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A COMMENTARY ON THE VIABILITY OF INSURED ATTORNEY OPINION LETTERS AS AN ALTERNATIVE TO TITLE INSURANCE





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A Commentary on the Viability of Insured Attorney Opinion Letters as an Alternative to Title Insurance¹

The use of title insurance alternatives, specifically the attorney opinion letter (AOL), has sparked public debate in recent months as Fannie Mae and Freddie Mac have vocalized support for and expanded their acceptance of the alternative product. Now, the Consumer Financial Protection Bureau (CFPB) has joined the conversation by issuing a Request for Information regarding certain fees charged in connection with residential mortgage transactions, including title insurance fees. As would be expected with any disruption in a well-established market like title insurance, critics of an alternative product have surfaced to voice their concerns. Specifically, the American Land Title Association (ALTA), the title insurance industry's largest trade group, has raised concern over the inherent differences between the AOL alternative and traditional title insurance. To clarify some of the information that has been circulated about AOLs, we conducted an in-depth review of one insured AOL product.

The team at Alita Group has been quietly at the forefront of the debate around title insurance alternatives with its AOLPro product, a modernized AOL wrapped with a tailored Mortgage Service Provider's Errors & Omissions (MSP E&O) insurance policy. In sharp contrast to AOLs of the past, the coverage of the AOLPro extends to lenders and borrowers and spans the closing process. Here, we provide a detailed assessment of how the AOLPro, backed by the MSP E&O policy, fits into the modern mortgage marketplace as an intended alternative to title insurance.

In this analysis, we will discuss several distinguishing features of insured AOLs, traditional AOLs, and standard title insurance products. As part of our process, we reviewed the "Coverage Comparison" prepared by Greenberg Traurig for ALTA, as well as the white paper entitled "Making the Old New Again: The Resurgence of Attorney Opinion Letters as an Alternative to Title Insurance" prepared by Blank Rome for the Mortgage Bankers Association.

While the coverage provided by Alita's insured AOL is not identical to title insurance – nor can it be for reasons we will discuss – many of the concerns that have been raised target traditional AOLs and do not contemplate the coverage provided by the modernized version wrapped by the MSP E&O policy. **Based on our review, including multiple conversations with representatives of Alita, we have concluded that the AOLPro wrapped with the MSP E&O policy and coupled with a closing protection letter addresses significant title-related risks, including the most commonly encountered title risks, and is poised as a viable option in the modern real estate and mortgage lending landscape.**

¹ The information provided in this paper does not, and is not intended to, constitute legal advice; instead, the information and commentary is for general informational purposes only. This paper is not intended as a legal opinion and should not be regarded as a substitute for legal advice. Further, this paper does not provide insurance coverage advice, nor can it be construed to replace or alter any policy provisions. Insurance coverage is subject to and governed by the terms and conditions of the policy as actually issued and a prospective insured should consult the terms and conditions of the insurance policy to analyze the risks and coverages contemplated.

Answering the GSE's Call for More Affordable Homeownership

Fannie Mae and Freddie Mac first highlighted their focus on reducing barriers to homeownership, including closing costs, in their 2022 Equitable Housing Finance Plans.² Specifically, both enterprises identified title insurance premiums as one of the largest closing costs paid by borrowers.³ Of course, lenders require title-related assurances as part of the mortgage lending process, and investors like Fannie Mae and Freddie Mac require lenders selling mortgages to them to make similar representations and warranties about title.⁴ In an effort to address affordability concerns, Fannie Mae amended its Selling Guide in April 2022 to allow for the use of AOLs in place of title insurance policies on certain loan types, tracking language already included in Freddie Mac's Seller Servicer Guide.⁵ More recently, both GSEs amended their guidelines to allow for even broader use of AOLs, including additional property types. As part of its December 2023 release, Fannie Mae published a "Frequently Asked Questions" paper, wherein it disclosed that it had purchased more than 10,000 loans with AOLs since 2009 and had "not experienced losses from title claims on these loans."⁶ Fannie Mae also highlighted the success of the 2022 Selling Guide amendment and noted that refinancing borrowers have saved an average of over \$1,000 per transaction when using an AOL in lieu of traditional title insurance.⁷ Notably, the updates released by Freddie Mac in May 2024 also included certain insurance requirements not previously included in either GSE's AOL guidelines.⁸

