

REPORT OF EXAMINATION  
OF THE  
2-10 HBW WARRANTY OF CALIFORNIA, INC.  
AS OF  
DECEMBER 31, 2015

Filed on April 6, 2017

## TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION .....	1
COMPANY HISTORY: .....	2
Capitalization .....	3
Dividends .....	3
MANAGEMENT AND CONTROL:.....	3
Management Agreements.....	3
TERRITORY AND PLAN OF OPERATION.....	7
REINSURANCE .....	8
ACCOUNTS AND RECORDS:.....	8
Related Party Transactions.....	8
FINANCIAL STATEMENTS: .....	8
Statement of Financial Condition as of December 31, 2015 .....	9
Underwriting and Investment Exhibit for the Year Ended December 31, 2015 .....	10
Reconciliation of Surplus as Regards Contract Holders from December 31, 2011 through December 31, 2015.....	11
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	12
Claims Adjusted & Unpaid or in Process of Adjustment.....	12
Unearned Home Protection Contract Fees .....	12
SUMMARY OF COMMENTS AND RECOMMENDATIONS: .....	12
Current Report of Examination .....	12
Previous Report of Examination .....	13
ACKNOWLEDGMENT .....	14

Los Angeles, California  
February 24, 2017

Honorable Dave Jones  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of

2-10 HBW WARRANTY OF CALIFORNIA, INC.

(hereinafter also referred to as the Company) at the primary location of its books and records, 10375 East Harvard Avenue, Denver, Colorado 80231.

#### SCOPE OF EXAMINATION

We have performed our single-state examination of the Company. The previous examination of the Company was made as of December 31, 2010. This examination covered the period from January 1, 2011 through December 31, 2015.

The examination was conducted in accordance with the National Association of Insurance Commissioners' Financial Condition Examiners Handbook (Handbook). The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, assess corporate governance, identify current and prospective risks, and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with California Insurance Code statutes. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination, an adjustment is identified, the impact of such adjustment will be documented separately following the Company's financial statements.

This examination report includes findings of fact and general information about the Company and its financial condition. There might be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), were not included within the examination report, but separately communicated to other regulators and/or the Company.

#### COMPANY HISTORY

The Company is a member of a non-insurance holding company system. On December 23, 2009, a transfer of ownership occurred which resulted in a change of ultimate ownership of controlling company. Accordingly, effective December 23, 2009, the ultimate controlling company of the insurance holding system is SP HBW Holdco, LLC (SP HBW), a Delaware limited liability company holding 54.4% interest in Arias Holdings, LLC, with other equity holders, each having less than ten percent equity interest. All of these transactions involved only SP HBW and the individual investors, and did not affect the Company or the structure of the insurance holding company system. The Company continues to be a wholly-owned subsidiary of HBW Services, LLC. HBW Services, LLC remains a wholly-owned subsidiary of Arias Acquisitions, Inc., which remains 100% owned by HBW Holdings, Inc. These changes were approved by the California Department of Insurance on December 23, 2009.

### Capitalization

The Company is authorized to issue 100,000 shares of common stock with a par value of \$50.00 per share. As of December 31, 2015, there were 4,000 shares outstanding.

