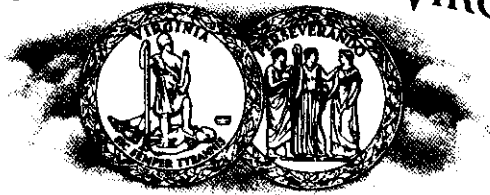


EXAMINATION REPORT
of
MID-ATLANTIC INSURANCE CORPORATION
T/A HW10
Chesapeake, Virginia
as of
December 31, 2006

COMMONWEALTH OF VIRGINIA

ALFRED W. GROSS
COMMISSIONER OF INSURANCE
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE



P.O. BOX 1157
RICHMOND, VIRGINIA 23218
TELEPHONE: (804) 371-9741
TDD/VOICE: (804) 371-9206
<http://www.state.va.us/scc>

I, Alfred W. Gross, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of Mid-Atlantic Insurance Corporation as of December 31, 2006, is a true copy of the original report on file with this Bureau.

IN WITNESS WHEREOF, I have hereunto set my hand
and affixed to the original the seal of the Bureau at the City
of Richmond, Virginia this 11th day of January, 2008

A handwritten signature in cursive script that reads "Alfred W. Gross".

Alfred W. Gross
Commissioner of Insurance

(SEAL)

TABLE OF CONTENTS

Description 1

History 1

Management and Control 2

Related Party Transactions 6

Officers and Employees' Welfare and Pension Plans 6

Fidelity Bond and Other Insurance 7

Territory and Plan of Operation 7

Growth of the Corporation 9

Reinsurance 10

Scope 11

Financial Statements 11

Recommendations for Corrective Action 17

Subsequent Event 19

Conclusion 20

Richmond, Virginia
September 21, 2007

Honorable Alfred W. Gross
Commissioner of Insurance
Commonwealth of Virginia
Richmond, Virginia

Dear Sir:

Pursuant to your instructions and by authority of § 38.2-1317 of the Code of Virginia, a financial condition examination of the records and affairs of the

**MID-ATLANTIC INSURANCE CORPORATION
T/A HW10**

Chesapeake, Virginia,

hereinafter referred to as the Corporation, has been completed. The report thereon is submitted for your consideration.

DESCRIPTION

The Corporation is licensed as a home protection company pursuant to Chapter 26 of Title 38.2 of the Code of Virginia and was last examined by representatives of the State Corporation Commission's Bureau of Insurance (Bureau) as of December 31, 2004. This examination covers the period January 1, 2005 through December 31, 2006.

HISTORY

The Corporation was formed on November 30, 1983, under the name of Home Warranty Corporation of Virginia and licensed by the Bureau to write home protection insurance on January 13, 1984. It commenced operations in June of 1984. The name of the Corporation was changed to Mid-Atlantic Insurance Corporation in August of 1984.

On August 24, 1988, the Corporation received notice from the Clerk of the State Corporation Commission (Commission) that it received an attested copy of an assumed name certificate for the Corporation to conduct business under the assumed name of HW10.

The Articles of Incorporation initially provided for 500 shares of no-par capital stock. These shares were issued for an aggregate amount of \$500,000 and recorded as common capital stock. On June 16, 1986, the Articles of Incorporation were amended to increase the aggregate number of shares that the Corporation shall have the authority to issue from 500 to 650, with each share having a par value of \$400.

According to its Articles of Incorporation, the Corporation was formed for the following purposes:

(a) To engage in the business of a 'home protection company' as defined in Chapter 29, Section 38.1-932, of the Code of Virginia, as amended;

(b) To issue insurance contracts and agreements whereby for a predetermined fee, it will undertake for a specified period of time to furnish, arrange for or indemnify for service, repair, or replacement of any and all of the structural components, parts, appliances, or systems of any covered residential dwelling necessitated by wear and tear, deterioration, inherent defect, or by the failure of an inspection to detect the likelihood of failure;

(c) To such extent as a corporation organized under the Virginia Stock Corporation Act may now or hereafter lawfully do, to do each and everything necessary, suitable, convenient, or proper for, or in connection with, or incidental to, the accomplishment of any one or more of the purposes or the exercise of any one or more of the powers hereinafter enumerated, or designed directly or indirectly to promote the interest of the Corporation or to enhance the value of its properties; and in general to do any and all things and exercise any and all powers, rights, and privileges for which a corporation may now or hereafter be organized under the Virginia Stock Corporation Act, or under any act amendatory thereof, supplemental thereto, or substituted therefor.