Shortcomings of Traditional Attorney Opinion Letters

"Traditional" title opinion letters, like the ones used in real estate transactions before the creation of title insurance, often left homeowners and lenders with inconsistent and inadequate protection from title defects. Most title insurance historians trace the origins of title insurance to an 1868 case from the Pennsylvania Supreme Court — *Watson v. Muirhead* — where a purchaser was left holding the bag for relying on a faulty title opinion letter.⁹ As that case highlighted, the standard to prove a malpractice claim arising from a traditional opinion letter can be difficult to overcome and even those claims capable of meeting the threshold can be undermined by a relatively short statute of limitations. Further, efforts to recoup a loss from a successful malpractice claim against an attorney can be frustrated by a lapse or rescission of the attorney's insurance coverage or insufficient coverage. As the *Muirhead* case illustrates, traditional opinion letters exposed homeowners and lenders to too much title-related risk. Title insurance was created to solve for those limitations and better manage the risk; it has served that purpose for more than 150 years. *However, in the same way that title insurance resulted from a need in the market and the ingenuity of market participants, the demand in the current market for more affordable homeownership presents a similar opportunity for ingenuity and a new option for addressing title-related risk, like an insurance-backed AOL.*

2 See Freddie Mac Equitable Housing Finance Plan, June 2022; Fannie Mae Equitable Housing Finance Plan, 2022.

3 Freddie Mac Equitable Housing Finance Plan, June 2022, Section 4.3: Single-Family Title Insurance Cost Reduction, p. 23.

4 See Fannie Mae, *Selling Guide—Single Family*, Section A2-2-07, August 2, 2023; Freddie Mac, *The Single-Family Seller Servicer Guide*, Chapter 4201.2, March 2, 2016.

5 See Fannie Mae, *Selling Guide—Single Family*, Section B7-2-06, December 13, 2023; Freddie Mac, *The Single-Family Seller Servicer Guide*, Chapter 4702.3, May 1, 2024. Fannie Mae expanded its acceptance of AOLs in December 2023 to include loans secured by condominium units and properties subject to restrictive agreements or covenants, and Freddie Mac followed suit in May 2024.

6 Fannie Mae, *Attorney Opinion Letter Lender Frequently Asked Questions—February 2024*, <https://singlefamily.fanniemae.com/media/37606/display#:~:text=Our%20April%202022%20change%20aligned,Q4> (last accessed April 5, 2024)

7 *Id.*

8 Freddie Mac, *The Single-Family Seller Servicer Guide*, Chapter 4702.3, May 1, 2024. Freddie Mac's updated guidelines include language requiring that the seller of a loan for which an AOL is issued must maintain a mortgage file that contains a copy of the AOL, proof of acceptable professional liability coverage, and current claim filing instructions.

9 Joyce Palomar, 1 Title Ins. Law § 1:3 (2023 ed.).

Rethinking the Use of Attorney Opinion Letters

Alita's modernized version of the AOL relies on the same title search and exam process that underlies a title insurance policy and is presented in a format that lenders are accustomed to seeing. It also has the added benefits of an attorney review and a carefully considered E&O policy issued by AM Best A-rated insurance carriers. The MSP E&O policy was designed to address the limitations of traditional AOLs highlighted above and to encompass the most common title and closing risks. For example, the MSP E&O policy insures the abstracting and closing services provided, which account for the **largest share of losses** reported by title insurers. The primary distinction between the insured AOL and a title insurance policy is that an insured AOL cannot provide coverage for title defects that are not discoverable from the public records, whereas these undiscoverable defects may be covered by a title insurance policy if they do not fall under an exclusion or exception to coverage. Now provided with an alternative to traditional title insurance, industry leaders must weigh any potential risk against the potential for cost savings – an analysis that becomes especially important in a market experiencing lower origination volumes. Alita's AOLPro gives prospective insureds an alternative and the option to choose their scope of coverage based on a cost-benefit analysis, like the way insureds purchase endorsements to attach additional coverages to standard title insurance policies.



