

REPORT OF EXAMINATION
OF THE
HOMEGUARD HOMEWARRANTY, INC.

AS OF
DECEMBER 31, 2009

Filed May 16, 2011

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San Francisco, California
March 12, 2011

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of

HOMEGUARD HOMEWARRANTY, INC.

(also referred to as the Company) at its main administrative and statutory home office located at 510 Madera Avenue, San Jose, California 95112.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of March 28, 2006. This examination covers the period from March 28, 2006 through December 31, 2009. The examination was conducted in accordance with the National Association of Insurance Commissioners' Financial Condition Examiners Handbook (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; employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

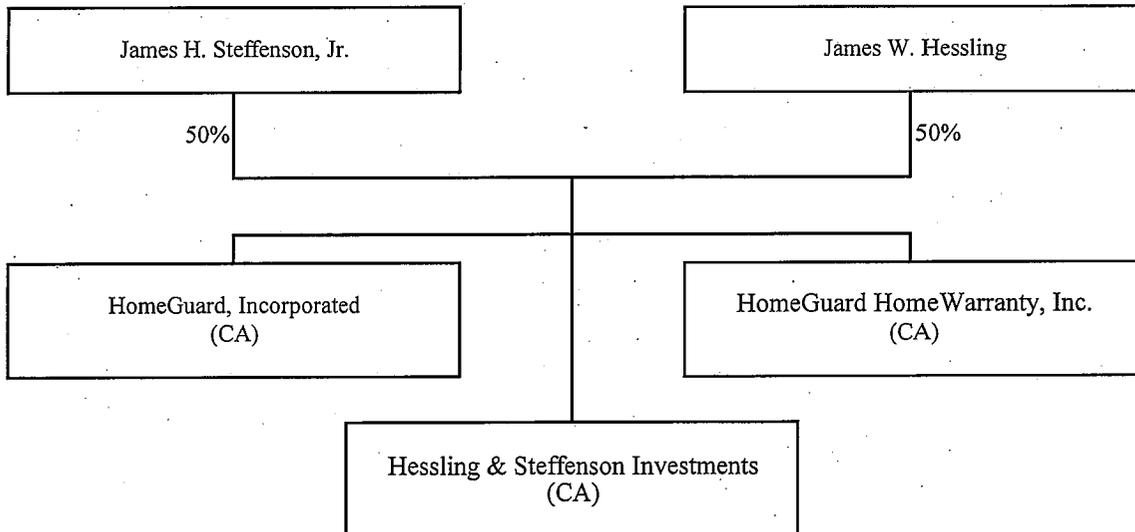
COMPANY HISTORY

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.

There were no dividends paid during the period covered by this examination

MANAGEMENT AND CONTROL

The Company is owned by James H. Steffenson (50%) and James W. Hessling (50%). An organizational chart that shows the Company within the holding company system follows:



Management of the Company is vested in a three member board of directors elected annually. A listing of the members in the board and principal officers serving on December 31, 2009 follows:

Directors

<u>Name and Residence City</u>	<u>Principal Business Affiliation</u>
Cathy C. Campbell* Castro Valley, California	Vice President HomeGuard Home Warranty, Inc.
James W. Hessling Morgan Hill, California	Chief Financial Officer HomeGuard, Incorporated
James H. Steffenson, Jr. Morgan Hill, California	President HomeGuard, Incorporated

* Cathy Campbell was replaced by Robert J. Hessling as of December 2, 2010.

Principal Officers

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

Inter-Company Rental Arrangement

The Company's affiliate, Hessling & Steffenson Investments, provides office space to the Company. It was noted that the Company began paying rent to Hessling & Steffenson Investments in 2010. This arrangement is not in compliance with California Insurance Code Section 1215.5(b)(4) as this arrangement needs prior approval from the California Department of Insurance (CDI). It is recommended that the Company formalize this arrangement in an agreement with Hessling & Steffenson Investments and submit the agreement to the CDI for approval.

Conflict of Interest

The Company has an established procedure whereby its directors and officers annually disclose, via a questionnaire, any actual or potential conflicts of interest. During the review of the conflict of interest statements, it was noted that the Company completed statements only for the 2010 year. It is recommended that the Company's conflict of interest procedures be completed on an annual basis.

TERRITORY AND PLAN OF OPERATION

The Company is licensed to issue home protection contracts only in the State of California. 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 the San Francisco Bay Area. The Company has indicated that it is also developing a market in Orange County in Southern California. The Company also sells directly to the public through its web site.

During the period of this examination, the Company wrote the following volume of business:

Year	Contract Fees Written
2006	\$ 0
2007	95,512
2008	488,116
2009	1,018,205

REINSURANCE

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

ACCOUNTS AND RECORDS

The Company did not report home protection contract fees receivable as prescribed by Exhibit 1 – Analysis of Assets page 10, Note (B) of Home Warranty Annual Statement Blank. It is recommended that the Company report its' home protection contract fees receivables in accordance with the prescribed guidance.

The Company did not report service fees receivable as prescribed by Exhibit 1 – Analysis of Assets page 10, Note (C) of the Home Warranty Annual Statement Blank. It is recommended that the Company report its service fees receivables in accordance with the prescribed guidance.

During the review of Claims Adjusted and Unpaid or in Process of Adjustment it was noted the Company is not recording the date of loss in accordance with the guidelines established by Statements of Statutory Accounting Principles (SSAP) No.55, paragraph 4. It is recommended that the Company record the date of loss as prescribed by SSAP No.55, paragraph 4.