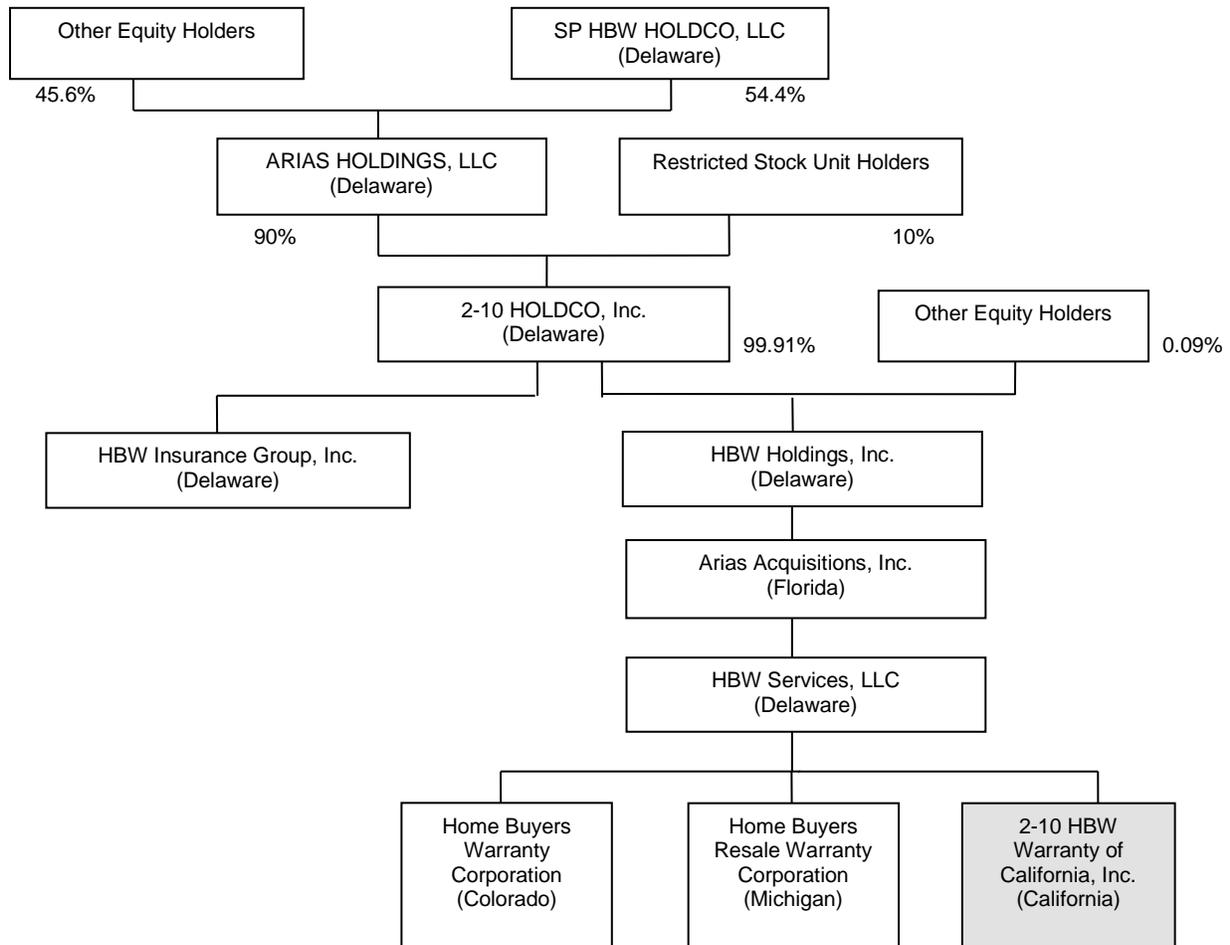
### Dividends

During the examination period, the Company declared and paid the following ordinary cash dividends to its parent, HBW Services, LLC, with approvals from the California Department of Insurance: \$696,000 in 2011, \$841,000 in 2012, \$284,126 in 2013, \$642,700 in 2014, and \$259,000 in 2015.

## MANAGEMENT AND CONTROL

### Management Agreements

The Company is a wholly-owned subsidiary of HBW Services, LLC, a Delaware limited liability company. The following abridged organization chart displays the relationships of the Company with its ultimate parents, along with its subsidiaries, and depicts the Company's relationship within the holding company system:



The two members of the board of directors, who are elected annually, manage the business and affairs of the Company. The following are members of the board of directors and principal officers of the Company serving as of December 31, 2015:

Directors

Name and Location

Principal Business Affiliation

Michael G. Bartosch  
Highlands Ranch, Colorado

Vice President  
Arias Acquisitions, Inc.

Name and Location

Mark C. Lewis  
Centennial, Colorado

Principal Business Affiliation

Chief Financial Officer and Treasurer  
Arias Holdings, LLC

Principal Officers

Name

Title

Michael G. Bartosch

President

Mark C. Lewis

Chief Financial Officer and Treasurer

Joan M. Riordan <sup>(a)</sup>

Secretary

Scott J. Cromie

Vice President

Curtis J. Addison <sup>(b)</sup>

Vice President – Finance

Scott D. Zinn

Senior Vice President Sales & Marketing

The following changes in management occurred subsequent to the examination date:

- <sup>(a)</sup> Joan M. Riordan resigned as Secretary of the Company, effective April 30, 2016.
- <sup>(b)</sup> Curtis J. Addison was elected as Secretary of the Company, effective April 30, 2016. Michael C. Fletcher was elected as Vice President and General Counsel, and replaced Curtis J. Addison as Secretary, effective December 31, 2016.

