

REPORT OF EXAMINATION
OF THE
HOMEGUARD HOMEWARRANTY, INC.
AS OF
DECEMBER 31, 2019

Filed on March 23, 2021

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Sacramento, California
March 9, 2021

Honorable Ricardo Lara
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

HOMEGUARD HOMEWARRANTY, INC.

(hereinafter also referred to as the Company). Its home office located at 510 Madera Avenue, San Jose, California 95112.

SCOPE OF EXAMINATION

We have performed our multi-state examination of the Company. The previous examination of the Company was as of December 31, 2013. This examination covers the period from January 1, 2014 through December 31, 2019.

This examination was conducted in accordance with California statutes and regulations 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. The examination also included 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. This included assessing significant estimates made by management. The examination does not attest to the fair presentation of the financial statements included herein. If an adjustment was identified during the course of the examination, the impact of such adjustment would 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 the Company.

COMPANY HISTORY

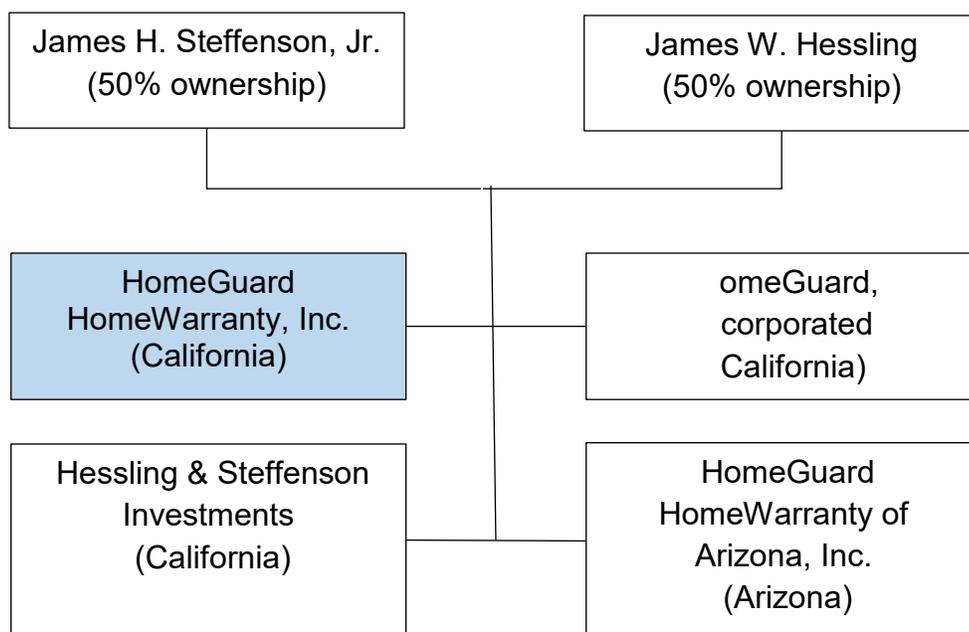
The Company was incorporated in the State of California on April 21, 2003, and commenced writing home warranty business on May 31, 2006.

Capitalization

The Company is 50% owned by James W. Hessling and 50% by James H. Steffenson, Jr. The Company is authorized to issue 10,000 shares of common stock with a par value of \$5 per share. As of December 31, 2019, there were 8,000 shares issued and outstanding.

MANAGEMENT AND CONTROL

The ultimate controlling persons of the Company are James H. Steffenson, Jr. and James W. Hessling. The following organizational chart depicts the Company within the holding company system as of December 31, 2019 (all ownership is 100% unless otherwise noted):



The Company is overseen by a three-member board of directors who are elected annually. Following are members of the board and officers of the Company as of December 31, 2019:

Directors

Name and Location

James W. Hessling
Morgan Hill, California

Robert J. Hessling
Morgan Hill, California

James H. Steffenson, Jr.
San Jose, California

Principal Business Affiliation

Secretary and Chief Financial Officer
HomeGuard HomeWarranty, Inc.

