REPORT OF EXAMINATION
OF THE
HERITAGE INDEMNITY COMPANY
AS OF
DECEMBER 31, 2010

Filed June 5, 2012

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Los Angeles, California
April 18, 2012

Honorable Dave Jones
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

HERITAGE INDEMNITY COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 7125 West Jefferson Avenue, Suite 200, Lakewood, Colorado 80235. The Company's statutory home office is located at 23 Pasteur, Irvine, California 92618.

SCOPE OF EXAMINATION

We have performed our single-state examination of the Company. The last examination was completed as of December 31, 2006. This examination covers the period from January 1, 2007 through December 31, 2010. 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. 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; statutory deposits; accounts and records; and sales and advertising.

COMPANY HISTORY

At the beginning of the examination period, the Company was a wholly-owned subsidiary of Heritage Insurance Group, Inc. (HIG), a Delaware corporation. HIG was owned by General Electric Capital Corporation (GECC), a Delaware corporation. GECC was a wholly-owned subsidiary of General Electric Capital Services, Inc., a Delaware corporation, which was a wholly-owned subsidiary of General Electric Company, a New York corporation.

On December 31, 2007, all outstanding shares of the Company were acquired by WDSI, LLC (WDSI), a Delaware corporation, a wholly-owned subsidiary of Wachovia Corporation (WC), a North Carolina corporation. The California Department of Insurance (CDI) approved the sale of the Company to WDSI on December 28, 2007.

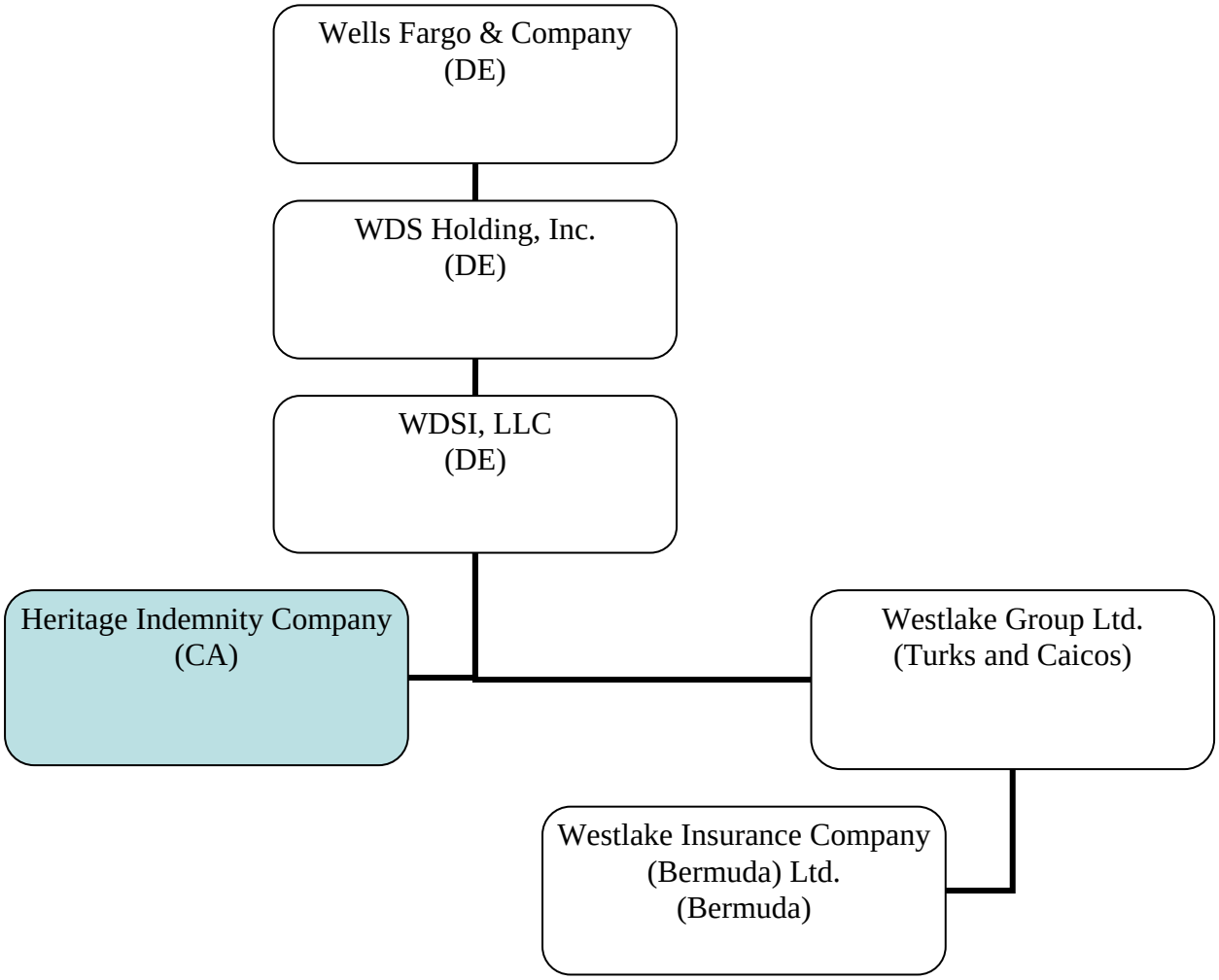
On December 31, 2008, Wells Fargo and Company (WFC), a Delaware corporation, acquired all the outstanding shares of WC. Subsequently, WC was merged with and into WFC. The CDI approved the acquisition of WC by WFC on September 11, 2009.

