

REPORT OF EXAMINATION
OF THE
AMERICAN STERLING INSURANCE COMPANY
AS OF
DECEMBER 31, 2007

Participating State
and Zone:

California

Filed May 26, 2009

TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION.....	1
SUBSEQUENT EVENTS	2
COMPANY HISTORY	3
MANAGEMENT AND CONTROL:	3
Affiliated Management Agreements.....	5
TERRITORY AND PLAN OF OPERATION	6
REINSURANCE:	7
FINANCIAL STATEMENTS:.....	7
Statement of Financial Condition as of December 31, 2007	8
Underwriting and Investment Exhibit for the Year Ended December 31, 2007.....	9
Reconciliation of Surplus as Regards Policyholders from December 31, 2004 through December 31, 2007.....	10
Reconciliation of Examination Changes as of December 31, 2007.....	11
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	12
Mortgage Loans on Real Estate	12
Receivables from Parent, Subsidiaries and Affiliates.....	12
Losses and Loss Adjustment Expenses	12
SUMMARY OF COMMENTS AND RECOMMENDATIONS:.....	13
Current Report of Examination.....	13
Previous Report of Examination.....	13
ACKNOWLEDGEMENT	14

Los Angeles, California
January 31, 2009

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Morris Chavez
Secretary, Zone IV-Western
Superintendent of Insurance
New Mexico Department of Insurance
Santa Fe, New Mexico

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

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

AMERICAN STERLING INSURANCE COMPANY

(hereinafter also referred to as the Company) at its statutory home office located at 27422 Portola Parkway, Foothill Ranch, California 92610.

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 examination was made pursuant to the National Association of Insurance Commissioners' (NAIC) plan of examination. 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; loss experience; accounts and records; and sales and advertising.

SUBSEQUENT EVENTS

The Company paid a cash dividend of \$250,000 during the first quarter of 2008 to American Sterling Corporation (ASC), its parent.

In August 2008, American Sterling Capital Corporation (ASCC), a wholly-owned subsidiary of American Sterling Productions Ltd. (ASP), obtained a mortgage on real estate owned by ASCC in the amount of \$13 million. Proceeds were used to repay approximately \$5 million in debt due ASC from ASP and to advance another \$7 million to ASC. ASC used the proceeds to repay amounts due American Sterling Bank (ASB), its subsidiary, and to make additional capital contributions to ASB.

In September 2008, the Company filed an application with the California Department of Insurance (CDI) for permission to make a loan to its parent, ASC, in the amount of \$7.5 million secured by 100% of the common stock of ASB. The note carries interest at 7.0% and is due in September 2009. The loan proceeds were used by ASC to contribute capital to ASB which was undercapitalized. The CDI granted approval for the loan on September 29, 2008.

On April 17, 2009, ASB was closed by the Office of Thrift Supervision and placed under the receivership of the Federal Deposit Insurance Corporation. On April 29, 2009 the CDI received a Form D filing requesting permission to supplement the collateral of the loan with real estate with a market value of \$7.5million. The filing is currently under review by the CDI.

