

REPORT OF EXAMINATION  
OF THE  
FIRST AMERICAN HOME BUYERS  
PROTECTION CORPORATION

AS OF  
DECEMBER 31, 2007

Filed June 16, 2009

TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION.....	1
SUBSEQUENT EVENTS .....	2
COMPANY HISTORY .....	2
MANAGEMENT AND CONTROL: .....	3
Management Agreements .....	5
TERRITORY AND PLAN OF OPERATION .....	7
REINSURANCE.....	7
FINANCIAL STATEMENTS:.....	8
Statement of Financial Condition as of December 31, 2007 .....	9
Underwriting and Investment Exhibit for the Year Ended December 31, 2007.....	10
Reconciliation of Surplus as Regards Contract Holders from December 31, 2003 through December 31, 2007.....	11
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	12
Claims Adjusted and Unpaid or in Process of Adjustment .....	12
SUMMARY OF COMMENTS AND RECOMMENDATIONS:.....	12
Current Report of Examination.....	12
Previous Report of Examination.....	13
ACKNOWLEDGEMENT .....	14

Los Angeles, California  
April 17, 2009

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

**FIRST AMERICAN HOME BUYERS PROTECTION CORPORATION**

(hereinafter also referred to as the Company) at the Company's statutory home office and main administrative office, located at 7833 Haskell Avenue, Van Nuys, California 91406.

**SCOPE OF EXAMINATION**

The previous examination of the Company was made as of December 31, 2003. This examination covers the period from January 1, 2004 through December 31, 2007. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the 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: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; accounts and records; loss experience; and sales and advertising.

## SUBSEQUENT EVENTS

On January 14, 2008 the Company declared an extraordinary dividend of \$65 million to its parent, First American Title Insurance Company (FATICO). This extraordinary dividend was approved by the California Department of Insurance on February 7, 2008. The Company paid the dividend by transferring bonds with a market value of approximately \$58.6 million on February 20, 2008. The remaining balance of \$6.4 million was paid in cash on March 11, 2008.

FATICO, the recipient of the entire \$65 million extraordinary dividend, owned 92.1% of the Company's common stock. The remaining 7.9% of stock was owned by one member of the management team, Daniel T. Langston, and two retired members, Martin R. Wool, and Philip B. Branson. Waiver letters were obtained by the Company concerning the non-payment of the dividend to the three individual minority shareholders.

During the 2<sup>nd</sup> quarter of 2008, FATICO purchased the minority shareholders' stock and currently owns 100% of the Company's common stock.

## COMPANY HISTORY

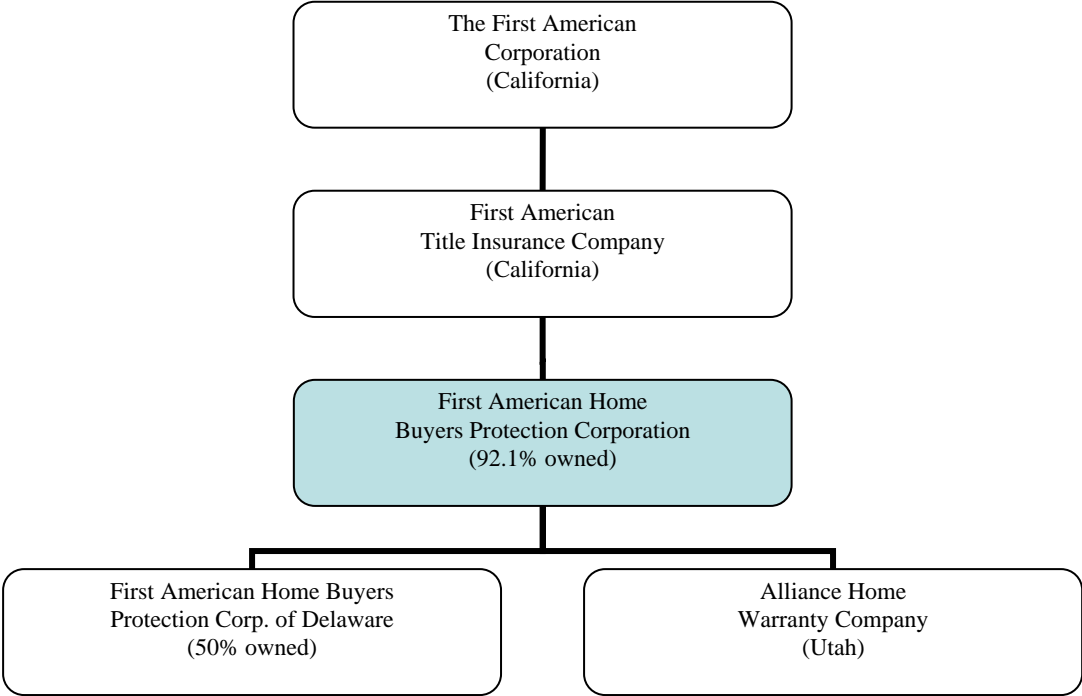
The Company was incorporated in California on February 8, 1984, for the purpose of conducting home warranty contract business.