Dividends Paid to Parent

On November 29, 2007, the Company paid an extraordinary dividend of $60 million to its then parent, HIG, which was approved by the CDI on July 10, 2007. The Company accounted for the dividend by charging $25,000 to paid-in capital stock, $24,975,000 to paid-in surplus adjustment and $35,000,000 to dividends to stockholders.

MANAGEMENT AND CONTROL

The following abridged organizational chart depicts the Company's relationship within the holding company system (all ownership is 100%):



Members of the board of directors, who are elected annually, manage the business and affairs of the Company. Following are members of the board and principal officers of the Company serving at December 31, 2010:

Directors

Name and Residence	Principal Business Affiliation
Jeffrey R. Fleischer Littleton, Colorado	Chief Actuary Warranty Solutions
Dawn Marie Martin Harp Dana Point, California	Chief Operating Officer Wells Fargo Dealer Services, Inc.
William J. Katafias Ladera Ranch, California	Executive Vice President and National Production Officer Wells Fargo Dealer Services, Inc.
John K. Palmer Coto de Caza, California	President Heritage Indemnity Company
Jonathan J. Wilmot Littleton, Colorado	Operations Leader Warranty Solutions
Thomas A. Wolfe Coto de Caza, California	President Wells Fargo Dealer Services, Inc.

Principal Officers

Name	Title
John K. Palmer	President
Jay H. Berman	Secretary and Vice President
Thomas J. Lari	Treasurer and Chief Financial Officer
Jeffrey R. Fleischer	Chief Actuary
James A. Chalmers III	Senior Vice President
David E. Haggard	Tax Manager and Vice President
Jonathan J. Wilmot	Vice President

Management Agreements

Tax-Sharing Agreement: Effective January 1, 2008, the Company entered into a Tax-Sharing Agreement with its then ultimate parent, Wachovia Corporation (WC) and several other affiliates for the purpose of filing federal income tax returns on a consolidated basis. Under this Agreement, the tax liability of the Company and its affiliates will be computed as if each member filed a separate stand-alone return. WC is the party primarily responsible for filing and making all tax payments on behalf of the Company and its subsidiaries. The Agreement was approved by the California Department of Insurance (CDI) on August 19, 2008. This Agreement should be amended to reflect the Company's new ultimate parent, Wells Fargo and Company.

Expense Allocation Agreement: The Company and Wachovia Shared Resources LLC, along with additional non-insurance company affiliates, are parties to an Expense Allocation Agreement which became effective on March 7, 2008. Under this Agreement, the intent is to allocate the expenses among the parties for the use of certain facilities as well as for shared data processing, marketing, human resources, accounting, tax, legal, and purchasing services. Charges for the services are based on actual costs. The Company's share of direct costs is determined based on time and usage, while the Company's share of common costs is determined based on percentage of the Company's revenue to the total revenue of all parties that have entered into this Agreement. Under the terms of the Agreement, settlements are made within 30 days of notification or billing. Billing will not be more often than monthly. Fees paid by the Company for 2008, 2009, and 2010 were $8,256,665, $11,292,485, and $12,467,487, respectively. The Agreement was approved by the CDI on March 7, 2008.

TERRITORY AND PLAN OF OPERATION

The Company primarily insures vehicle service contracts administered and marketed by affiliated companies through automobile dealers and original equipment manufacturers throughout the United States. As of December 31, 2010, the Company was licensed in all 50 states and the District of Columbia.

In 2010, the Company wrote $82.4 million of direct premiums. Of the direct premiums written, $9.8 million (11.9%) was written in California, $7.9 million (9.6%) was written in Minnesota, $6.4 million (7.8%) was written in New York, $5.9 million (7.1%) was written in North Carolina, $4.1 million (5.0%) was written in Massachusetts, and $48.3 million (58.6%) was written in the remaining states.

REINSURANCE

Assumed

The Company assumes a relatively small amount of business, only $17,000, as compared to its direct writings of $82.4 million. The assumed business is from Aria (Sac) Ltd., a Bermuda based insurance company.

Ceded

The Company entered into a 100% quota-share agreement, effective March 1, 1984 and amended on June 12, 1996, with its affiliate, Westlake Insurance Company (Bermuda) Ltd. (Westlake), whereby it cedes vehicle service contract liabilities for certain accounts specified in the agreement. During 2010, the Company ceded $29 million in premiums to Westlake or approximately 35% of the Company's direct business of $82.4 million. The agreement was approved by the California Department of Insurance on June 18, 1996, in accordance with California Insurance Code Section 1215.5 (c).