MANAGEMENT AND CONTROL

The bylaws provide that management be vested in a board of directors consisting of not more than twelve members. Directors need not be shareholders of the Corporation. At any meeting, a majority of the members of the board constitutes a quorum for the transaction of business.

The bylaws further provide that officers of the Corporation shall be a president, a first vice president, a second vice president, a secretary and a treasurer. Directors and officers of the Corporation as of December 31, 2006, were as follows:

<u>Directors</u>	<u>Principal Occupation</u>
John W. Ainslie, Jr.	Builder/Developer Ainslie/Widener Virginia Beach, Virginia
Samuel L. Cohen	Builder/Developer Joey Corporation Chesapeake, Virginia
Thomas W. Dye	Branch Manager Ferguson Enterprises Virginia Beach, Virginia
William H. Halprin	Real Estate R.L. Nusbaum Realty Co. Norfolk, Virginia
John W. Iuliano, III	Builder/Developer Area Builders Chesapeake, Virginia
Pete A. Kotarides	Builder/Developer Kotarides Builders Virginia Beach, Virginia
Charles J. Miller, II	Builder/Developer Miller Custom Homes Virginia Beach, Virginia
John E. Olivieri	Builder/Developer Associated Development LLC Virginia Beach, Virginia
Edward R. Sadler	Builder/Developer Sadler Building Corporation Virginia Beach, Virginia

Directors (continued)Principal Occupation

C. Grigsby Scifres

Legal Counsel
 Williams, Mullen, Clark & Dobbins, P.C.
 Virginia Beach, Virginia

H. Mac Weaver, II

Banker
 SunTrust Bank
 Chesapeake, Virginia

Jeffrey J. Wermers

Builder/Developer
 Genesis Group, Inc.
 Chesapeake, Virginia

Officers

John W. Ainslie, Jr.