Level Setting and Contextualizing Title-Related Risks

A discussion and comparison of traditional title insurance and the insured AOL should include a) how title defects are discovered, b) how often they arise following a real estate transaction, and c) the ultimate size of the risk. In short, the question is whether the cost of the insurance is commensurate with the risk. Reviewing historical title defect and claims information provides relevant insight to this question.

In its 2022 Equitable Housing Plan, Freddie Mac observed that a “[c]omplete failure of title is extremely rare,”¹⁰ which appears to be supported by available data. For example, the Texas Department of Insurance issued a Texas Title Insurance Industry Experience Report for the years 2016 through 2020. In those five years, title insurers in Texas reported total premiums of \$11,131,905,930 from 12,731,795 residential and commercial transactions.¹¹ During that span, insurers reported a total of 21,013 claims made equating to approximately one claim for every 606 transactions or .165%. As for losses, title insurers in Texas reported \$131,232,466 during that period, reflecting a ratio of claim losses to premiums of approximately 1.18% or \$6,245.30 per claim.¹² To be sure, title defects and resulting losses are serious and should be guarded against, but this additional context is helpful when comparing risk and cost, which is what the mortgage industry, at large, is currently doing.

Reviewing the Texas Title Insurance Industry Experience Report in more granular detail, we also gain insight into the types of defects leading to claims and losses during this same five-year period. Specifically, insurers were required to provide information on claims, including losses incurred, broken down by ALTA risk codes. This determination is typically made at the outset of a claim and the categorization of a claim can be imprecise. Claims resulting from errors in the title examination or closing process, which are typically human errors, are generally assigned Risk Codes C, D, F and G in the Texas report. These risk codes accounted for \$52,385,692 of claims losses during that five-year span equating to approximately 39.91% of the claims-related losses. The claims falling into these categories are the primary focus of Alita’s AOLPro wrapped with the MSP E&O policy. For example, if a title examiner fails to identify a relevant recorded lien, then the risk should fall into Risk Code C and would be covered by the AOL Pro. Claims categorized as “Basic Risk” (ALTA Risk Code A) – including fraud, forgery, competency, undisclosed heirs, marital rights, and a list of insurer-assumed risks – accounted for approximately 28.87% of the Texas claim losses from 2016 to 2020.¹³

The “basic risk” group claims, while including some claims that may not be covered by the AOLPro product, do appear to include a notable number of title issues that should fall within the coverages afforded by the AOLPro backed by the MSP E&O policy or closing protection letter. If there is a prior forged deed in the chain of title that could not be detected by an examiner through objective evidence, then the risk would arguably fall within a Risk Code A.2 and would not typically be covered by the AOLPro. However, when fraud, forgery, incapacity, impersonation, improper execution of documents or improper recording are discoverable by a title examination or preventable

10 *Freddie Mac Equitable Housing Finance Plan*, June 2022, Section 4.3: Single-Family Title Insurance Cost Reduction, p. 23. While Freddie Mac notes the rarity of a complete failure of title, it states that the occurrence “usually leads to Seller/Service remedy.” Both Fannie Mae and Freddie Mac require a selling lender to provide representations and warranties about clear title and first-lien enforceability regardless of whether an AOL or title policy is obtained. And, while the GSEs may allow the use of AOLs in lieu of title insurance policies, the lender is ultimately responsible for the harm caused by a title defect clouding title or impairing a loan’s first lien position. As a result, Freddie Mac highlighted refinance transactions as presenting less risk because “major title problems should have been cured at purchase and the incremental risk of title defects arising between purchase and refinance is small.”

11 *Texas Department of Insurance, Texas Title Insurance Industry Experience Report*, <https://www.tdi.texas.gov/reports/pc/documents/2020uwexrpt.pdf> (last accessed March 15, 2024). Although the data provided in this report includes residential and commercial transactions, our analysis is primarily focused on the viability of insured AOLs as an alternative to title insurance in residential transactions. Given that commercial transactions are typically larger than a residential transaction, the losses and premiums for commercial transactions are inherently larger figures, which may skew the data in the cited report.