Chairman and President
HomeGuard HomeWarranty, Inc.

Chief Executive Officer
HomeGuard HomeWarranty, Inc.

Principal Officers

<u>Name</u>	<u>Title</u>
James H. Steffenson, Jr.	Chief Executive Officer
Robert J. Hessling	President
James W. Hessling	Secretary and Chief Financial Officer

Management Agreements

California Commercial Lease Agreement: Effective September 1, 2010, the Company and its affiliate, Hessling & Steffenson Investments, entered into a California Commercial Lease Agreement (Agreement). Under the terms of the Agreement, Hessling & Steffenson Investments provides office space to the Company. Effective September 1, 2013, a first amendment to the Agreement was made to extend the lease term to August 31, 2018. On June 15, 2015, the California Department of Insurance (CDI) consented to the use of the Agreement and amendment pursuant to California Insurance Code (CIC) Section 1215.5(b)(4). Effective September 1, 2018, a second amendment to the Agreement was made to expand the leased space to 2,600 square feet and to extend the lease term to August 31, 2023. This amendment was approved by the CDI on February 23, 2018 pursuant to CIC section 1215.5(b)(8). The Company incurred \$62,400 in rent expense under this Agreement in 2019, payable in monthly installments of \$5,200.

Intercompany Affiliated Service Agreement: The Company and its affiliate, HomeGuard, Incorporated (HGI) entered into an Intercompany Affiliated Service Agreement (Agreement) on March 1, 2012, in which HGI provides accounting, tax, auditing, and contract solicitation services and the Company reimburses HGI for the actual cost of these services. Pursuant to CIC Section 1215.5(b)(4), the CDI approved the Agreement on March 2, 2012. The fees incurred under this Agreement in 2019 were \$148,423.

Intercompany Affiliated Service Agreement: Effective September 26, 2019 the Company and its affiliate, HomeGuard HomeWarranty of Arizona Inc. (HGHW AZ) entered into an Intercompany Affiliated Service Agreement (Agreement). Under the terms of the

Agreement, the Company agrees to provide claims services and customer service services and HGHW AZ reimburses the Company for the actual cost of these services. The CDI approved the Agreement pursuant CIC Section 1215.5(b)(4) on September 26, 2019. The fees recovered under this Agreement in 2019 were \$265,000.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2019, the Company was licensed to write home warranty business in the states of Arizona, California, and Nevada. The Company wrote 100% of its business in California. During 2019, the Company issued 14,407 home warranty contracts and collected home protection contract fees in the amount of \$7.65 million.

The Company provides a one-year home protection plan that covers repair or replacement of covered systems and/or appliances that are damaged due to normal use. The Company contracts with outside independent contractors to perform service calls. The Company markets its home protection plans through direct sales representatives to real estate professionals in California. The Company also sells directly to the public through its website. The Company has developed a long-term strategic plan comprising of maintaining a strong presence in Northern California as well as extending its sales reach to Southern California and several other western states such as Arizona and Nevada.

REINSURANCE

The Company did not assume or cede any reinsurance during the period covered by the examination.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the California Department of Insurance for the period ending December 31, 2019. The accompanying comments to the amounts reported in the financial statements should be considered an integral part of the financial statements. No adjustments were made to the financial statements as a result of the examination.

Statement of Financial Condition as of December 31, 2019

Underwriting and Investment Exhibit for the Year Ended December 31, 2019

Reconciliation of Surplus as Regards Contract Holders from December 31, 2013
through December 31, 2019

