

REPORT OF EXAMINATION
OF THE
HOMEGUARD HOMEWARRANTY, INC.
AS OF
DECEMBER 31, 2013

A handwritten signature in black ink that reads "Dave Jones". The signature is written in a cursive style with a large, looping initial "D".

Insurance Commissioner

FILED 6-8-15

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San Francisco, California
May 5, 2015

Honorable Dave Jones
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) at 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 made as of December 31, 2009. This examination covers the period from January 1, 2010 through December 31, 2013. The examination was conducted in accordance with the National Association of Insurance Commissioners Financial Condition Examiners Handbook. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, to identify prospective risks, and to obtain information about the Company, including corporate governance, identification and assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, and management's compliance with Statutory Accounting Principles and Annual Statement instructions. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

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; pensions, stock ownership and insurance plans; growth of company; loss experience; and statutory deposits.

COMPANY HISTORY

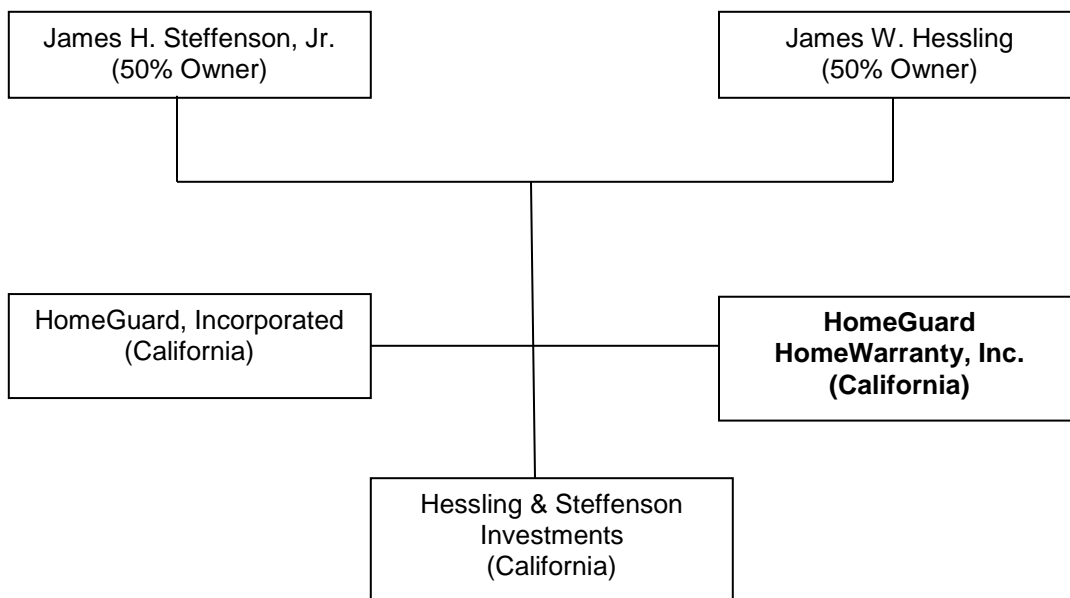
The Company was incorporated in the State of California on April 21, 2003 and was licensed in California to write home warranty business on May 31, 2006. Effective October 19, 2012, the Company also licensed to write home warranty business in Arizona.

Capitalization

The Company is 50% owned by James W. Hessling and 50% by James H. Steffenson, Jr. There are 10,000 shares of common stock authorized. The Company has 8,000 shares issued with a \$5 per share par value. The total capital contribution as of December 31, 2013 was \$864,000. During the examination period, there were no changes in ownership and shares were not actively traded. The Company received capital infusions of \$24,000 in 2011 and \$40,000 in 2013, respectively from its owners.

MANAGEMENT AND CONTROL

The following organizational chart depicts the Company within the holding company system as of December 31, 2013 (all ownership is 100% unless otherwise noted):



The Company is overseen by a four-member board of directors who are elected annually. The following is a list of the directors and officers of the Company as of December 31, 2013:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Cathy Campbell* Castro Valley, California	Vice President of Sales HomeGuard HomeWarranty, Inc.
James W. Hessling Morgan Hill, California	Chief Financial Officer HomeGuard HomeWarranty, Inc.
Robert J. Hessling Morgan Hill, California	President HomeGuard HomeWarranty, Inc.
James H. Steffenson, Jr. San Jose, California	Chief Executive Officer HomeGuard HomeWarranty, Inc.

*Cathy Campbell resigned from the board, effective March 18, 2015.

Principal Officers

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

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. Under the terms of the Agreement, Hessling & Steffenson Investments provides office space to the Company. The Company did not submit the Agreement to the California Department of Insurance (CDI) for approval in accordance with California Insurance Code Section 1215.5(b)(4). It is recommended that the Company submit the Agreement to the CDI for approval. This is a repeat finding from the prior examination report.

Intercompany Affiliated Service Agreement: Effective March 1, 2012, the Intercompany Affiliated Service Agreement was executed between the Company and its affiliate, HomeGuard, Incorporated (HGI), under which HGI provides accounting, tax, auditing, and contract solicitation services. The Agreement was approved by the CDI on March 2, 2012.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2013, the Company was licensed to write home warranty business in the states of California and Arizona. The Company wrote 100% of its business in California. During 2013, the Company issued 5,070 home warranty contracts and collected home protection contract fees in the amount of \$2.03 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 who 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 southwestern states, such as Arizona.