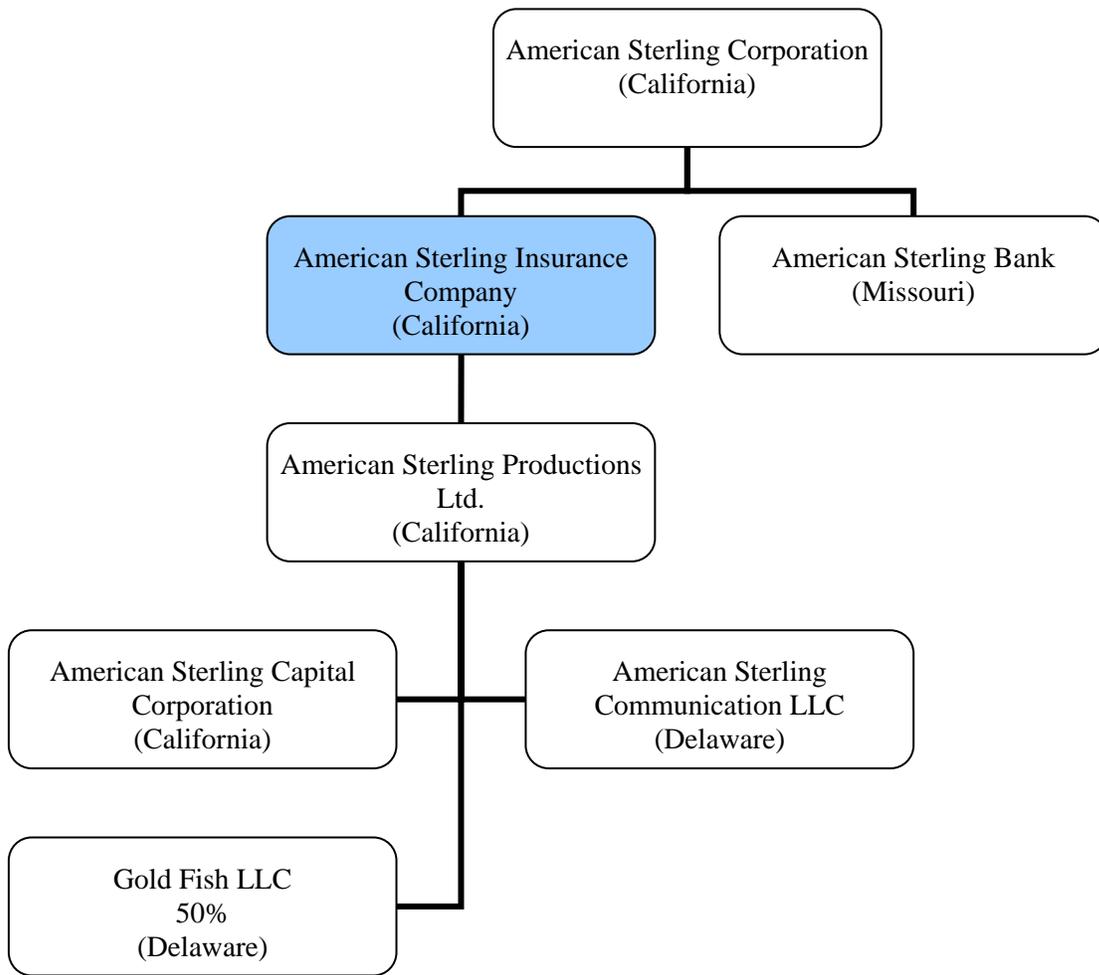
COMPANY HISTORY

The Company, a California insurer, is a wholly-owned subsidiary of American Sterling Corporation (ASC), a holding company domiciled in California, which is 87.69% owned by Lawrence K. Dodge, the ultimate controlling person.

On March 29, 2006, ASC contributed \$8,978,589 to the Company. The contribution was in the form of 100% of the common shares of American Sterling Productions Ltd. (ASP) which wholly-owns American Sterling Capital Corporation. As of December 31, 2007, the ASP shares were valued at \$4,233,025.

MANAGEMENT AND CONTROL

The following abridged organizational chart, which is limited to the Company's parent along with its subsidiary insurance companies, depicts the Company's relationship within the holding company system:



(*) all ownership is 100% unless otherwise stated

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

Directors

Name and Residence

Ron Dearden
Laguna Niguel, California

Kristina Jane Dodge

Principal Business Affiliation

Treasurer and Chief Financial Officer
American Sterling Corporation

Stockholder

Name and Residence

Principal Business Affiliation

Dana Point, California

American Sterling Productions Ltd.

Lawrence Keith Dodge
Dana Point, California

Founding Chairman and
Chief Executive Officer
American Sterling Corporation

John William Meara
Kansas City, Missouri

Partner
Meara, King, & Company

Michael Dean Thompson
Overland Park, Kansas

Chairman and Director
American Sterling Corporation

Principal Officers

Name

Title

Lawrence Keith Dodge
Michael Dean Thompson
Janice Karen Thrower
Ron Dearden

Chief Executive Officer
President
Secretary
Treasurer

Affiliated Management Agreements

Loan Servicing and Custodian Agreement: On January 9, 1998, the Company entered into a Loan Servicing and Custodian Agreement with American Sterling Bank (ASB). The Company acts as a lender from time to time for loans originated by ASB. Under the terms of the agreement, ASB prepares loan closing documents and services loans that are negotiated, approved and funded by the Company. ASB and the Company negotiate the servicing fee of each loan individually, on a case-by-case basis. The Company failed to file the agreement with the California Department of Insurance (CDI) for prior approval in compliance with California Insurance Code (CIC) Section 1215.5(b)(4). It is recommended that the Company file the agreement with the CDI which may be subject to late filing fees for failure to obtain prior approval.

