCC, ITC, DOJ, FTC, and the United States Congress. Dr. Martin was formerly a member of the economics faculty at the University of Virginia and the University of Miami Law and Economics Center.

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