REINSURANCE

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

ACCOUNTS AND RECORDS

Information Systems Controls

During the course of the examination, a limited review was made of the Company's general controls over its information systems. As a result of this review, weaknesses were noted in the areas of disaster recovery and business continuity plan. The weaknesses were presented to the Company along with recommendations to strengthen its controls. The Company should evaluate the findings and recommendations and make appropriate changes to strengthen its information systems controls.

FINANCIAL STATEMENTS

The following financial statements are included in this report of examination:

Statement of Financial Condition as of December 31, 2013

Underwriting and Investment Exhibit for the Year Ended December 31, 2013

Reconciliation of Surplus as Regards Contract Holders from December 31, 2009
through December 31, 2013

Statement of Financial Condition
as of December 31, 2013

<u>Assets</u>	<u>Ledger and Non-ledger Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Cash and short-term investments	\$ 1,678,392	\$ 1,678,392	
Service fees receivable	650	650	
Federal income tax recoverable	<u>9,001</u>	<u>9,001</u>	
 Total assets	 <u>\$ 1,688,043</u>	 <u>\$ 1,688,043</u>	
 <u>Liabilities, Surplus and Other Funds</u>			
Claims adjusted and unpaid or in process of adjustment		\$ 147,048	(1)
Claims service expenses		12,555	
Other expenses		484	
Taxes, licenses and fees		9,760	
Unearned home protection contract fees		810,269	
Customer deposits		<u>14,945</u>	
 Total liabilities		 995,061	
Common capital stock	\$ 800,000		
Gross paid-in and contributed surplus	64,000		
Unassigned funds (surplus)	<u>(171,018)</u>		
 Surplus as regards contract holders		 <u>692,982</u>	
 Total liabilities, surplus and other funds		 <u>\$ 1,688,043</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2013

Statement of Income

Underwriting Income

Home protection contract fees earned		\$ 1,861,817
Deductions:		
Claims incurred	\$ 1,077,381	
Claims service expenses incurred	131,159	
Other underwriting expenses incurred	<u>617,404</u>	
Total underwriting deductions		<u>1,825,944</u>
Net underwriting gain		35,873

Investment Income

Net investment income earned	\$ <u>5,034</u>	
Net investment gain		<u>5,034</u>
Net income before federal income taxes		40,907
Federal income taxes incurred		<u>177</u>
Net income		<u>\$ 40,730</u>

Capital and Surplus Account

Surplus as regards contract holders, December 31, 2012		\$ 612,251
Net income	\$ 40,730	
Capital changes: paid in	<u>40,000</u>	
Change in surplus as regards contract holders for the year		<u>80,730</u>
Surplus as regards contract holders, December 31, 2013		<u>\$ 692,982</u>

Reconciliation of Surplus as Regards Contract Holders
from December 31, 2009 through December 31, 2013

Surplus as regards contract holders, December 31, 2009 per Examination			\$ 666,798
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net loss	\$	\$	35,838
Capital changes: paid in	64,000		
Change in nonadmitted assets	<u> </u>	<u>1,978</u>	
Total gains and losses	<u>\$ 64,000</u>	<u>\$ 37,816</u>	
Net increase in surplus as regards contract holders			<u>26,184</u>
Surplus as regards contract holders, December 31, 2013, per Examination			<u>\$ 692,982</u>

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 the 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, 2013 was reasonable and has been accepted for the purpose of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Management Agreements (Page 4): It is 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).

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

Previous Report of Examination

Management and Control - Inter-Company Rental Arrangement (Page 3): It was recommended that the Company formalize its rental arrangement with Hessling & Steffenson Investments and submit the agreement to the CDI for approval. The Company has not complied with this recommendation.

Management and Control - Conflict of Interest (Page 4): It was recommended that the Company's conflict of interest procedures be completed on an annual basis. The Company has complied with this recommendation.

Accounts and Records (Page 5): It was recommended that the Company report its home protection contract fees receivables in accordance with the prescribed guidance. The Company has complied with this recommendation.

Accounts and Records (Page 5): It was recommended that the Company report its service fees receivables in accordance with the prescribed guidance. The Company has complied with this recommendation.

Accounts and Records (Page 5): It was recommended that the Company record a date of loss as prescribed by Statements of Statutory Accounting Principles No. 55, paragraph 4. The Company has complied with this recommendation.

Accounts and Records (Page 5): It was recommended that the Company segregate claims paid and other expenses into separate general ledger accounts so that each can be accounted for separately. The Company has complied with this 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 not fully complied with these findings and recommendations.

Comments on Financial Statement Items: Claims Adjusted and Unpaid or in Process of Adjustment (Page 11): It was recommended that the Company establish sufficient reserves for its claims adjusted and unpaid or in the process of adjustment. The Company has complied with this recommendation.

Comments on Financial Statement Items - Claims Service Expenses (Page 11): It was recommended that the Company establish sufficient reserves for its claims service expenses. The Company has complied with this recommendation.

ACKNOWLEDGEMENT

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

Respectfully submitted,



Sam Chiu, CFE
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California