Management Services Agreement: On January 1, 1995, the Company entered into a Management Services Agreement with American Sterling Corporation (ASC) to act as its exclusive management consultant. Under this agreement, the Company reimburses ASC the actual costs incurred on its behalf. The Company paid ASC \$12,712 per month in 2007.

Sublease Agreement: On July 1, 2004 the Company entered into a Sublease Agreement with American Sterling Bank (ASB). Under this agreement, the Company leases office space to ASB. The Company failed to file the agreement with the CDI for prior approval in compliance with CIC Section 1215.5(b)(4). It is recommended that the Company file the agreement with the CDI for approval which may be subject to late filing fees for failure to obtain prior approval.

Consolidated Federal Income Tax Liability Allocation Agreement: On January 1, 2001, the Company and its affiliates entered into a consolidated federal income tax agreement with ASC. The allocation of taxes is based upon separate return calculations. The Company failed to file the agreement with the CDI for prior approval in compliance with CIC Section 1215.5(b)(4). It is recommended that the Company file the agreement with the CDI for approval which may be subject to late filing fees for failure to obtain prior approval.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2007, the Company was licensed to transact multiple lines of property and casualty insurance in the following 16 states:

Arizona	Nevada
California	New Mexico
Florida	Ohio
Indiana	Oklahoma
Kansas	Oregon
Kentucky	Pennsylvania
Missouri	Washington
Nebraska	Wisconsin

The Company currently writes non-standard private passenger automobile coverage. The Company's business is marketed primarily by independent agents. The majority of direct premiums written are in Kansas, \$16.5 million (55.1%); Nevada, \$10.6 million (35.6%); and Arizona, \$2.6 million (8.8%).

REINSURANCE

The Company does not assume or cede any reinsurance.

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 Policyholders
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	\$ 1,580,480	\$	\$ 1,580,480	
Stocks:				
Common	8,440,066	4,207,041	4,233,025	
Mortgage loans on real estate:				
First liens	6,999,300		6,999,300	(1)
Real Estate:				
Properties held for the production of income	3,277,389		3,277,389	
Properties held for sale	1,411,344		1,411,344	
Cash and short-term investments	3,092,667		3,092,667	
Investment income due and accrued	18,339		18,339	
Premiums and considerations:				
Uncollected premiums and agents' balances in course of collection	2,487,527		2,487,527	
Current federal income tax recoverable	553,426	553,426		(2)
Net deferred tax asset	800,956	386,397	414,559	
Receivable from parent, subsidiaries and affiliates	647,050	647,050		(2)
Aggregate write-ins for other than invested assets	<u>611,800</u>	<u>611,800</u>		(2)
Total assets	<u>\$ 29,920,344</u>	<u>\$ 6,405,714</u>	<u>\$ 23,514,630</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 8,541,902	(3)
Loss adjustment expenses			1,362,096	(3)
Other expenses			21,223	
Taxes, licenses and fees			524,949	
Unearned premiums			<u>1,075,211</u>	
Total liabilities			11,525,381	
Common capital stock		\$ 2,600,000		
Gross paid-in and contributed surplus		10,929,052		
Unassigned funds (surplus)		<u>258,623</u>		
Surplus as regards policyholders			<u>13,787,675</u>	
Total liabilities, surplus and other funds			<u>\$ 25,313,056</u>	

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

Statement of Income

Underwriting Income

Premiums earned		\$ 30,074,403
Deductions:		
Losses incurred	\$ 17,121,407	
Loss expenses incurred	2,663,930	
Other underwriting expenses incurred	<u>10,085,366</u>	
Total underwriting deductions		<u>29,870,703</u>
Net underwriting gain		203,700

Investment Income

Net investment income earned	\$ <u>871,300</u>	
Net investment gain		871,300

Other Income

Aggregate write-ins for miscellaneous income	\$ <u>4,875</u>	
Total other income		<u>4,875</u>
Net income before federal income taxes		1,079,875
Federal income taxes incurred		<u>520,992</u>
Net income		<u>\$ 558,883</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2006		\$ 13,061,477
Net income	\$ 558,883	
Change in net unrealized capital gains or (losses)	(295,268)	
Change in net deferred income tax	163,963	
Change in non-admitted assets	<u>298,620</u>	
Change in surplus as regards policyholders for the year		<u>726,198</u>
Surplus as regards policyholders, December 31, 2007		<u>\$ 13,787,675</u>