A significant portion of the Company's assets at the examination date consisted of unsecured loans made to its ultimate parent, First American Corporation (FAC). The Company obtained the California Department of Insurance approval for each of these loans. The following schedule depicts the specific issuances and amounts outstanding at December 31, 2007:

Date Issued	Interest Rate	Loan Amount	Principal	Maturity Date
12/14/2001	6.500%	\$ 8,970,705	\$ 6,371,834	12/15/2016
06/24/2002	4.875%	10,000,000	7,141,885	04/01/2017
01/31/2002	4.000%	10,000,000	7,451,821	02/01/2018
01/09/2004	4.250%	10,000,000	8,059,712	01/09/2019
03/12/2004	4.250%	30,000,000	24,179,134	03/12/2019
03/07/2005	4.000%	10,000,000	8,583,705	03/07/2020
	Totals	\$78,970,705	\$61,788,091	

MANAGEMENT AND CONTROL

The Company is a subsidiary of First American Title Insurance Company (FATICO). The following abridged organizational chart depicts the Company’s relationship within the holding company system at December 31, 2007:



(\* ) All ownership is 100% unless otherwise noted. The First American Home Buyers Protection Corp. of Delaware, an inactive company, was dissolved effective December 31, 2008.

Management of the Company is vested in a seven-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2007 follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Eric L. Gleason (*) Stevenson Ranch, California	Chief Information Officer First American Home Buyers Protection Corporation
Mary “Kathleen” Goldsmith (*) Malibu, California	Divisional Sales Manager First American Home Buyers Protection Corporation
Lawrence F. Hariton (*) Oak Park, California	Chief Financial Officer and Chief Operations Officer First American Home Buyers Protection Corporation
Maggie E. Havas (*) Valencia, California	National Sales and Marketing Manager First American Home Buyers Protection Corporation
Daniel T. Langston Camarillo, California	Chairman of the Board, President and Chief Executive Officer First American Home Buyers Protection Corporation
Debra S. Nagasawa (*) Agoura Hills, California	Administration and Secretary First American Home Buyers Protection Corporation
Carla M. Roupe (*) Canoga Park, California	Controller and Treasurer First American Home Buyers Protection Corporation

(\*) On January 21, 2009, all of the above directors (with the exception of Daniel T. Langston) were replaced with the following individuals: Larry Davidson, Dennis J. Gilmore, J. Mark Harmsworth, Parker S. Kennedy, Leslie Paton, and Jeffrey S. Robinson.

## Principal Officers

<u>Name</u>	<u>Title</u>
Daniel T. Langston	President
Lawrence F. Hariton (*)	Vice President - Chief Financial Officer and Chief Operations Officer
Debra S. Nagasawa	Secretary
Carla M. Roupe	Vice President, Controller and Treasurer
Eric L. Gleason	Vice President, Chief Information Officer
Maggie E. Havas	Vice President, National Sales Manager
Mary "Kathleen" Goldsmith	Vice President, National Sales Manager
Suzan K. Kelly	Vice President, National Sales Manager
Myrna L. Stone	Vice President, National Sales Manager
Harold H. Sterling III	Vice President, National Sales Manager
Patrick Hogan	Vice President, Renewal Sales Manager
Jeffrey Powell	Vice President, Consumer Sales

(\*) Left the Company on January 23, 2009, and has not been replaced.

### Management Agreements

Tax Allocation Agreement: The Company and its affiliates are parties to a tax sharing agreement dated December 15, 1994 with the First American Corporation (FAC), its ultimate parent. FAC prepares, files, and pays consolidated federal income taxes due. Allocation of federal income taxes is based on separate return calculations with inter-company balances settled in the quarter subsequent to the filing of the consolidated return. The Company's portion of the federal income taxes paid for 2004, 2005, 2006, and 2007 were \$12,600,000, \$11,030,000, \$9,871,000, and \$7,023,000, respectively.

