

*2020 Update*

## Regional Title Underwriter Escrow Theft & Defalcation Prevention Measures

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As the first to review and rate Title underwriters, for more than 30 years, Demotech, Inc. has observed and reported on the impact of defalcations and escrow theft on the Title industry. As part of its ongoing monitoring and review process, Demotech annually requests Title underwriters assigned a Financial Stability Rating® to submit information pertaining to mitigation of defalcations and escrow theft.

The information requested by Demotech consists of a questionnaire and detailed summary for each Title underwriter as well as any additional information or documentation they wish to provide. Title underwriters responded by submitting their current agent review process, defalcation prevention procedures, and any other mitigation procedures. The information

Demotech receives as part of this data request is confidential and is not shared at an individual underwriter level. The information contained in this study reflects the aggregate results of regional underwriters as it applies to their agency appointment policies as well as defalcation and escrow theft prevention measures.

### **Escrow Theft – What is it?**

Escrow theft is a serious problem for consumers, the Title insurance industry, and the broader real estate community. Title insurance agents play an important role in real estate transactions and are often entrusted with significant funds intended to be applied on behalf of the parties to the transaction.

A major problem can arise when fiduciaries betray their obligations and embezzle the money entrusted to them.

Escrow theft occurs when someone misappropriates funds held in a fiduciary capacity.

The most common form of escrow theft occurs when a settlement agent receives funds to apply to a real estate transaction, but rather than disbursing the funds properly, the agent misappropriates the funds. Then the agent may continue making payments to the previous lender, which keeps the loan current, and masks the fraudulent activity.

Escrow theft is a problem, not because of its frequency, but rather because of the egregious breach of trust, the amount of money typically lost, and the damage to the industry's reputation. This is of significant consequence for an industry that has acquired a negative public perception as well as limited appreciation for its definitive role in facilitating real estate transfers.



## Summary of Results

Below is the summary of responses to Demotech's data request. The results of this request are as of June 30, 2020 and pertain to only 40 regional Title underwriters.

### Agency Application Process

37 underwriters indicated that they have a formal or distinct process for reviewing agencies prior to appointment.

### Verification of Licensing

36 indicated they require an independent verification of an individual agent's license.

37 indicated they require an independent verification of an individual agency's license.

### Committee Review of Appointment

31 indicated they conduct a committee review of the potential agent.

### Escrow Review

37 indicated they examine the agent's latest escrow reconciliation.

31 indicated they check the balance of the escrow accounts of the appointed agents at least quarterly.

### Sample Transactions

33 indicated they ask agents for a sample of their work, such as a commitment and a policy, and then complete an independent review of the agent's work.

### Background and Credit Checks

31 indicated they conduct a background check of potential agents.

31 indicated they conduct a Google search of potential agents, while 30 indicated they conduct a credit check of potential agents.

### Bonds and E&O Coverage

28 indicated they currently have a crime bond to protect policyholders in the event criminal activity (such as agent theft, computer fraud, forgery, burglary, etc.) is discovered.

31 indicated they currently have a fidelity bond to protect policyholders in the event fraudulent acts are discovered.

27 indicated they currently require a surety bond.

34 indicated they currently require Errors and Omissions coverage on agents in the event errors or omissions are discovered.

### Cyber Security Investigated

24 indicated they have conducted an independent investigation of actual or potential cyber security risks within the last year.

### Frequency of Agent Review

18 indicated they conduct an agent review on a monthly basis.

35 indicated they conduct an agent review on an annual or bi-annual basis.

27 indicated they conduct agent reviews with a committee.

### Software Corporate Policy Issuance

26 indicated they use proprietary software or third party software to monitor agency activity.

### Mediation Procedures

25 indicated they have a specific corporate policy on mediation procedures in the event a defalcation or escrow theft is discovered.

27 indicated they conduct these mediation procedures with a committee.

### Probability Review

29 indicated they conduct a probability review of its agency base.



### Interpretation of Results

While not all Title underwriters have formalized, documented procedures and practices related to each of the various activities listed above, many have multiple procedures in place to monitor agencies in an effort to prevent defalcations and escrow theft.

Demotech recommends that regional Title underwriters have a formal process for agency reviews. Regardless of the personal relationship an underwriter may have with a potential agent, it makes good business sense to conduct a thorough investigation into their background and credit history. 93 percent of regional Title underwriters have a formal application process for vetting potential agencies prior to writing business with them.

88 percent of regional Title underwriters conduct agent reviews on at least an annual basis. 93 percent conduct a periodic reconciliation of escrow. 73 percent conduct a probability review of their agency base. Demotech recommends that those regional Title underwriters that have not conducted reviews do so as

part of their Enterprise Risk Management as these reviews are important components for an underwriter to make informed decisions on its agency base.

Overall, the aggregate results of regional Title underwriters seem consistent. For the period July 1, 2019 to June 30, 2020, only four defalcations were discovered by regional Title underwriters. For perspective, regional Title underwriters wrote over 2.6 million policies in 2019. While no system may be completely effective, it seems the processes and procedures currently in place are mitigating defalcation activity.

Keep in mind, this is not an indication that systems should remain stagnant or that processes and procedures should not be reviewed periodically and updated accordingly. In fact, robust enhancements are necessary to remain ahead of the curve.

For further context, this annual study of agency appointment and defalcation prevention information is part of the overall monitoring Demotech conducts on each rated

Title underwriter, national or regional, as part of the Financial Stability Rating® assignment process. Demotech reviews and evaluates quantitative and qualitative data. Regarding supplemental information, every entry, whether related to financial data (footnotes, etc.) in any quarterly financial statement, annual statement, reinsurance treaty, independent audit, examination report by a department of insurance, or business plan as well as information in the public domain or otherwise submitted, is reviewed and interpreted. The information submitted for this study has been reviewed in conjunction with the other efforts Demotech utilizes in its review process to establish an overall determination of the financial stability of each rated Title underwriter. Ⓢ

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**Douglas A Powell**, *Senior Financial Analyst*, supports the formulation and assignment of Financial Stability Ratings® (FSRs) for Demotech.

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