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

Surplus as regards policyholders, December 31, 2004, per Examination			\$ 8,585,550
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 596,898	\$	
Change in net unrealized capital losses		538,523	
Change in net deferred income tax	601,287		
Change in nonadmitted assets		4,436,126	
Surplus adjustment: Paid in	<u>8,978,589</u>	<u> </u>	
Totals	<u>\$10,176,774</u>	<u>\$ 4,974,649</u>	
Net increase in surplus as regards policyholders for the examination			<u>5,202,125</u>
Surplus as regards policyholders, December 31, 2007, per Examination			<u>\$ 13,787,675</u>

Reconciliation of Examination Changes
as of December 31, 2007

	<u>Per</u> <u>Company</u>	<u>Per</u> <u>Examination</u>	<u>Surplus</u> <u>Increase</u> <u>(Decrease)</u>	<u>Notes</u>
<u>Assets</u>				
Current federal income tax recoverable	\$ 553,426	\$ 0	\$ (553,426)	(2)
Receivable from parent, subsidiaries and affiliates	647,050	0	(647,050)	(2)
Aggregate write-ins for other than invested assets	597,950	0	<u>(597,950)</u>	(2)
Net decrease to surplus			(1,798,426)	
Surplus as regards policyholders, December 31, 2007 per Company			<u>13,787,675</u>	
Surplus as regards policyholders, December 31, 2007 per Examination			<u>\$ 11,989,249</u>	

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Mortgage Loans on Real Estate

The Company is a party to a Loan Servicing and Custodian Agreement with American Sterling Bank (ASB). The Company failed to file the said agreement with the California Department of Insurance (CDI) pursuant to California Insurance Code (CIC) Section 1215.5(b)(4). In December 2007, the Company purchased and funded mortgage loans of \$7.0 million from ASB. The transaction did not reflect any transfer of ownership to the Company which is in violation of CIC Section 1100. In January 2008, the Company sold these same mortgage loans to outside investors. The Company earned a total interest income of \$28,930. It is recommended that the Company comply with CIC Sections 1215.5(c) and 1100. Late filing fees may be assessed by the CDI because prior approval was not obtained.

(2) Current Federal Income Tax Recoverable Receivables from Parent, Subsidiaries and Affiliates Aggregate Write-ins for Other Than Invested Assets

The Company reported inter-company receivables from its parent, American Sterling Corporation including \$553,426 of Current Federal Income Tax Recoverable, \$647,050 of Receivables from Parent, Subsidiaries and Affiliates, and \$597,950 of Aggregate Write-ins related to the foreign sale of the "Dark Matter" film as admitted assets. The receivables were not timely settled, within 90 days subsequent to the reporting date, which is in violation of Statements of Statutory Accounting Principles Number 96. Based upon the review all inter-company receivables as of December 31, 2007 were non-admitted.

(3) Losses and Loss Adjustment Expenses

A Casualty Actuary from the California Department of Insurance (CDI) reviewed the Company's actuarial work papers with regard to loss and loss adjustment expense reserves. The Casualty Actuary determined that the reserves held by the Company were deficient by \$2.3 million as of December 31, 2007. The deficiency was due entirely to the Lender's Representation and Warranty

Master Policy which was issued to American Sterling Bank (ASB) with an effective date of December 31, 2007. The policy retroactively covered ASB for errors and omissions that occurred in the production of its mortgage portfolio during the 18 months prior to January 1, 2008. Subsequent to the examination date, the Company and ASB mutually agreed to rescind the policy. The Company refunded paid premiums to ASB and ASB reimbursed paid loss payments to the Company. Based upon this rescission, the Casualty Actuary from the CDI determined that reserves booked by the Company as of December 31, 2007 were reasonably stated.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control - Management Agreements: Loan Servicing and Custodian Agreement (Page 5): It is recommended that the Company file this agreement with the California Department of Insurance (CDI) for approval.

Management and Control - Management Agreements: Sublease Agreement (Page 6): It is recommended that the Company file this agreement with the CDI for approval.

Management and Control - Management Agreements: Consolidated Federal Income Tax Liability Allocation Agreement (Page 6): It is recommended that the Company file this agreement with the CDI for approval.

Comments on Financial Statement Items - Mortgage Loans on Real Estate (Page 12): It is recommended that the Company comply with California Insurance Code Sections 1215.5(b)(4) and 1100.

Previous Report of Examination

None

ACKNOWLEDGEMENT

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

Respectfully submitted,

/S/

Jack Ho, AES, CFE, CISA
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California