Management Agreements

Agreement for Services: Effective January 1, 2013, an Agreement for Services was entered into between the Company and its affiliate, Home Buyers Warranty Corporation (“HBW of Colorado”), a Colorado corporation. Services provided by HBW of Colorado to the Company include: information technology service and equipment, customer service, administration of service contracts, adjustment of contract claims, service contractor network administration, human resources and benefits administration, management advisory services, legal and regulatory compliance services, accounting services, financial statement preparation and reporting, general office management, mail service, telephone service and equipment, and facilities sharing. Personnel expense and cost allocations for services rendered by HBW of Colorado are charged to

the Company according to actual salaries, wages and direct costs of benefits and overhead. Equipment, supplies and special projects costs and expenses incurred by HBW of Colorado are charged to the Company on a direct pass-through basis according to HBW of Colorado's actual cost. Office space allocations are charged to the Company on a prorated basis according to the amount of square footage used by the Company in relation to the total square footage of the office space. All charges to the Company are based on actual costs with no profit factors built in. This Agreement for Services was filed and approved on January 3, 2013 by the California Department of Insurance (CDI) as required under California Insurance Code (CIC) Section 1215.5(b)(4). Under the terms of the agreement, the following fees were paid: \$495,473 in 2011, \$422,017 in 2012, \$340,866 in 2013, \$316,969 in 2014, and \$311,404 in 2015.

Marketing and Licensing Agreement: Effective January 1, 2013, a Marketing and Licensing Agreement was entered into between the Company and HBW of Colorado. Services provided by HBW of Colorado include: advertising, development of sales methods, as well as development, production, distribution, issuance and administration of marketing brochures and service contracts. The Marketing and License Agreement also provides the Company with a non-exclusive license to use the 2-10 HBW service mark in connection with the Company's service contracts program. Sales and marketing staff allocations for services rendered are charged according to actual salaries, wages and direct costs of benefits and overhead. Advertising, marketing brochures, services contracts and other items or methods for marketing the Company's service contracts are charged on a direct pass-through basis according to their actual cost. All charges by HBW of Colorado are based on actual costs with no profit factors built in. There is no separate charge to the Company for the license to use the 2-10 HBW service mark. This Marketing and Licensing Agreement was filed and approved on March 12, 2013 by the CDI as required under CIC Section 1215.5(b)(4). Under the terms of the Marketing and Licensing Agreement, the following fees were paid: \$425,641 in 2011, \$380,034 in 2012, \$325,616 in 2013, \$285,314 in 2014, and \$274,679 in 2015.

Tax Consolidation Agreement: The Tax Consolidation Agreement is between 2-10 HoldCo, Inc. and each of its subsidiaries that qualify for consolidated tax return treatment. HBW of Colorado, a subsidiary of 2-10 HoldCo, Inc., is responsible for making federal income tax estimates and final payments on behalf of the affiliated group. Under the terms of the Tax Consolidation Agreement, each company computes its separate tax liability as if it had filed a separate tax return. This Tax Consolidation Agreement was filed and approved on April 4, 2011 by the CDI as required under CIC Section 1215.5(b)(4). On September 20, 2011 the CDI approved the Company's Form D filing exemption request regarding a new Tax Consolidation Agreement, effective December 31, 2010. Under the terms of the Tax Consolidation Agreement, the following federal income taxes were paid: \$254,268 in 2011, \$509,077 in 2012, \$249,383 in 2013, \$334,456 in 2014, and \$117,702 in 2015.

#### TERRITORY AND PLAN OF OPERATION

The Company is licensed to transact home warranty business solely in the state of California. The Company utilizes sales representatives to market its product through the real estate community. The basic service contract covers major mechanical and plumbing systems as well as certain appliances against failures due to normal wear and tear. The term of the service contract is normally one year in length and is renewable annually at the option of the contract holder. A service contract is typically purchased in connection with a residential home purchase transaction by the seller for the benefit of the buyer from closing proceeds, or in some cases directly by the buyer. Pricing and coverage of the service contract generally vary by coverage level, type of equipment, deductibles or trade fees. Under the service contract terms, the Company's financial exposure to repair or replace covered items is capped by category and in the aggregate. In 2015, the Company had direct written premium of approximately \$1.5 million.

## REINSURANCE

The Company does not have reinsurance assumed or ceded.

## ACCOUNTS AND RECORDS

### Related Party Transactions

A review of the Company's related party transactions disclosed that settlement activities were undertaken between the Company and its affiliate, Home Buyers Resale Warranty Corporation, a Michigan company, without any documented agreements. These transactions were also undertaken without the required filing and prior approval from the California Department of Insurance as required by California Insurance Code Section 1215.5(b)(4). It is recommended that the Company file the agreement in accordance with CIC Section 1215.5(b)(4).

## FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the California Department of Insurance and present the financial condition of the Company for the period ending December 31, 2015. The accompanying comments to the amounts reported in the annual statements should be considered an integral part of the financial statements. There were no examination adjustments made to surplus as a result of the examination.

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2015

Underwriting and Investment Exhibit for the Year Ended December 31, 2015

Reconciliation of Surplus as Regards Contract Holders from December 31, 2011 through December 31, 2015

Statement of Financial Condition  
as of December 31, 2015

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 2,334,294	\$	\$ 2,334,294	
Cash and short-term investments	438,699		438,699	
Service Fees Receivable	433,303	4,531	428,772	
Receivables from parents subsidiaries and affiliates	357	357	0	
Interest, dividends and real estate income due and accrued	<u>14,924</u>		<u>14,924</u>	
 Total assets	 <u>\$ 3,221,577</u>	 <u>\$ 4,888</u>	 <u>\$ 3,216,689</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Claims adjusted & unpaid or in process of adjustment			\$ 69,605	(1)
Other expenses			173,299	
Taxes, licenses and fees			9,466	
Federal income taxes			(122,326)	
Unearned home protection contract fees			<u>715,138</u>	(2)
 Total liabilities			 845,182	
Common capital stock		\$ 200,000		
Gross paid-in and contributed surplus		811,412		
Unassigned funds (surplus)		<u>1,360,095</u>		
Surplus as regards contract holders			<u>2,371,507</u>	
 Total liabilities and surplus			 <u>\$3,216,689</u>	

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2015

Statement of Income

Underwriting Income

Home protection contract fees earned \$ 1,589,484

Deductions:

Claims incurred	\$	647,167
Claims service expense incurred		145,966
Other underwriting expenses incurred		<u>572,864</u>

Total underwriting deductions 1,365,997

Net underwriting gain 223,487

Investment Income

Net investment income earned	\$	62,697
Net realized capital loss		<u>(12,187)</u>

Net investment gain 50,510

Other Income

Miscellaneous	\$	<u>68,686</u>
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Total other income 68,686

Net income before federal income taxes 342,683

Federal income taxes incurred 100,818

Net income \$ 241,865

Capital and Surplus Account

Surplus as regards contract holders,  
December 31, 2014 \$ 2,379,346

Net income	\$	241,865
Change in non-admitted assets		(3,788)
Dividends to stockholders		(259,000)
Other gains in surplus		<u>13,084</u>

Change in surplus as regards contract holders for the year (7,839)

Surplus as regards contract holders,  
December 31, 2015 \$ 2,371,597

Reconciliation of Surplus as Regards Contract Holders  
from December 31, 2011 through December 31, 2015

Surplus as regards contract holders, December 31, 2010			\$ 3,446,642
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 1,659,000	\$	
Change in non-admitted assets	13,602		
Dividends to stockholders		2,722,826	
Other losses		<u>24,911</u>	
Total gains and losses	<u>\$ 1,672,602</u>	<u>\$ 2,747,737</u>	
Net decrease in surplus as regards contract holders			<u>(1,075,135)</u>
Surplus as regards contract holders, December 31, 2015			<u>\$ 2,371,507</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Claims Adjusted & Unpaid or in Process of Adjustment

Claims related to home warranty contracts are generally paid within a short period of time after the repairs are made. The Company engaged KPMG, LLC Actuarial Services to evaluate the reserves. Based on the analysis, the Company's December 31, 2015 unpaid claims reserve appears reasonable and has been accepted for purposes of this examination.

### (2) Unearned Home Protection Contract Fees

Pursuant to California Insurance Code (CIC) Section 12753, a home protection company shall maintain a reserve for unearned premiums in an amount not less than 40 percent of the aggregate premiums charged on its contracts currently in force. Per review of the Company's reserve for unearned premiums, the Company is in compliance with CIC Section 12753.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Accounts and Records – Related Party Transaction (Page 8): A review of the Company's related party transaction disclosed that settlement activities were undertaken between the Company and its affiliate, Home Buyers Resale Warranty Corporation, a Michigan company, without an agreement in place as required by California Insurance Code (CIC) Section 1215.5(b)(4). It is recommended that the Company file the agreement in accordance with CIC Section 1215.5(b)(4).

Previous Report of Examination

None

ACKNOWLEDGMENT

The courtesy and cooperation extended by the Company's officers and the affiliates' employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

Shelly Liu  
Examiner-In-Charge  
Associate Insurance Examiner  
Department of Insurance  
State of California

/S/

Grace Asuncion, CFE  
Senior Insurance Examiner, Supervisor  
Department of Insurance  
State of California