

REPORT OF EXAMINATION
OF THE
FIDELITY NATIONAL
HOME WARRANTY COMPANY
AS OF
DECEMBER 31, 2007

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San Francisco, California
May 10, 2009

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of

FIDELITY NATIONAL HOME WARRANTY COMPANY

(also referred to as the Company) at its home office located at 1850 Gateway Boulevard, Suite 400, Concord, California 94520.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2004. This examination covers the period from January 1, 2005 through December 31, 2007. The present examination of the Company included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions, an evaluation of assets, and a determination of liabilities as of December 31, 2007, as deemed necessary under the circumstances. In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

COMPANY HISTORY

During the period of this examination, the Company paid dividends to its parent company Fidelity National Financial, Inc., as follows:

Year Paid	Amount Paid
2005	\$ 8.3 million
2006	8.4 million
2007	<u>9.5 million</u>
Total	<u>\$26.2 million</u>

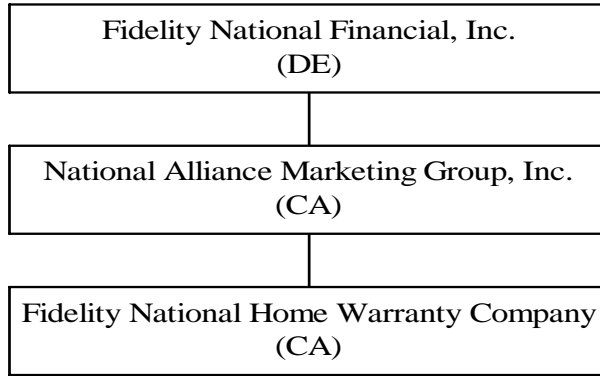
There were no financial objections by the California Department of Insurance for these dividend distributions.

CORPORATE RECORDS

The Company was not in compliance with California Insurance Code (CIC) Section 735, which requires the examination report be presented to the board of directors and recorded in its board of directors' minutes. During the examination, the Company has taken action to comply. It is recommended that in the future, the Company comply with CIC Section 735.

MANAGEMENT AND CONTROL

The Company is wholly-owned by National Alliance Marketing Group and is part of a larger group of companies ultimately controlled by Fidelity National Financial, Inc. The following is an abridged version of the holding company chart showing only the ultimate parent company, the parent company, and the Company.



Management of the Company is vested in a five-member board of directors elected annually. Members of the board of directors and principal officers serving at December 31, 2007 were as follows:

Directors

<u>Name and Residence City</u>	<u>Principal Business Affiliation</u>
Billy D. Jensen Santa Rosa, California	President and Chief Executive Officer Fidelity National Home Warranty
Roger S. Jewkes Santa Barbara, California	Executive Vice President and Division Manager Fidelity National Financial, Inc.
Anthony J. Park Jacksonville, Florida	Chief Financial Officer Fidelity National Financial, Inc.
Raymond R. Quirk Jacksonville, Florida	President Fidelity National Financial, Inc.
Alan L. Stinson Jacksonville, Florida	Chief Operating Officer Fidelity National Financial, Inc.

Principal Officers

<u>Name</u>	<u>Title</u>
Billy D. Jensen	President and Chief Executive Officer
Charles M. Dyer	Executive Vice President and Chief Operating Officer

<u>Name</u>	<u>Title</u>
Cathy M. Tristant	Executive Vice President and Assistant Secretary
Marjorie R. Nemzura	Vice President and Assistant Secretary
Matthew G. Hartmann	Vice President
Kevin R. Chiarello	Vice President
Donald E. Partington	Vice President
Richard L. Cox	Vice President
Patrick G. Farenga	Vice President
Peter T. Sadowski	Vice President
Sue A. D'Arcy	Vice President
Debra J. Estrada	Vice President
Olga M. Gander	Vice President
Pattie A. Hackman	Vice President

Inter-Company Management Agreement

The Company has a Master Services Agreement with Fidelity National Financial, Inc. (FNF), whereby FNF provides various accounting and administrative services to the Company. The Company received approval for the agreement from the California Department of Insurance (CDI) to implement this arrangement on March 11, 2003. The agreement became effective on March 12, 2003.

Federal Income Tax Allocation Agreement

The Company files a consolidated Federal Income Tax return with FNF, its ultimate parent, but the Company is not specifically listed as a participant in the Federal Income Tax Allocation Agreement. It is recommended that the Company submit an amended Federal Income Tax Allocation agreement to the CDI for approval. The Company has submitted the agreement to the CDI, and it is currently being reviewed.

TERRITORY AND PLAN OF OPERATION

The Company writes only home protection contracts and is licensed in Arizona, California, Colorado, Illinois, Nevada, Oregon, Texas, and Washington. Direct contract fees written for 2007 were \$61,414,521. Of this amount, 80% of the business was written in California, 12% in Arizona, and 5.25% in Nevada.

The Company writes home protection contracts for single family homes, condominiums, town homes, mobile homes, duplex, triplex, and fourplex units for a duration of twelve months. During the contract period, the Company is obligated to pay for repairs or replacement of covered systems and/or appliances that are damaged due to normal use. The Company also offers optional buyer's coverage for an additional fee, which includes additional items not covered in the standard plan.

