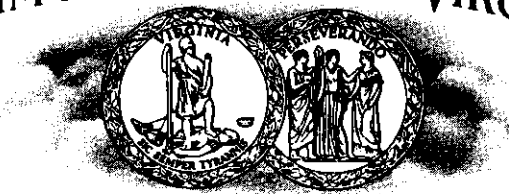


Association Examination Report
on
HOME SECURITY ASSOCIATION OF VIRGINIA, INC.
Madison, Wisconsin
as of
December 31, 2004

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE

COMMONWEALTH OF VIRGINIA

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



P.O. BOX 1157
RICHMOND, VIRGINIA 23218
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I, Alfred W. Gross, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of Home Security Association of Virginia, Inc. as of December 31, 2004, 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 8th day of November, 2005

A handwritten signature in black ink, appearing to read 'Alfred W. Gross', written over a horizontal line.

Alfred W. Gross
Commissioner of Insurance

(SEAL)

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Richmond, Virginia
July 28, 2005

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, an examination of the records and affairs of

HOME SECURITY ASSOCIATION OF VIRGINIA, INC.
Madison, Wisconsin

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

DESCRIPTION

The Corporation is licensed in Virginia as a home protection company pursuant to Chapter 26 of Title 38.2 of the Code of Virginia. It was last examined by representatives of the Virginia State Corporation Commission's Bureau of Insurance (Bureau) as of December 31, 2001. This examination, covering a three-year period from January 1, 2002 through December 31, 2004, was conducted by the Bureau, representing the Southeastern Zone of the National Association of Insurance Commissioners (NAIC).

HISTORY

The Corporation was organized by and is a wholly owned subsidiary of Home Security of America, Inc. (HSA), a home warranty company domiciled in the State of Wisconsin. The Commonwealth of Virginia issued a Certificate of Incorporation on April 19, 1990. Effective July 30, 1998, the Corporation's parent, HSA, was 90% owned by CNA Warranty, Inc. and 10% owned by Mr. Robert J. Lehmann. CNA Warranty, Inc. was a wholly owned subsidiary of CNA Financial Corporation, which was controlled by Loews Corporation, a holding company in the State of New York. The Corporation was licensed by the Bureau under this ownership structure to write home protection insurance on April 9, 2001.

Effective December 31, 2001, Home Security Corporation (HSC), a Wisconsin Corporation that is 100% owned by Mr. Lehmann, acquired the 90% ownership interest in HSA held by CNA Warranty, Inc. and the remaining 10% held by Mr. Lehmann. As a result, Mr. Lehmann, as sole shareholder of HSC, acquired 100% control of HSA and the Corporation.

The articles of incorporation provide for 10,000 shares of common stock with a par value of \$100. Initial capitalization consisted of \$300,000, recorded as common capital stock. The Corporation's parent, HSA, made additional contributions of \$2,718 in 2001 and \$20,000 in 2003, recorded as gross paid in and contributed surplus.

MANAGEMENT AND CONTROL

The bylaws provide that management shall be vested in a board of directors consisting of three members. A majority of the directors shall constitute a quorum for the transaction of business. Action required or permitted to be taken at a board of directors' meeting may be taken without a meeting if the action is taken by all members of the board. The action shall be evidenced by one or more written consents stating the action taken, signed by each director and included in the minutes or filed with the corporate records.

The bylaws further provide that officers of the Corporation shall be a President and a Secretary. The board of directors may, at its discretion, choose one or more vice presidents and other officers and assistant officers as deemed necessary.