The Company's quarterly federal income tax estimated payments to FAC during 2005, 2006, and 2007 were in excess of the Company's actual tax obligations. However, the settlements had been substantially delayed. The tax allocation agreement specifies settlement to occur within 90 days of the due date of the tax filing. Subsequently, on March 20, 2009, FAC paid \$3,859,357 to the Company in settlement. The Company also provided a reconciliation which indicated the following amounts were settled for each of the specified years:

<u>Year</u>	<u>Amount</u>
2005	\$1,575,711
2006	877,464
2007	1,406,182
Total	\$3,859,357

It is recommended that the Company and FAC settle future intercompany tax balances, and accrued interest, on a timely basis.

Developmental Services and License Agreement: The Company is party to a computer system, developmental services and license agreement dated May 15, 2006, with CodeObjects, Inc. (CodeObjects), a non-affiliate, of Milpitas, California. Pursuant to this agreement, CodeObjects retains title to the software and documentation while the Company has a nonexclusive and nontransferable license to use the software for its internal information and processing needs. CodeObjects developed the Company's new computer system, FALCON, which went on-line in April 2008. CodeObjects also provides ongoing support services. For 2006 and 2007, fees paid by the Company to CodeObjects were \$1,850,000 and \$3,400,000, respectively.

Management Service Agreement: The Company entered into a management services agreement with its wholly-owned subsidiary, Alliance Home Warranty Company (Alliance), effective July 30, 2004. Under the terms of this agreement, the Company provided Alliance with management services which include, but are not limited to, contract issuance, premium processing, claims processing, accounting and legal. The California Department of Insurance approved this agreement on March 2, 2005. Fees paid by Alliance for 2004, 2005, 2006, and 2007 were \$825,758, \$972,286, \$1,046,901, and \$1,000,623, respectively.

## TERRITORY AND PLAN OF OPERATION

As of December 31, 2007, the Company was licensed to transact home protection business in all states and the District of Columbia.

In 2007, the Company wrote \$170 million of direct premiums. Of the direct premiums written \$59.6 million (35%) was written in California, \$35.8 million (21.1%) was written in Texas, \$12.8 million (7.5%) was written in Arizona and \$61.8 million (36.4%) was written in the remaining states. The Company is a direct writer and during 2007 wrote approximately 412,000 home warranty contracts.

Effective October 1, 2008 the Company ceased writing new and renewal business in the following states:

Alabama	New Jersey
Connecticut	New York
Delaware	Oklahoma
Illinois	Rhode Island
Louisiana	Washington
Massachusetts	Wisconsin
Minnesota	

The Company is running off the existing business in those states, but retains its licenses.

## REINSURANCE

The Company has no reinsurance assumed or ceded.

## 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, 2003 through 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>Note</u>
Bonds	\$ 146,286,751	\$	\$ 146,286,751	
Mortgage loans on real estate	1,012,553		1,012,553	
Real estate, less encumbrances	6,065,659		6,065,659	
Cash on hand and on deposit	11,973,137		11,973,137	
Common stocks	3,675,000	3,675,000		
Home protection contract fees receivable	26,707,028	25,019,029	1,687,999	
Receivables from affiliates	77,200		77,200	
Federal income tax recoverable	1,897,545		1,897,545	
Electronic data processing equipment	1,413,053		1,413,053	
Interest, dividends, and real estate income due and	2,048,579		2,048,579	
Prepaid expenses and deposits	702,647	702,647		
Equipment, furniture, and supplies	848,012	848,012		
Data processing software	7,730,069	7,730,069		
Leasehold improvements	70,611	70,611		
Other assets	<u>61,788,091</u>		<u>61,788,091</u>	
Total assets	<u>\$ 272,295,935</u>	<u>\$ 38,045,368</u>	<u>\$ 234,250,567</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Claims adjusted and unpaid or in process of adjustment			\$ 8,300,757	(1)
Claims services expenses			175,000	
Other expenses			7,926,201	
Taxes, licenses and fees			2,929,963	
Unearned home protection contract fees			77,664,536	
Other liabilities			<u>751,553</u>	
Total liabilities			97,748,010	
Common capital stock		\$ 1,947,700		
Gross paid-in and contributed surplus		1,480,500		
Unassigned funds (surplus)		<u>133,074,357</u>		
Surplus as regards contract holders			<u>136,502,557</u>	
Total liabilities, surplus and other funds			<u>\$ 234,250,567</u>	

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

Statement of Income

Underwriting Income

Home protection contract fees earned		\$ 170,007,348
Deductions:		
Claims incurred	\$ 94,346,957	
Claims service expense incurred	19,881,745	
Other expenses incurred	<u>49,448,007</u>	
Total underwriting deductions		<u>163,676,709</u>
Net underwriting gain		6,330,639