President

Edward R. Sadler

First Vice President

Thomas W. Dye

Second Vice President

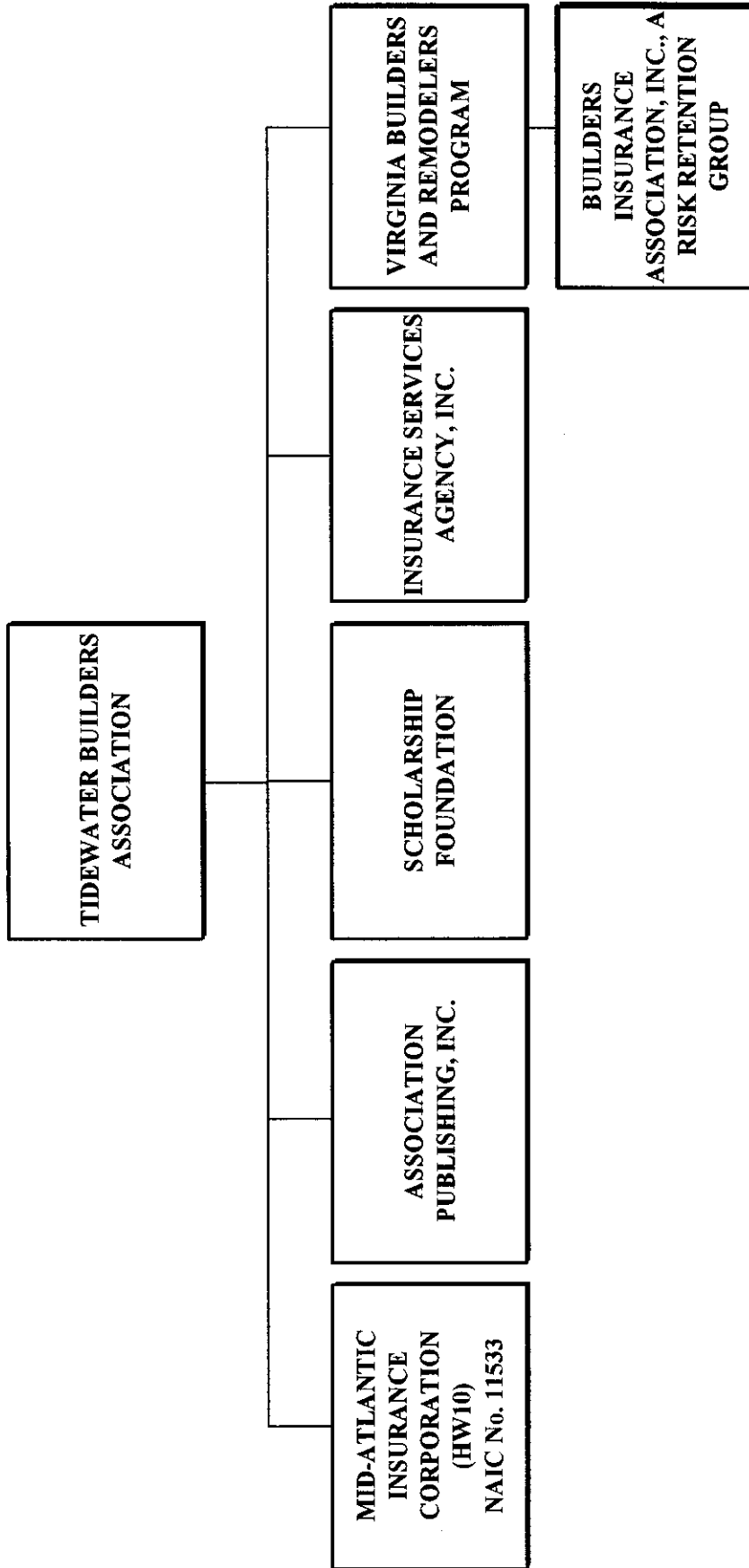
William H. Halprin

Secretary

Pete A. Kotarides

Treasurer

All of the Corporation's 650 shares of issued stock, with a par value of \$400, are held by Tidewater Builders Association, Inc. (TBA). The following chart shows the Corporation's relationship to its parent and affiliates:



RELATED PARTY TRANSACTIONS

Management Agreements

The Corporation entered into a management agreement with its parent, TBA. The agreement provides that for a predetermined fee, TBA will provide the following services: accounting services, building maintenance, computer services, management and administrative services, salaries, health benefits and various other services. In addition, certain portions of the Corporation's salaries are allocated back to TBA. The fees pursuant to the agreement were \$7,542 for 2005 and \$7,320 for 2006.

The Corporation entered into a management agreement with an affiliate, Association Publishing, Inc. (API), formerly Mid-Atlantic Home Builders Trade Exposition, Inc. The agreement provides that for a predetermined fee, API will provide the following services: utilities, cleaning, insurance, maintenance, personal property taxes, public relations, computer, postage and telephone. The management fee, as stated in the agreements, was \$63,673 for 2005 and \$61,641 for 2006.

The Corporation entered into a management agreement with Insurance Services Agency, Inc. (ISA). The agreement provides for the Corporation to perform the services of salaries, payroll taxes and life and health insurance. The management fees pursuant to this agreement were \$218,686 for 2005 and \$163,944 for 2006.

OFFICERS AND EMPLOYEES' WELFARE AND PENSION PLANS

The Corporation's employees are covered under API's defined contribution profit sharing retirement plan, which is fully funded by the participating corporations. Contributions to the retirement plan are discretionary and the Corporation elected to contribute \$47,900 in 2005 and \$61,171 in 2006. Prior to January 1, 1992, employees were allowed to make voluntary contributions of up to 10% of their compensation to the plan.

On January 1, 1992, the retirement plan was amended to include a 401(k) option that allowed employees to contribute up to 15% of their compensation on a pre-tax basis and also allowed the Corporation the discretionary option to match the employees' contribution. The plan also allowed the Corporation to make a discretionary profit sharing contribution that was not limited by the Corporation's net profits. This contribution was to be allocated on an integrated level of 80.01% of the Taxable Wage Base.

