MANAGEMENT’S DISCUSSION AND ANALYSIS

Home Protection Companies are classified as insurers pursuant to CIC Sec. 12743 J(1) and, as such, are required to file a supplement to the annual statement titled “Management’s Discussion and Analysis” by April 1 each year. This supplement is primarily a narrative document setting forth information that enables regulators to enhance their understanding of the insurer’s financial position, results of operations, changes in capital and surplus accounts and cash flow. The narrative may refer to such schedules, exhibits, General Interrogatories, and Five-Year Historical Data contained in the annual statement, as management believes to be necessary.

INSTRUCTIONS

1. Generally, the discussion shall be of the two year period covered by the annual statement and shall use year-to-year comparisons or any other formats that, in the insurer’s judgment, enhance the regulator’s understanding of its financial condition. However, where trend information is relevant, reference to the Five-Year Historical Data and other exhibits or schedules of the annual statement may be necessary. Where in the insurer’s judgment a discussion of lines of business or groups of lines would be appropriate to an understanding of the insurer’s business, the discussion may focus on each relevant grouping. The terms material and significant, when used to qualify a requirement for information as to any subject limit the information required to those matters about which a prudent regulator ought reasonably to be informed.

2. Where the financial statements reveal material changes from year to year in one or more significant line items, the causes for the changes shall be described to the extent necessary to provide an understanding of the insurer’s business or operations and reference to the exhibits or schedules of the annual statement shall be incorporated where deemed appropriate by the insurer. If the causes for a change in one line item also relate to other line items, no repetition is required on a line-by-line analysis of the financial statements. The insurer need not recite the amounts of changes from year to year that are readily computable from the financial statements. The discussion shall not merely repeat numerical data contained in the financial statements and schedules or exhibits to the annual statements.

3. The discussion and analysis shall also focus specifically on material events known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial position (e.g., the occurrence of a recent catastrophe). This would include descriptions and amounts of: (i) matters that would have an impact on future operations and have not had an impact in the past, and (ii) matters that have had an impact on reported operations and are not expected to have an impact upon future operations.

4. The insurer’s discussion and analysis shall be of the financial statements and other exhibits or schedules of the Annual Statement deemed appropriate by the insurer that enable regulators to enhance their understanding of the insurer’s financial condition. The discussion should provide regulators with information that is relevant to an assessment of solvency, financial position, results of operations, cash flow, and trends in the amount of capital and surplus. The information provided need only include that which is available to the insurer with expense and diligence as required for completion of the other parts of the annual statement and generally would include the following:
A. Financial Position

(i) Assets-
Discuss material changes in the insurer’s invested asset mix and quality distribution. This discussion should identify the impact, if any; those changes have on the insurer’s liquidity relative to current and future operational needs. Discuss any material changes in other asset categories (e.g., agents’ balances, reinsurance recoverables, amounts due from affiliated companies, etc.).

(ii) Liabilities-
Discuss the adequacy of the insurer’s policy or loss reserves and describe any material changes between years. Comment on any other liability categories having material changes between years (e.g., expense liability, balances due affiliated companies, unauthorized reinsurance liability, etc.).

(iii) Capital and Surplus Accounts-
Identify and describe any known material trends, favorable or unfavorable, in the insurer’s capital and surplus accounts. If a material unfavorable trend exists, indicate the courses of remedial action available to the insurer and the potential effects of each.

B. Results of Operations

(i) Describe any unusual or infrequent events or transactions or any significant changes that materially affected the amount of reported income from continuing operations and, where possible, indicate the extent to which income was so affected. In addition, describe any other significant components of revenues or expenses that, in the insurer’s judgment, should be discussed in order to understand the insurer’s results of operations.

(ii) Describe any known trends that have had or that the insurer reasonably expects will have a material favorable or unfavorable impact on net revenues or net income. If the insurer knows of events that will cause a material change in the relationship between benefits, losses, and expenses, the change in the relationship shall be disclosed.

(iii) To the extent that the financial statements disclose material increase in net revenues, provide a narrative discussion of the extent to which such increase are attributable to price or inflation increases or to increase in the volume of services being sold or to the introduction of new services.

C. Cash flow and Liquidity

(i) Indicate those balance sheet conditions or income or cash flow items that the company believes, may be indicators of its current liquidity condition. The term “liquidity” as used herein refers to the ability of the insurer to generate adequate amounts of cash to meet the insurer’s current needs for cash.
(ii) Identify and describe sources of cash flow and briefly discuss any material unused sources of liquid assets. Identify any known demands or events that will result in or that are reasonably likely to result in the insurer’s cash flow increasing or decreasing in any material way. Describe the material changes and, where possible, indicate what remedial courses of action are available to the company along with the potential effects of each.

(iii) Identify the insurer’s material commitments for capital expenditures as of the end of the latest fiscal period, and indicate the general purpose of such commitments and the anticipated source of funds needed to fulfill such commitments. This discussion shall consider material changes between equity, debt and any off-balance sheet financing arrangements.

5. Insurers are encouraged to supply forward-looking information concerning trends, demands, commitments or events that: (i) are likely to occur, and (ii) are likely to have a material impact upon the company.

In the event that an insurer does supply forward-looking information, the insurer may disclaim any responsibility for the accuracy of such information and condition the delivery of such information upon a waiver of any claim under any theory of law based on the inaccuracy of such information; provided that the insurer supplied such information in good faith.

6. Insurers are required to prepare the discussion on a non-consolidated basis, unless the following conditions are met:

A. The insurer is part of a consolidated group of insurers that utilizes a pooling arrangement or one hundred percent reinsurance agreement that affects the solvency and integrity of the insurer’s reserves and such insurer ceded substantially all of its direct and assumed business to the pool. An insurer is deemed to have ceded substantially all of its direct and assumed business to a pool if the insurer has less than $1,000,000 total direct plus assumed written premiums during a calendar year that are not subject to a pooling arrangement and the net income of the business not subject to the pooling arrangement represents less than 5% of the company’s capital and surplus. Or,

B. The insurer’s state of domicile permits audited consolidated financial statements.

If a group of insurance companies prepares the Management’s Discussion and Analysis on a consolidated basis, the discussion should identify and discuss significant differences between companies (e.g., investment mix, leverage, liquidity, etc.).