Investment Income

Net investment income earned	<u>\$ 10,060,795</u>	
Net investment gain		<u>10,060,795</u>
Net income, before federal income taxes		16,391,434
Federal income taxes incurred		<u>6,316,509</u>
Net income		<u>\$ 10,074,925</u>

Capital and Surplus Account

Surplus as regards contract holders, December 31, 2006		\$ 136,063,951
Net income	\$ 10,074,925	
Change in non-admitted assets	<u>(9,636,319)</u>	
Change in surplus as regards contract holders		<u>438,606</u>
Surplus as regards contract holders, December 31, 2007		<u>\$ 136,502,557</u>

Reconciliation of Surplus as Regards Contract Holders  
from December 31, 2003 through December 31, 2007

Surplus as regards contract holders, December 31, 2003, per Examination		\$ 103,149,372								
	<table style="margin-left: auto; margin-right: auto; border-collapse: collapse;"> <thead> <tr> <th style="text-align: center; border-bottom: 1px solid black;">Gain in Surplus</th> <th style="text-align: center; border-bottom: 1px solid black;">Loss in Surplus</th> </tr> </thead> <tbody> <tr> <td style="text-align: right;">\$60,972,532</td> <td style="text-align: right;">\$</td> </tr> <tr> <td style="text-align: right; border-top: 1px solid black;">_____</td> <td style="text-align: right; border-top: 1px solid black;">27,619,347</td> </tr> <tr> <td style="text-align: right; border-top: 1px solid black;"><u>\$60,972,532</u></td> <td style="text-align: right; border-top: 1px solid black;"><u>\$ 27,619,347</u></td> </tr> </tbody> </table>	Gain in Surplus	Loss in Surplus	\$60,972,532	\$	_____	27,619,347	<u>\$60,972,532</u>	<u>\$ 27,619,347</u>	
Gain in Surplus	Loss in Surplus									
\$60,972,532	\$									
_____	27,619,347									
<u>\$60,972,532</u>	<u>\$ 27,619,347</u>									
Net income										
Change in non-admitted assets										
Totals										
Net increase in surplus as regards contract holders		<u>33,353,185</u>								
Surplus as regards contract holders, December 31, 2007, per Examination		<u>\$ 136,502,557</u>								

## COMMENTS ON FINANCIAL STATEMENT ITEMS

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

Home warranty contract claims are generally paid within a short period of time after the repairs are made. The Company does not utilize an actuary to determine reserves. Instead, the accounting department uses a model that incorporates the number of open work order invoices, average payment amounts, and certain assumptions, to estimate the reserve for claims adjusted and unpaid or in process of adjustment. The examiners performed a six-month retrospective loss development review which indicated that the Company's unpaid claims reserve was deficient by approximately \$3.7 million at December 31, 2007. However, the amount of the deficiency was deemed below materiality thresholds and no examination adjustment was made. It is recommended that the Company periodically perform internal retrospective reviews to assess the accuracy of the assumptions used in their claims reserving model and make appropriate adjustments to the model.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Management and Control – Management Agreements – Tax Allocation Agreement (Page 5): At December 31, 2007, the Company had not received its federal income tax overpayments back from its ultimate parent, First American Corporation (FAC) for several years. Settlements of those tax years were made on March 20, 2009. It is recommended that the Company and FAC settle future intercompany tax balances, and accrued interest, on a timely basis.

Claims Adjusted and Unpaid or in Process of Adjustment (Page 12): It is recommended that the Company periodically perform internal retrospective reviews to assess the accuracy of the assumptions used in their claims reserving model and make appropriate adjustments to the model.

### Previous Report of Examination

Management and Control – Management Agreements (Page 4): It was recommended that the Company execute a management agreement with its subsidiary, Alliance Home Warranty Company (Alliance), and submit it to the California Department of Insurance (CDI) for approval. The Company subsequently executed a written agreement to provide management services to Alliance, which was approved by the CDI on March 2, 2005.

Accounts and Records (Page 5): It was recommended that the Company review its information systems and make appropriate changes to strengthen internal controls. The CDI's Information System Specialist indicated no current significant weaknesses in the information system internal controls.

ACKNOWLEDGEMENT

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

Respectfully submitted,

\_\_\_\_\_/S/\_\_\_\_\_  
Gary McMurray, CFE  
Examiner-In-Charge  
Contract Insurance Examiner  
Department of Insurance  
State of California