On January 1, 2002, the retirement plan was amended to allow 401(k) deferrals up to the maximum percentage allowed by law. It also allowed total participant-directed investments and Frontier Trust Company was named as Trustee of the plan.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2006, the Corporation was listed as a named insured on a \$300,000 fidelity bond. The Corporation also had directors and officers coverage of \$2,000,000 in the aggregate each policy year. This coverage is subject to a \$25,000 retention on each claim. The Corporation is also a named insured under commercial property, commercial general liability, commercial umbrella, workers compensation and employers liability, and business auto policies as of December 31, 2006.

TERRITORY AND PLAN OF OPERATION

The Corporation confines its operations to Virginia where it is licensed as a Home Protection Company under Chapter 26 of Title 38.2 of the Code of Virginia. The Corporation currently issues one type of policy, a Home Protection Policy.

The policy is issued to the first person that purchases the home, and the coverage extends to any successor in title during the first ten years after the effective date of coverage. The policy provides coverage in the amount of the sales price of the home, up to a maximum of \$200,000. The coverage is subject to a one time deductible of \$250 for the first two years of the policy and a \$250 deductible per claim during years three through ten of the policy. No deductible shall be charged for the reoccurrence of a previously corrected defect.

During the first year, the policy covers most defects in workmanship and materials, including equipment, and major structural defects. The second year of coverage is limited to major structural defects and defects in the plumbing, electrical heating, cooling and ventilating systems but does not cover any manufactured item of equipment, appliances, or other item whether covered by a manufacturer's warranty or not. Coverage for years three through ten is limited to major structural defects. Currently, policies are only issued on homes constructed by builders who belong to TBA. These builders sign an agreement with the Corporation which provides that the builder will be responsible for repairing, replacing, or paying to any homeowner the reasonable and actual cost to correct covered defects during the first two years of the policy. The Corporation requires some builders to furnish a letter of credit or other security during the two-year period. The letter of credit requirement and the premium rate charged are based on the builder's experience and annual sales volume. The following schedule shows the premium rates:

Builder's Category A	\$1.80 per \$1,000 of sales price or \$200,000 whichever is less
Builder's Category B	\$2.24 per \$1,000 of sales price or \$200,000 whichever is less
Builder's Category C	\$3.00 per \$1,000 of sales price or \$200,000 whichever is less

In addition to the above charges, builders pay the Corporation a first year registration fee of \$200 and a \$100 annual renewal fee. A warranty service fee of either \$50 or \$75, based on the builder's experience, is charged for each home and is paid by the builder.

The Corporation's employees process all claims.

GROWTH OF THE CORPORATION

The following data, obtained from Annual Statements filed with the Bureau and from examination reports, indicates the growth of the Corporation for the ten year period ending December 31, 2006:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital Paid Up</u>	<u>Gross Paid In and Contributed Surplus</u>	<u>Unassigned Funds (Surplus)</u>
1997	\$5,243,287	\$3,066,327	\$260,000	\$390,000	\$1,526,960
1998	5,421,350	3,041,473	260,000	390,000	1,729,877
1999	5,534,199	3,334,379	260,000	390,000	1,549,820
2000	5,228,058	3,201,105	260,000	390,000	1,376,953
2001	5,341,060	3,402,216	260,000	390,000	1,288,844
2002	5,337,237	3,651,582	260,000	390,000	1,035,655
2003	5,798,567	3,950,510	260,000	390,000	1,198,057
2004	6,355,412	4,124,155	260,000	390,000	1,581,257
2005	6,943,408	4,431,029	260,000	390,000	1,862,379
2006	6,986,422	4,430,521	260,000	390,000	1,905,901

<u>Year</u>	<u>Premiums Earned</u>	<u>Losses Incurred</u>	<u>Loss Adjustment Expenses Incurred</u>	<u>Other Underwriting Expenses Incurred</u>	<u>Net Underwriting Gain or (Loss)</u>
1997	\$521,554	(\$41,626)	\$131,977	\$745,203	(\$314,000)
1998	506,775	57,461	71,087	728,765	(350,538)
1999	498,651	260,409	73,797	781,352	(616,907)
2000	502,381	1,515	108,998	761,376	(369,508)
2001	530,549	66,555	92,255	632,471	(260,732)
2002	441,156	30,501	83,005	601,197	(273,547)
2003	577,241	34,477	68,899	634,290	(160,425)
2004	494,641	45,330	57,943	563,907	(172,539)
2005	633,694	45,718	81,089	507,088	(201)
2006	663,176	70,845	88,354	603,915	(99,938)