The Company's 2009 Annual Statement amounts for claims paid could not be traced directly to the Company's general ledger. The Company commingled other expenses and claims paid into one account. The Company uses a calculation to arrive at claims paid. It is recommended that the Company segregate claims paid and other expenses into separate general ledger accounts so that each can be accounted for separately.

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 following

areas: data security, IT governance, and contingency planning. 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 financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2009

Underwriting and Investment Exhibit for the Year Ended December 31, 2009

Reconciliation of Surplus as Regards Contract Holders from March 28, 2006
through December 31, 2009

Reconciliation of Examination Changes as of December 31, 2009

Statement of Financial Condition
as of December 31, 2009

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Cash and short-term investments	\$ 1,124,173	\$ 1,124,173	
Interest, dividends and real estate income due and accrued	<u>98</u>	<u>98</u>	
Total assets	<u>\$ 1,124,171</u>	<u>\$ 1,124,171</u>	
 <u>Liabilities, Surplus and Other Funds</u>			
Claims adjusted and unpaid or in process of adjustment		\$ 33,304	(1)
Claims service expenses		3,009	(2)
Other expenses		1,826	
Taxes, licenses and fees		12,455	
Unearned home protection contract fees		406,864	
All other liabilities – Refundable deposits		<u>15</u>	
Total liabilities		457,473	
Common capital stock	\$ 800,000		
Unassigned funds (surplus)	<u>(133,202)</u>		
Surplus as regards contract holders		<u>666,798</u>	
Total liabilities, surplus and other funds		<u>\$ 1,124,271</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2009

Statement of Income

Underwriting Income

Home protection contract fees earned		\$ 806,106
Deductions:		
Claims incurred	\$ 498,707	
Claims service expenses incurred	41,256	
Other expenses incurred	<u>268,631</u>	
Total underwriting deductions		<u>808,594</u>
Net underwriting gain		(2,488)

Investment Income

Net investment income earned	<u>\$ 16,438</u>	
Net investment gain		16,438

Other Income

Other income	<u>\$ 40</u>	
Total other income		<u>40</u>
Net income before federal income taxes		13,990
Federal income taxes incurred		<u>0</u>
Net income		<u>\$ 13,990</u>

Capital and Surplus Account

Surplus as regards contract holders, December 31, 2008		\$ 652,808
Net income	<u>\$ 13,990</u>	
Change in surplus as regards contract holders		<u>13,990</u>
Surplus as regards contract holders, December 31, 2009		<u>\$ 666,798</u>

Reconciliation of Surplus as Regards Contract Holders
from March 28, 2006 through December 31, 2009

Surplus as regards contract holders, March 28, 2006 per Examination		\$800,000
	<u>Loss in Surplus</u>	
Net loss	\$133,202	
Net decrease in surplus as regards contract holders		<u>133,202</u>
Surplus as regards contract holders, December 31, 2009, per Examination		<u>\$666,798</u>

Reconciliation of Examination Changes
as of December 31, 2009

	<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>Liabilities</u>				
Claims adjusted and unpaid or in process of adjustment	\$209	\$33,304	\$ (33,095)	(1)
Claims service expenses	322	3,009	<u>(2,687)</u>	(2)
Net decrease to surplus as regards contract holders			(35,782)	
Surplus as regards contract holders, December 31, 2009, per Company			<u>702,580</u>	
Surplus as regards contract holders, December 31, 2009, per Examination			<u>\$ 666,798</u>	

COMMENTS ON FINANCIAL STATEMENT ITEMS

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

The Company's reserve for claims adjusted or in the process of adjustment was tested using a 12 month loss development. Based on the results of the test, it was determined that claims adjusted and unpaid were deficient by \$33,095. An examination adjustment in the amount of \$33,095 was made to correct this situation. It is recommended that the Company establish sufficient reserves for its claims adjusted and unpaid or in the process of adjustment.

(2) Claims Service Expenses

The Company's reserve for claims service expenses was tested by applying a 3-year paid-to-paid ratio of claims service expenses paid against claims paid for the same 3-year period to the unpaid claims at December 31, 2009. Based on the results of the test it was determined that claims service expenses were deficient by \$2,687. An examination adjustment in the amount of \$2,687 was made to correct this situation. It is recommended that the Company establish sufficient reserves for its claims service expenses.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Inter-Company Rental Arrangement (Page 3): It is recommended that the Company formalize its rental arrangement with Hessling & Steffenson Investments and submit the agreement to the California Department of Insurance for approval.

Management and Control - Conflict of Interest (Page 4): It is recommended that the Company's conflict of interest procedures be completed on an annual basis.

Accounts and Records (Page 5): It is recommended that the Company report its home protection contract fees receivables in accordance with the prescribed guidance.

Accounts and Records (Page 5): It is recommended that the Company report its service fees receivables in accordance with the prescribed guidance.

Accounts and Records (Page 5): It is recommended that the Company record a date of loss as prescribed by Statements of Statutory Accounting Principles No.55, paragraph 4.

Accounts and Records (Page 5): It is recommended that the Company segregate claims paid and other expenses into separate general ledger accounts so that each can be accounted for separately.

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.

Comments on Financial Statement Items - Claims Adjusted and Unpaid or in Process of Adjustment (Page 11): It is recommended that the Company establish sufficient reserves for its claims adjusted and unpaid or in the process of adjustment.

Comments on Financial Statement Items – Claims Service Expenses (Page 11): It is recommended that the Company establish sufficient reserves for its claims service expenses.

Previous Report of Examination

The prior examination was a qualifying report

ACKNOWLEDGMENT

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

Respectfully submitted,

/s/

Yania M. Munro
Associate Insurance Examiner
Examiner-In-Charge
Department of Insurance
State of California