12 Although there were 21,013 claims made, that number is not tied to policies issued between 2016 and 2020. Like the MSP E&O policy, title insurance policies can be subject to claims years after the policy is issued. However, the five-year sample does provide context for the volume of claims in relation to the number of title insurance policies issued during that same span of time.

13 Additional ALTA Risk Codes include: Special Risks (“B”), Taxes and Special Assessments (“H”), Apparent Non-Covered Claims (“I”), Stakeholder/Interpleader Cases (“J”) and Disputed Procedure (“K”).

in connection with the current transaction, we would expect the AOLPro claim outcomes to track title insurance claim outcomes. Also, there are some sub-categories of Risk Code A that should be covered by the AOLPro including right of access issues (listed as an affirmative coverage in the AOLPro) and also some sub-categories of Risk Code A that would not be covered by either the AOLPro or a title insurance policy, including post-policy issues and assumed risks. All told, looking at the five-year period in the Texas report, we can see that Risk Code A items – without making any distinction for whether the title issue arose outside of the closing at issue – account for a small portion of losses relative to the premiums charged, and human error claim types account for a larger share of claim losses.

What Is Covered by Alita's Insured AOL?

While the coverage available under a standard title insurance policy and the insured AOL can be nuanced based on the facts and circumstances of individual claims, it is helpful to consider what is generally contemplated to be covered by each. Alita's insured AOL provides the following affirmative opinions:

1. Title to the property is vested as set forth in the AOL and is subject only to the encumbrances and exceptions described in the AOL.
2. Title is "marketable title," subject only to the subject mortgage and any encumbrances and exceptions described in the AOL.
3. The holder of the title as set forth in the AOL enjoys a right of legal access to and from the property.
4. The lien of the subject mortgage is a valid and enforceable lien on the title and has priority over any other liens and encumbrances, except as otherwise expressly set forth in the AOL.
5. The lien of the subject mortgage has priority over any statutory liens for services, labor, material, or equipment arising from construction of an improvement or work related to the property.
6. The lien of the subject mortgage has priority over the lien of any assessments for street improvements under construction or completed as of the effective date of the AOL.

Alita's insured AOL does include standard exceptions and exclusions from coverage such as traditional title insurance products. Further, as previously outlined, title defects that cannot be detected from a title examination or prevented by a careful closing are not within the scope of an errors and omissions policy such as the MSP E&O policy. However, as noted above, the exclusion of certain undiscoverable or unpreventable risks appears to be limited to title defects that occurred in the back chain of title, i.e., in connection with the closing of a prior transaction as opposed to the current transaction. *These risks, when they are discoverable or preventable and occur in connection with the current transaction, should fall within the scope of either the MSP E&O policy or the closing protection letter issued with the insured AOL.*

Important Notes Regarding Alita's Insured AOL

As part of our review, we engaged in discussions with Alita representatives to understand concerns voiced by others regarding the efficacy of AOLs as an alternative to title insurance and the ways in which the protections offered by the insured AOL could be clarified to address those concerns. Here are a few notes we believe are worth considering regarding Alita's offering:

- Alita has explained that it provides a primarily SaaS-based offering to facilitate the production of insured AOLs by approved service providers, whereby lenders enter into master services agreements with Alita's approved providers for the provision of insured AOLs and closing services.
- The AOL provided through the AOLPro is provided by licensed attorneys who are regulated by their respective state bars, and the MSP E&O policy insurers are regulated by state insurance regulators.
- Through the MSP E&O policy that backs Alita's AOL and the closing protection letter issued in connection with the transaction, Alita's offering provides coverage for incidents resulting from errors in the title examination, closing and recording processes, similar to what prospective insureds are accustomed to with title insurance.
- The coverage of the MSP E&O policy is linked to an identified error so that the insured party filing the claim does not need to prove the elements of malpractice or negligence to trigger coverage.
- To address the statute of limitations issue with traditional AOLs and issues with lapsed malpractice coverage, the notice period for a claim under the MSP E&O policy is 30 years, which is consistent with the typical term of security instruments. As a result, the MSP E&O coverage is not tied to the continued existence of the service provider or attorney issuing the AOL and a claim may be filed by any insured party at any time during that 30-year notice period.
- The conditions precedent to a loss payment are not limited to the completion of a foreclosure. The inability to foreclose due to a covered title issue, a charge off based on a commercially uneconomical foreclosure, and loan sale repricing are also conditions that could substantiate the basis for a loss payment under the MSP E&O policy.
- The insured AOL contemplates coverage to future holders of the loan. The coverage travels with the loan through the secondary market without the need for endorsements of the MSP E&O policy, which addresses the concern that a transferee of the loan would be unable to seek indemnity under a traditional AOL.



The Insured AOL and the “Duty to Defend”

In our experience, a significant number of title defects can be resolved through curative litigation or the defense of title. As a result, a critical feature of any product providing indemnification for losses resulting from title defects is what that product obligates the insurer to do when a title defect is discovered. Critics of traditional AOLs have pointed to the fact that, under traditional errors and omissions coverage, the insured is the provider of the service, which means the service provider or law firm providing the title and closing services – not the lender or the borrowers – would be the insured entitled to the benefit of the duty to defend. Alita’s insured AOL solves for this issue by including the mortgagee and mortgagor in the definition of an “insured”¹⁴ and further states that the insurer “shall have the right and duty to defend any Suit against the Insured seeking Damages or other non-monetary relief as a result of an Incident to which this insurance applies.”

Further, with the AOLPro, the expenses incurred in the defense of such actions are subject to a separate per incident limitation (\$50,000) that *does not erode the applicable Limit of Liability under the MSP E&O policy, which is based on the full amount of the loan in the case of the mortgagee or the purchase price of the property in the case of the mortgagor*. While it is possible that the defense costs of title curative litigation could exceed this \$50,000 claim expense limitation, the insurers issuing MSP E&O policies have advised that they will continue to monitor claims and assess the potential need to increase this limitation. Of course, should the \$50,000 claim expense limitation be exhausted, the lender and insurer would need to decide whether additional curative or defense of title efforts are viable and, if the lender decides not to undertake those on its own, the insurer may find itself in a position of needing to pay the claim.

The Claim Process

To fit within lenders’ current workflows, the claim submission process and ability to seek recourse directly from the issuer of the MSP E&O policy has been streamlined by Alita’s insured AOL. One of the limitations of the traditional errors and omissions insurance backing attorney opinion letters was the need for a claimant to submit its dispute to the service provider and to rely on the service provider to seek coverage from its insurer. To address this, the mortgagee and mortgagor are insureds under the MSP E&O policy wrapping the AOLPro and can submit their claims directly to the insurer and pursue all available remedies. With this direct line of communication to the insurer, the process to file a claim more closely resembles the process that lenders and homeowners are accustomed to with title insurance.

¹⁴ The definition of “insured” in the MSP E&O policy also directly addresses any skepticism about a borrower/homeowner’s rights and coverages in connection with Alita’s AOL product.



The Insured AOL Provides Indemnity in the Event of Title-Related Repurchase Demands

Loans sold in the secondary market may be subject to repurchase or reprice demands if there are breaches of representations and warranties regarding the status of title or enforceability of the security instrument, particularly when those title defects pose substantial risks. In our experience, when a lender sells a loan and subsequently receives a reprice or repurchase demand due to a title-related issue, title insurers typically deny any present obligation for indemnification on the basis that title insurance policies do not provide coverage for representations and warranties between lenders and investors. Claim denials by title insurers are common in these situations and, in the rare circumstance where an insured can negotiate coverage for this type of issue under a title insurance policy, the delay, time, and expense of those negotiations are costly.