Business is written through a sales force of 60 sales representatives who make contact with real estate professionals. The Company has three vice presidents of sales; one to manage the Northern California sales force, one to manage the Southern California sales force, and the third to manage the Northwest and Southwest sales force.

REINSURANCE

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

ACCOUNTS AND RECORDS

Information Systems Controls

An information systems (IS) audit conducted by the Company parent's internal audit department identified control weaknesses in the following areas: segregation of IS duties, promotion and deployment of program changes into the production environment, program developer access to

computer resources and sensitive files, and system development life cycle standards and procedures. The Company acknowledges the deficiencies noted and accepts these risks as it currently believes that the cost of implementing controls in these areas outweighs the benefits derived. It is recommended that the Company periodically assess and monitor these risk areas to determine whether it should continue to accept these risks or establish appropriate controls to mitigate them.

Although the Company backs up its computer files to an offsite location, has a scaled down hot-site, and a disaster recovery framework, it has not documented a comprehensive and detailed business continuity/disaster recovery plan in writing. It is recommended that the Company establish a comprehensive and detailed business continuity/disaster recovery plan in writing that addresses the recovery of all business units in addition to its IS operations. It is also recommended that the Company test its business continuity/disaster recovery plan periodically to determine the plan's workability.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2007

Underwriting and Investment Exhibit for the Year Ended December 31, 2007

Reconciliation of Surplus as Regards Contract Holders from December 31, 2004
through December 31, 2007

Reconciliation of Examination Changes as of December 31, 2007

Statement of Financial Condition
as of December 31, 2007

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$41,485,317	\$	\$41,485,317	
Cash on hand and on deposit:				
Cash in company's office	600		600	
Cash on deposit	4,021,932		4,021,932	
Home protection contract fees receivable	1,082,177		1,082,177	
Receivable from affiliates	7,038,215	3,643,384	3,394,831	(1)
Interest, dividends and real estate income due and accrued	639,567		639,567	
Other assets	<u>25,624</u>	<u> </u>	<u>25,624</u>	
Total assets	<u>\$54,293,432</u>	<u>\$ 3,643,384</u>	<u>\$50,650,048</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Claims adjusted and unpaid or in process of adjustment			\$ 3,544,917	(2)
Claims service expense			38,790	
Other expenses			1,978,947	(3)
Taxes, licenses and fees			1,503,453	(4)
Federal income taxes			1,267,293	
Unearned home protection contract fees			24,565,808	
Due to affiliate			<u>779,519</u>	(5)
Total liabilities			33,678,727	
Common capital stock		\$ 1,598		
Gross paid-in and contributed surplus		5,606,729		
Unassigned funds (surplus)		<u>11,362,994</u>		
Surplus as regards contract holders			<u>16,971,321</u>	
Total liabilities, surplus and other funds			<u>\$50,650,048</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2007

Statement of Income

Underwriting Income

Home protection contract fees earned		\$64,436,734
Deductions:		
Claims incurred	\$31,156,993	
Claims service expenses incurred	4,355,899	
Other underwriting expenses incurred	<u>19,294,090</u>	
Total underwriting deductions		<u>54,806,982</u>
Net underwriting gain		9,629,752

Investment Income

Net investment income earned	<u>\$ 2,340,792</u>	
Net investment gain		<u>2,340,792</u>
Net income before federal income taxes		11,970,544
Federal income taxes incurred		<u>2,903,571</u>
Net income		<u>\$ 9,066,973</u>

Capital and Surplus Account

Surplus as regards contract holders, December 31, 2006		\$21,362,666
Net income	\$ 9,066,973	
Change in nonadmitted assets	(2,669,918)	
Annual statement reporting errors	(1,288,400)	
Dividends to stockholders	<u>(9,500,000)</u>	
Change in surplus as regards contract holders		<u>(4,391,345)</u>
Surplus as regards contract holders, December 31, 2007		<u>\$16,971,321</u>

Reconciliation of Surplus as Regards Contract Holders
from December 31, 2004 through December 31, 2007

Surplus as regards contract holders: December 31, 2004, per Examination			\$ 20,194,826
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$27,055,572	\$	
Change in nonadmitted assets		2,790,677	
Annual statement reporting errors		1,288,400	
Dividends to stockholders (cash)	_____	<u>26,200,000</u>	
Total gains and losses in surplus	<u>\$27,055,572</u>	<u>\$30,279,077</u>	
Decrease in surplus as regards contract holders			<u>(3,223,505)</u>
Surplus as regards contract holders, December 31, 2007, per Examination			<u>\$16,971,321</u>

Reconciliation of Examination Changes
as of December 31, 2007

<u>Assets</u>	Per <u>Company</u>	Per <u>Examination</u>	Surplus Increase (Decrease)	<u>Note(s)</u>
Receivable from affiliates	\$7,038,215	\$3,394,831	\$(3,643,384)	(1)
 <u>Liabilities</u>				
Other expenses	3,246,240	1,978,947	1,267,293	(1) (3)
Taxes, licenses and fees	514,297	1,503,453	(989,156)	(1) (4)
Due to affiliate	0	779,519	<u>(779,519)</u>	(1) (5)
Net decrease to unassigned funds			(4,144,766)	
Surplus as regards policyholders, December 31, 2007 per Company			<u>21,116,087</u>	
Surplus as regards policyholders, December 31, 2007 per Examination			<u>\$16,971,321</u>	