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2010

Underwriting and Investment Exhibit for the Year Ended December 31, 2010

Reconciliation of Surplus as Regards Policyholders from December 31, 2006 through December 31, 2010

Statement of Financial Condition
as of December 31, 2010

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 180,152,295	$	$ 180,152,295	
Cash, cash equivalents and short-term investments	11,213,600		11,213,600	
Investment income due and accrued	2,531,256		2,531,256	
Net deferred tax asset	8,509,809	5,411,729	3,098,080	
Receivables from parent, subsidiaries and affiliates	2,196,743		2,196,743	
Aggregate write-ins for other than invested assets	178,495	177,990	505	
Total assets	$ 204,782,198	$ 5,589,719	$ 199,192,479	
Liabilities, Surplus and Other Funds				
Losses			$ 1,473,556	(1)
Loss adjustment expenses			32,596	(1)
Other expenses			232,105	
Taxes, licenses and fees			664,906	
Current federal and foreign income taxes			908,511	
Unearned premiums			108,132,539	
Provision for reinsurance			5,000	
Payable to parent, subsidiaries and affiliates			3,076,816	
Total liabilities			114,526,029	
Common capital stock		$ 3,000,000		
Gross paid in and contributed surplus		60,749,090		
Unassigned funds (surplus)		20,917,360		
Surplus as regards policyholders			84,666,450	
Total liabilities, surplus and other funds			$ 199,192,479	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2010

Statement of Income

Underwriting Income		
Premiums earned		$ 51,990,431
Deductions:		
Losses incurred	$ 36,214,594	
Loss adjustment expenses incurred	612,020	
Other underwriting expenses incurred	14,720,778	
Total underwriting deductions		51,547,392
Net underwriting gain		443,039
Investment Income		
Net investment income earned	$ 6,596,723	
Net realized capital gain	467,588	
Net investment gain		7,064,311
Net income before federal and foreign income taxes		7,507,350
Federal and foreign income taxes incurred		788,051
Net income		$ 6,719,299

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2009		$ 77,855,364
Net income	$ 6,719,299	
Change in net unrealized capital losses	(2,167)	
Change in net deferred income tax	(236,841)	
Change in nonadmitted assets	(133,703)	
Change in provision for reinsurance	(5,000)	
Aggregate write-ins for gains in surplus	469,498	
Change in surplus as regards policyholders for the year		6,811,086
Surplus as regards policyholders, December 31, 2010		$ 84,666,450

Reconciliation of Surplus as Regards Policyholders
from December 31, 2006 through December 31, 2010

Surplus as regards policyholders, December 31, 2006 per Examination			$ 103,052,860
	Gain in Surplus	Loss in Surplus	
Net income	$ 36,678,812	$	
Net unrealized capital gains	66,187		
Change in net foreign exchange capital losses		2,331	
Change in net deferred income tax	1,870,165		
Change in nonadmitted assets	2,879,712		
Change in provision for reinsurance		1,000	
Capital changes: Transferred from surplus (Stock Dividend)		25,000	
Surplus adjustments: Paid-in		24,975,000	
Dividends to stockholders		35,000,000	
Aggregate write-ins for gains and losses in surplus	122,045		
Total gains and losses	$ 41,616,921	$ 60,003,331	
Net decrease in surplus as regards policyholders			(18,386,410)
Surplus as regards policyholders, December 31, 2010, per Examination			$ 84,666,450

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary for the California Department of Insurance, the Company's unearned premium, loss, and loss adjustment expense reserves as of December 31, 2010 were found to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Management Agreements – Tax-Sharing Agreement (Page 5): It is recommended that the Company amend its Tax-Sharing Agreement to reflect its current ultimate parent, Wells Fargo and Company.

Previous Report of Examination

Management and Control – Management Agreements – Services and Shared Expenses Agreement (Page 5): It was recommended that the Company submit its Services and Shared Expenses Agreement to the California Department of Insurance (CDI) for approval to ensure compliance with California Insurance Code (CIC) Section 1215.4(b)(4). On March 7, 2008, the CDI issued its approval of the Company's Expense Allocation Agreement.

Management and Control – Management Agreements – Tax Allocation Agreement (Page 6): It was recommended that the Company submit its Tax Allocation Agreement to the CDI for approval to ensure compliance with CIC Section 1215.4(b)(3). On August 19, 2008, the CDI issued its approval of the Company's Tax Allocation Agreement.

Corporate Records (Page 6): It was recommended that the Company implement procedures to ensure compliance with CIC Section 735. The Company has complied with this recommendation.

Losses (Page 12): It was recommended that the Company report the reserves for loss adjustment expenses separately from the loss reserve to ensure compliance with Statements of Statutory Accounting Principal No. 55. The Company has complied with this 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/_____
Greg Lieber, CFE
Examiner-In-Charge
Department of Insurance
State of California