REINSURANCE

For policies effective January 1, 2005, the Corporation elected to self-insure all risks and not cede any risk pursuant to a reinsurance agreement. In order to comply with the limitation per risk as prescribed by § 38.2-208 of the Code of Virginia, the amount of coverage provided under such new policies is \$200,000. Prior to January 1, 2005, the coverage provided was \$250,000.

The Corporation has an agreement that covers loss events taking place and reported to the reinsurer between January 1, 2004 and December 31, 2004 for those policies issued by the Corporation during this twelve-month period. The agreement contains an insolvency clause and a guaranty of intermediary's credit.

The Corporation also has reinsurance agreements for prior years through individual agreements covering corresponding ten-year periods.

The agreements effective January 1, 2002 and January 1, 2003 were with a reinsurer that is not licensed or accredited in Virginia, nor were the reinsurance credits collateralized pursuant to Code of Virginia § 38.2-1316.4 2. Therefore, as of December 31, 2006, the Corporation reported a provision for reinsurance of \$105,417. This amount is being amortized over the period of the coverage provided under these agreements.

SCOPE

This is a full scope financial condition examination initiated and conducted under the provisions of Article 4, Chapter 13 of Title 38.2 of the Code of Virginia. The examination covers the period from January 1, 2005, through December 31, 2006. Assets were verified and liabilities were established at December 31, 2006. A review of income and disbursements for the period was made to the extent deemed necessary.

The items comprising the Balance Sheet for which Specific Risk Analyses (SRA) were required had medium or low risk assessments as determined from the *National Association of Insurance Commissioners Examiners Handbook*. Analytical review procedures were applied for non-SRA items.

The services of Oliver Wyman Actuarial Consulting, Inc. were engaged pursuant to the provisions of Code of Virginia § 38.2-1318 E. This engagement was made to provide an actuarial report as to the reasonableness of the Corporation's total loss and loss adjustment expense reserves as of December 31, 2006.

In addition, the following items were reviewed, several of which are discussed separately under their respective captions in this report.

- History
- Records of the Corporation
- Management and Control
- Fidelity Bond and Other Insurance
- Related Party Transactions
- Welfare and Pension Plans
- Territory and Plan of Operation
- Conflict of Interest
- Growth of the Corporation
- Reinsurance
- Accounts and Records
- Financial Statements

FINANCIAL STATEMENTS

There follows a statement of financial condition as of December 31, 2006, a statement of income for the period ending December 31, 2006, a reconciliation of surplus for the period under review, and a statement of cash flow for the period ending December 31, 2006. The financial statements are presented in accordance with Statutory Accounting Principles.

ASSETS

	<u>Assets</u>	<u>Nonadmitted Assets</u>	<u>Net Admitted Assets</u>
Bonds	\$5,360,582		\$5,360,582
Common stocks	891,856		891,856
Cash and short-term investments	448,511		448,511
Investment income due and accrued	89,288		89,288
Uncollected premiums and agents' balances in the course of collection	21,689		21,689
Current federal income tax recoverable	77,596		77,596
Net deferred tax asset	220,000	123,100	96,900
Furniture and equipment	2,470	2,470	
Receivables from parent, subsidiaries and affiliates	163,944	163,944	
Prepaid expense	13,020	13,020	
Totals	<u>\$7,288,956</u>	<u>\$302,534</u>	<u>\$6,986,422</u>

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses		\$273,927
Loss adjustment expenses		155,433
Other expenses		180,097
Taxes, licenses and fees		9,242
Unearned premiums		3,648,383
Ceded reinsurance premiums payable		47,090
Amounts withheld or retained by company for account of others		7,301
Provision for reinsurance		105,417
Payable to parent, subsidiaries and affiliates		<u>3,631</u>
 Total liabilities		 \$4,430,521
 Common capital stock	\$260,000	
Gross paid in and contributed surplus	390,000	
Unassigned funds (surplus)	<u>1,905,901</u>	
 Surplus as regards policyholders		 <u>2,555,901</u>
 Totals		 <u><u>\$6,986,422</u></u>