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Receivable from Affiliates

Due to the reclassification of liability items (reported as contra assets), corrections of annual statement reporting errors, and the non-admittance of unidentified and unsupported items, the Company's receivable from affiliates account was reduced by \$3,643,384. The following exhibit shows the adjustments that were made to this account:

<u>Items Comprising Account</u>	<u>Per Company</u>	<u>Examination Adjustment</u>	<u>Per Examination</u>	<u>Comment</u>
Intercompany	\$ 417,666	\$ (25,006)	\$ 392,660	Adjustment reclassified to taxes, licenses and fees
Intercompany corporate	(779,519)	779,519	-	Reclassified to Due to affiliate
Deferred income tax	3,002,171		3,002,171	
State income tax payable	(1,014,162)	1,014,162	-	Reclassified to taxes, licenses and fees
Keying errors	(1,513)	1,513	-	Correct annual statement reporting error
Federal income tax accrual	1,267,293	(1,267,293)	-	Reverse double accounting
2007 income tax	1,604,430	(1,604,430)	-	Correct annual statement reporting error
Unrealized gain on investment	(314,517)	314,517	-	Correct annual statement reporting error
Unidentified/unsupported items	2,856,366	(2,856,366)	-	Non-admitted
Total	\$ 7,038,215	\$ (3,643,384)	\$ 3,394,831	

The Company and its parent, Fidelity National Financial, Inc. (FNF) could not provide documentation supporting a number of items that comprised the receivable from affiliates account which is in violation of California Insurance Code (CIC) Section 1215.5(a)(4) and the terms of the companies' Master Services Agreement.

It is recommended that the Company institute control procedures to prevent the errors that were noted in this account from occurring in the future. It is also recommended that full documentation of the intercompany balances be maintained and that the Company and FNF comply with CIC Section 1215.5(a)(4) and the terms of their Master Services Agreement.

The Company indicated that it has made corrections to the receivable from affiliate account during 2009. The corrections resulted in the Company reporting a prior period adjustment that reduced surplus by \$4,216,598 in its March 31, 2009 Quarterly Statement.

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

The Company's reserve for claims adjusted and unpaid was tested using a 12-month loss development. Based on the results of the test, no adjustment was made to the Company's claims reserve.

(3) Other Expenses

The Company in the construction of its 2007 Annual Statement included federal income tax payable in the amount of \$1,267,293 as a liability under other expenses and also under federal income taxes. An examination adjustment of \$1,267,293 was made to correct this annual statement reporting error. It is recommended that the Company institute control procedures to prevent this situation from occurring in the future.

(4) Taxes, Licenses and Fees

This account was increased by \$989,156 due to reclassification of two tax related items from the receivable from affiliates account.

(5) Due to Affiliate

The balance in this account was established as the result of an affiliated transaction that was reclassified from the receivable from affiliates account in the amount of \$779,519.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Corporate Records – (Page 2): It is recommended that the Company comply with California Insurance Code (CIC) Section 735.

Management and Control - Federal Income Tax Allocation Agreement – (Page 4): It is recommended that the Company submit an amended Federal Income Tax Allocation agreement to the California Department of Insurance for approval.

Accounts and Records – Information Systems Controls (Page 5): It is recommended that the Company periodically assess and monitor the risk areas identified by its parent's internal audit department to determine whether it should continue to accept these risks or establish appropriate controls to mitigate them.

It is recommended that the Company establish a comprehensive and detailed business continuity/disaster recovery plan in writing that addresses the recovery of all business units in addition to its information system operations. It is also recommended that the Company test its business continuity/disaster recovery plan periodically to determine the plan's workability.

Comments on Financial Statement Items – Receivable from Affiliates – (Page 11): It is recommended that the Company institute control procedures to prevent the errors that were noted in this account from occurring in the future.

It is recommended that documentation of the intercompany balances be maintained and that the Company and its parent company comply with CIC Section 1215.5(a)(4) and the terms of their Master Services Agreement.

Comments on Financial Statement Items – Other Expenses – (Page 12): It is recommended that the Company institute control procedures to prevent errors in the reporting of its accounts and financial position in the future.

Previous Report of Examination

Comments on Financial Statement Items – Claims Service Expenses – (Page 9): It was recommended that the Company maintain workpapers to support the claims service expense reserve on claims that are adjusted and unpaid or in the process of adjustment in future financial statements. The Company did not comply with this recommendation, but during the course of this examination, it took corrective measures to maintain workpapers to support the claims service expense.

ACKNOWLEDGEMENT

The undersigned would like to thank the Company's officers and employees for their cooperation and assistance during the course of this examination.

Respectfully Submitted,

_____/s/_____

Jennifer Whitehurst, CFE
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California