Statement of Financial Condition
as of December 31, 2019

<u>Assets</u>		<u>Notes</u>
Cash and short-term investments	\$ 3,699,745	
Home protection contract fees receivable	175,578	
Service fees receivable	3,207	
Receivable from parent, subsidiaries and affiliates	122,297	
Federal income tax recoverable	19,089	
Interest, dividends and real estate income due and accrued	2,553	
Other assets	<u>1,700</u>	
 Total assets	 \$ <u>4,024,169</u>	
 <u>Liabilities, Surplus and Other Funds</u>		
Claims adjusted and unpaid or in process of adjustment	\$ 310,800	(1)
Claims service expenses	56,228	
Other expenses	37,514	
Taxes, licenses and fees	22,163	
Unearned home protection contract fees	3,097,136	
Customer Deposits	31,170	
Credit card payables	2,824	
 Total liabilities	 <u>3,557,835</u>	
 Common capital stock	 \$ 800,000	
Gross paid-in and contributed surplus	64,000	
Unassigned funds (surplus)	<u>(397,666)</u>	
 Surplus as regards contract holders	 \$ <u>466,334</u>	
 Total liabilities, surplus and other funds	 \$ <u>4,024,169</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2019

Statement of Income

Underwriting Income

Home protection contract fees earned		\$ 7,377,566
Deductions:		
Claims incurred	\$ 3,743,030	
Claims service expenses incurred	886,186	
Other underwriting expenses incurred	<u>3,079,631</u>	
Total underwriting deductions		<u>7,708,847</u>
Net underwriting loss		<u>(331,281)</u>

Investment Income

Net investment income earned	<u>\$ 65,949</u>	
Net investment gain		65,949
Net loss before federal income taxes		<u>(265,332)</u>
Net loss		<u>\$ (265,332)</u>

Capital and Surplus Account

Surplus as regards contract holders, December 31, 2018		\$ 718,880
Net loss	\$ (265,332)	
Change in non-admitted assets	<u>12,786</u>	
Change in surplus as regards contract holders for the year		<u>(252,546)</u>
Surplus as regards contract holders, December 31, 2019		<u>\$ 466,334</u>

Reconciliation of Surplus as Regards to Contract Holders
from December 31, 2013 through December 31, 2019

Surplus as regards contract holders, December 31, 2013			\$ 692,982
	Gain in Surplus	Loss in Surplus	
Net loss	\$	\$	230,077
Change in non-admitted assets	3,429		
Total gains and losses	\$ 3,429	\$ 230,077	
Net decrease in surplus as regards contract holders			(226,648)
Surplus as regards contract holders, December 31, 2019			\$ 466,334

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Claims Adjusted and Unpaid or in Process of Adjustment

The Company's reserves for claims adjusted and unpaid or in process of adjustment was tested using a 12-month loss development. Based on the results of the test, it was concluded that the claims adjusted and unpaid or in process of adjustment reported at December 31, 2019 was reasonable and has been accepted for the purpose of this examination.

SUSEQUENT EVENTS

The Coronavirus Disease 2019 (COVID-19) global pandemic has triggered unprecedented government mandates and health and safety measures, which have significantly impacted the U.S. and global economy and financial markets. The Company experienced no adverse impact on its asset management and investment valuations as a result of COVID-19. The Company estimates that it lost approximately \$1 million in potential sales due to government shutdowns which slowed economic activity. The Company is seeing sales recover and experienced a 20% increase in sales for the fourth quarter of 2020 compared to the fourth quarter of 2019. Additionally, the Company experienced higher claims rates in 2020 due to both the slowed sales growth and the increased usage rates by customers as a result of the government stay at home orders. The Company received financial assistance under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which provided funds in the Paycheck Protection Program and federal tax refunds. Because of these federal benefits, the Company was able to continue its growth strategy and achieve a profit in 2020.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

Management and Control – Management Agreements (Page 4): It was recommended that the Company submit the Lease Agreement executed with its affiliate, Hessling & Steffenson Investments, to the California Department of Insurance (CDI) for approval in accordance with California Insurance Code Section 1215.5(b)(4). The Company has complied with the recommendation.

Accounts and Records – Information Systems Controls (Page 5): It was recommended that the Company evaluate the findings and recommendations and make appropriate changes to strengthen its information systems controls. The Company has complied with the recommendation.

ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

_____/S/_____

Christian Mitterholzer
Examiner-In-Charge
Insurance Examiner
Department of Insurance
State of California

_____/S/_____

Li Lim, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California