UNDERWRITING AND INVESTMENT EXHIBIT
STATEMENT OF INCOME

UNDERWRITING INCOME

Premiums earned	\$663,176
<hr/>	
Deductions:	
Losses incurred	\$70,845
Loss expenses incurred	88,354
Other underwriting expenses incurred	603,915
<hr/>	
Total underwriting deductions	\$763,114
<hr/>	
Net underwriting loss	(\$99,938)
<hr/>	

INVESTMENT INCOME

Net investment income earned	\$219,491
Net realized capital gains	863
<hr/>	
Net investment gain	\$220,354
<hr/>	

OTHER INCOME

Finance and service charges not included in premiums	\$53,088
Miscellaneous income	21
<hr/>	
Total other income	\$53,109
<hr/>	
Net income before federal income taxes	\$173,525
Federal income taxes incurred	53,684
<hr/>	
Net income	\$119,841
<hr/> <hr/>	

RECONCILIATION OF CAPITAL AND SURPLUS
FOR PERIOD UNDER REVIEW

	<u>2005</u>	<u>2006</u>
Surplus as regards policyholders, December 31, previous year	<u>\$2,231,257</u>	<u>\$2,512,379</u>
Net income	\$197,624	\$119,841
Change in net unrealized capital gains or (losses)	(14,684)	70,364
Change in nonadmitted assets	44,997	(177,828)
Change in provision for reinsurance	25,000	25,583
Audit adjustment - federal income tax	<u>28,185</u>	<u>5,562</u>
Change in surplus as regards policyholders for the year	<u>\$281,122</u>	<u>\$43,522</u>
Surplus as regards policyholders, December 31, current year	<u><u>\$2,512,379</u></u>	<u><u>\$2,555,901</u></u>

CASH FLOW**Cash From Operations**

Premiums collected net of reinsurance	\$727,514
Net investment income	222,087
Miscellaneous income	53,109
Total	<u>\$1,002,710</u>
Benefits and loss related payments	\$52,975
Commissions, expenses paid and aggregate write-ins for deductions	641,632
Federal income taxes paid	232,093
Total	<u>\$926,700</u>
Net cash from operations	<u>\$76,010</u>

Cash From Investments

Proceeds from investments sold, matured or repaid:	
Bonds	\$1,859,053
Stocks	213,463
Total investment proceeds	<u>\$2,072,516</u>
Cost of investments acquired (long-term only):	
Bonds	\$2,095,861
Stocks	187,911
Total investments acquired	<u>\$2,283,772</u>
Net cash from investments	<u>(\$211,256)</u>

Cash From Financing and Miscellaneous Sources

Cash provided (applied):	
Other cash applied	<u>(\$66,664)</u>
Net cash from financing and miscellaneous sources	<u>(\$66,664)</u>
Net change in cash and short-term investments	<u><u>(\$201,910)</u></u>

RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS

Cash and short-term investments:	
Beginning of year	\$650,421
End of year	448,511
Net change in cash and short-term investments	<u><u>(\$201,910)</u></u>

RECOMMENDATIONS FOR CORRECTIVE ACTION

Management and Control

1. A recommendation for corrective action was included in the two previous examination reports regarding the Corporation's expenses. The recommendation indicated that the Corporation's other underwriting expenses appeared disproportionate when compared to the corresponding premiums. The underwriting expenses exceeded premiums earned for each year during the period of the current examination. The relative high level of expenses for salaries, payroll taxes, employee relations and welfare contributed significantly to the total amount of other underwriting expenses. The Corporation responded that it had already begun a review of the underwriting expenses and that it was management's intention to seek ways to remedy this situation in order to continue the viability of the Corporation's future operations. While the expense ratio has improved during the period covered by this examination, the Corporation should continue to review its operations to further decrease such expenses and to ensure that such expenses do not affect the future viability of the Corporation given its current volume of business.
2. During the Examiners' review of the Information Systems Questionnaire (ISQ), it was noted the Corporation did not have written procedures to support controls listed as being in place. The Examiners recommend the Corporation document the necessary procedures to support the information systems controls. This is the second consecutive examination report that has included this recommendation.
3. The Corporation has cost sharing agreements in place with several affiliated companies. These agreements provide for the sharing of certain operating costs. Those costs that can be charged directly to a specific affiliate are charged on dollar-for-dollar basis. Any costs which cannot be allocated to a specific affiliate are shared on a pro-rata basis among the parties. However, these agreements do not provide for specific dates of settlement for receivable or payable balances among the group. Settlements are performed on an ad hoc basis during the course of the year with some balances not settling until the end of the year. The Examiners recommend the Corporation ensure that all intercompany receivables and payables be settled in a timely fashion, such as monthly or quarterly, and the applicable agreements be amended to include such settlement dates.