In contrast, Alita's product embraces the expectations and realities of the secondary mortgage market by providing indemnity for these known occurrences and the ability to recoup a loss associated with the repricing or repurchase of a loan. Specifically, two of the possible triggers for coverage under the MSP E&O policy, in addition to a loss resulting from an error in the services provided, are that a mortgagee "received a repurchase demand from a third-party investor and resold the loan in the Scratch and Dent Market at a reduced value" or "was required to renegotiate at less favorable terms a pending loan purchase agreement with a third-party investor." Secondary market trading is an important component of the modern mortgage market, and this thoughtful inclusion reflects that modern reality in a way that provides substantial value to investors.



The Insured AOL Integrates into Existing Loan Origination Processes

Alita's AOL product was designed to fit within lenders' existing origination processes. Typically, a lender places an order with a title insurance agent for title work, including the issuance of a title insurance policy, and closing services. Next, the title agent performs a title examination and generates a title commitment. Once the requirements in the title commitment are satisfied, the closing is scheduled and completed, and documents are recorded. Once the recorded documents are returned, the title insurance policy is issued. Alita's approved service providers, many of whom, we understand, are also title insurance agents, follow the same processes to issue the insured AOL and close the loan. Alita's approved service providers are also subject to periodic reviews of key performance indicators and service level agreements to ensure compliance and consistency, which can be lacking in traditional title insurance processes that are managed individually by agents at the local level. Finally, as noted above, Alita's insured AOL also comes with an insured closing protection letter that is like the standard CPL that lenders are accustomed to receiving. This closing protection letter is backed by a professional liability insurance policy issued by an AM Best A-rated carrier and, notably, provides a two-year claim notice period compared to the one-year period found in the traditional ALTA CPL.

Conclusion

The mortgage industry has evolved substantially since the *Muirhead* case highlighted the need for a new way of confirming title in 1868. In the same way that various other aspects of the mortgage process have adapted to a changing landscape (e.g., data, appraisals, notarization), the approach to title-related risks should be evaluated. The insured AOL is a modern variation of a well-established concept. It was designed specifically to overcome the inherent limitations of traditional AOLs and to operate as an alternative to title insurance, which has become an area of focus for various agencies operating in the mortgage space, including Fannie Mae, Freddie Mac, and the VA. The AOLPro addresses the most common title risks and offers unique features such as portability into the secondary market, a 30-year claims period, and the inclusion of a duty to defend that aligns the alternative product with the expectations of an industry that has become accustomed to the protections afforded by title insurance. Additional features, such as secondary market repurchase coverage and an extended CPL notice period, should also make the AOLPro appealing to some market participants. Ultimately, each lender and homeowner will need to engage in a cost-benefit analysis and choose the most appropriate scope of coverage for the circumstances, and for the first time in 150 years, there is a GSE vetted and approved alternative that allows for that consideration and provides optionality beyond traditional title insurance.



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Hall Eady is a commercial and financial services litigator. His practice includes defending against borrower and customer-driven claims, and providing advice regarding recoupment options, including lien rights, closing errors, title insurance, mortgage insurance and correspondent/broker agreements. He has served as the firm's lead relationship attorney for several large financial services companies over the years with a focus on the delivery of consistent and high-quality legal services at competitive rates. Hall prides himself on listening closely to the needs of his clients and helping his clients identify the best solution for their specific and tailored legal needs, which can include anything from a single borrower lawsuit to a class action to regulatory and compliance issues impacting the operations of the company. His curiosity and genuine concern for his clients is the driving force behind his practice and experience.



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Spencer Mobley represents financial services clients throughout the country with a focus on resolving issues arising from the enforceability of mortgage liens and note obligations and borrower-driven litigation. He regularly provides counsel to lenders, mortgage servicers, and banks to help maximize recovery and mitigate mortgage loan losses through recoupment efforts involving title insurance, closing protection letters, mortgage insurance and the exercise of mortgage lien rights. Due to the wide and varied nature of issues bearing on the validity, enforceability and priority of mortgage liens, Spencer takes a creative, solutions-based approach to each matter. Through negotiation and litigation of insurance and real property claims, he has helped clients recoup millions of dollars and resolved title issues to enable clients to exercise their lien rights.