Accounts and Records4. **Unearned Premiums**

During the Examiners' testing of unearned premiums, it was noted that the controls over the policy system information did not appear adequate. The Examiners determined that the Corporation's electronic database for policies was not consistent with the provided hardcopy documentation. This could result in potential misstatement unless reconciled on a regular basis. The Examiners recommend that the Corporation confirm that all information entered into the database is entered correctly and reviewed by a person independent of the data entry function.

SUBSEQUENT EVENT

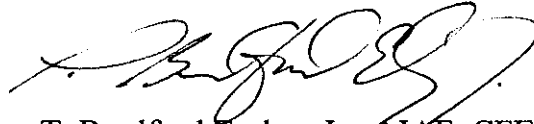
The Corporation is currently in the process of merging the Corporation, along with an affiliate, into a new insurer that will be licensed pursuant to the provisions of Chapter 10 of Title 38.2 of the Code of Virginia. An application for this purpose was submitted to the Commission in August 2007. The new insurer, pending approval of the Commission, is projected to commence business as of January 1, 2008.

CONCLUSION

The courteous cooperation extended by the Corporation's officers and employees during the course of the examination is hereby gratefully acknowledged.

In addition to the undersigned, Jennifer K. Crawley, CFE, Mario A. Cuellar, CFE, Sheila E. Freeman, AFE, and Theresa C. Lewis, CFE, of the Bureau participated in the work of the examination.

Respectfully submitted,



T. Bradford Earley, Jr., AIAF, CFE, CPCU
Insurance Principal Financial Analyst



INSURANCE
12 21 AM 10: 22

December 20, 2007

Mr. David H. Smith, CFE, CPA, CPCU
Chief Examiner
State Corporation Commission
Bureau of Insurance
PO Box 1157
Richmond, VA 23218

Dear Mr. Smith:

Please find listed below our response to the Recommendations For Corrective Action contained in the Examination Report of Mid-Atlantic Insurance Corporation (MAIC) as of December 31, 2006.

Management and Control

1. MAIC management initiated cost cutting measures during fiscal year 2000 to reduce other underwriting expense and, over a period of seven years since, has reduced this expense by 23%. It is management's intent to further decrease such expenses in order to insure the Corporation's future viability.
2. MAIC management has again addressed this issue with the Information Technology Director. The Corporation will have in place the necessary procedures to support the information systems controls.
3. The Corporation will revise all in place cost sharing agreements to include a provision for quarterly settlement dates which will ensure that all intercompany receivables and payables are settled in a timely fashion.

2117 Smith Avenue
Chesapeake, Virginia 23320-2515
757/424-6523 • Fax 757/420-8021

Accounts and Records

4. Unearned Premiums – MAIC management is giving strong consideration to upgrade the underwriting software in order to strengthen controls over policy administration. This will help to insure that all information entered into the database is entered correctly. In addition, the Corporation will initiate a process whereby a review will routinely be performed by a person independent of the data entry function.

The Officers and staff of Mid-Atlantic Insurance Corporation appreciate the cooperation and support provided by the examination team while they were here. As always, they handled themselves in a most professional and courteous manner and were very helpful toward the correction and implementation of the above mentioned deficiencies.

Sincerely,

A handwritten signature in black ink, appearing to read "Randolph S. Latham". The signature is fluid and cursive, with the first name being the most prominent.

Randolph S. Latham
Chief Financial Officer