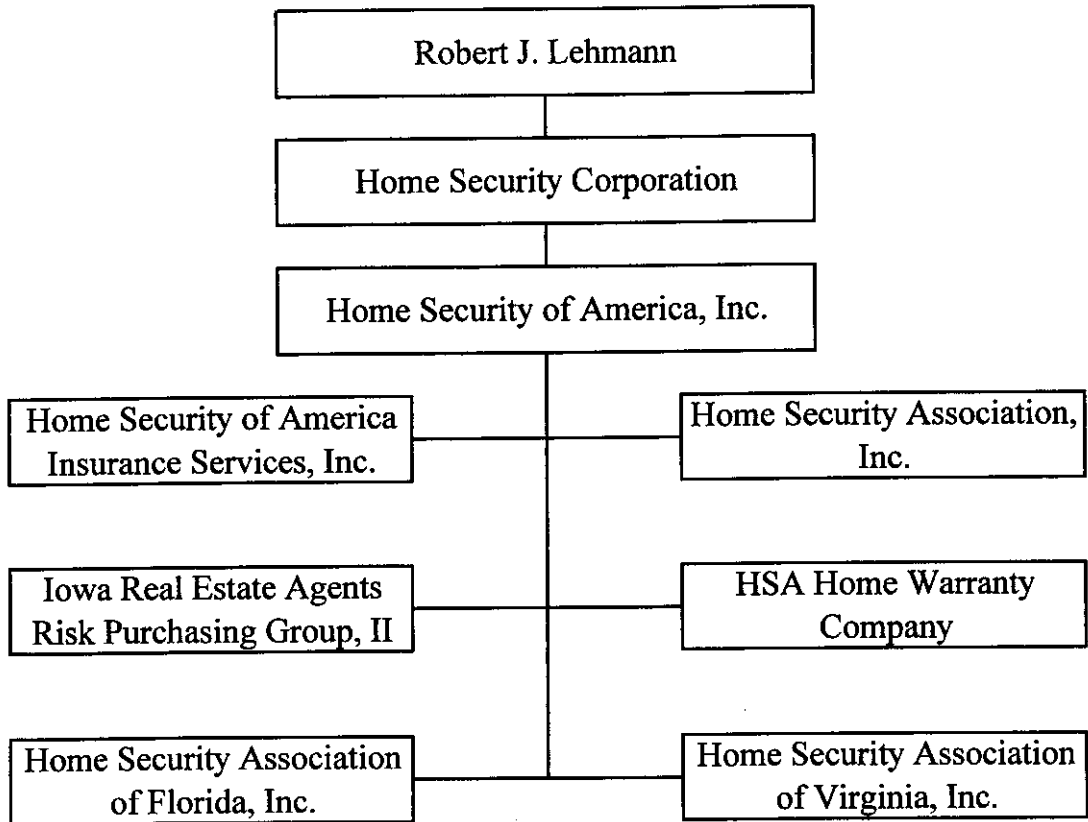
At December 31, 2004, the directors and officers of the Corporation were as follows:

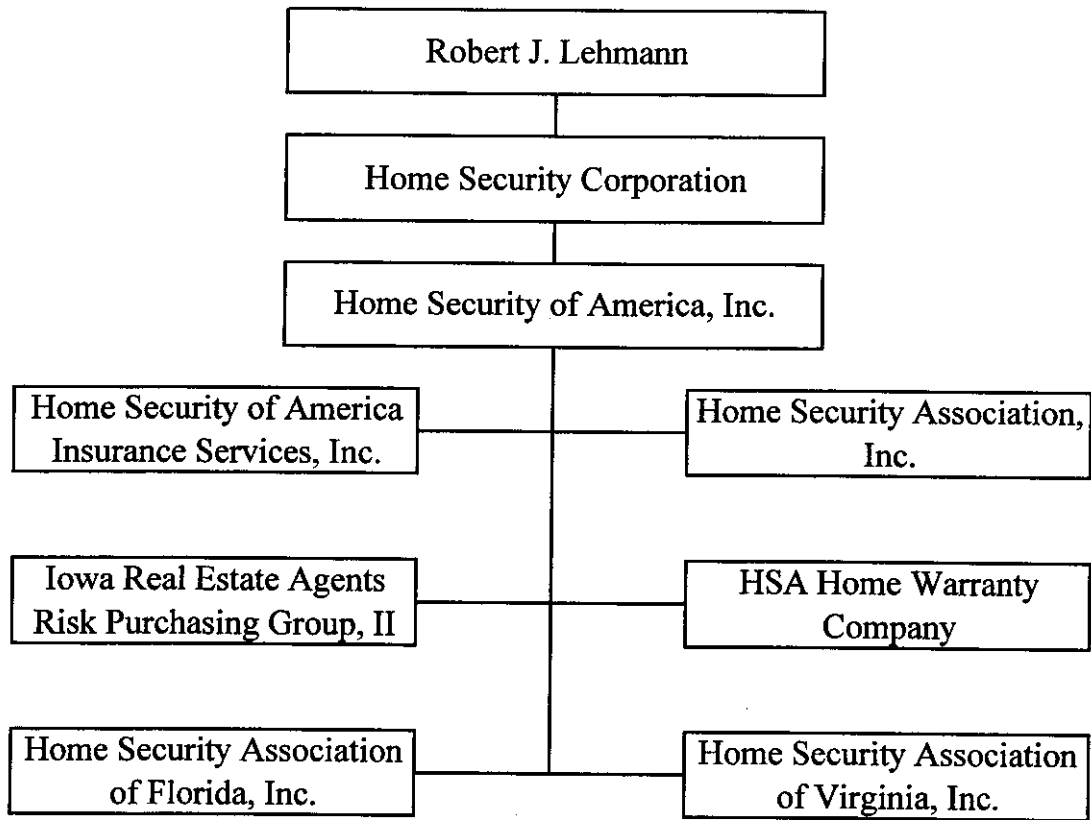
<u>Directors</u>	<u>Principal Occupation</u>
Robert J. Lehmann	President and Chief Executive Officer Home Security Corporation Madison, Wisconsin
Michael F. Clear	Chief Operating Officer Home Security Corporation Madison, Wisconsin
David R. Lehmann	Service Operations Director Home Security Association of Virginia, Inc. Madison, Wisconsin

Officers

Robert J. Lehmann	President and Chief Executive Officer
Michael F. Clear	Vice President and Chief Operating Officer
Steven P. Dedo	Treasurer and Chief Financial Officer
Darlene F. Schwab	Secretary

At December 31, 2004, all the shares of issued and outstanding common capital stock of the Corporation are held by Home Security of America, Inc. The following chart shows the Corporation's relationship to the parent and to other affiliated companies:





The Corporation retains responsibility for any tax liability for those states which do not recognize the Corporation as a Qualifying Subchapter S subsidiary of HSC.

INSURANCE COVERAGE

The Corporation is a named insured on HSA's commercial general liability insurance policy, fidelity bond and directors and officers liability insurance policy.

TERRITORY AND PLAN OF OPERATION

At December 31, 2004, the Corporation limited its operations to Virginia and Maryland. The Corporation currently issues two types of policies:

Seller's Home Protection Plan

This plan is available to sellers of single-family dwellings, two family dwellings or dwellings with up to eight family dwelling units which must be used for residential purposes only, where a dwelling unit is a defined residential area that contains, at a minimum, sleeping quarters, a bathroom, and a kitchen areas as well as a separate entryway to the unit. The residence includes the primary physical structure, as well as attached garages. Protection must be purchased for each unit of a multiple family dwelling in order to qualify the property for protection. Coverage attaches at 12:01 A.M. at the address of the residence on the eleventh day from the Corporation's receipt of the application, unless otherwise notified in writing. Coverage continues the length of the listing period, not to exceed twelve months. Coverage may be extended in additional six-month increments at the Corporation's discretion. The seller's coverage terminates at the date and hour legal title to the residence transfers from seller to buyer.

The Corporation will repair or replace covered parts or components of equipment, systems, and appliances that become inoperative as a result of mechanical breakdown due to normal wear, tear and use resulting in the failure of the covered parts or components to function. The covered parts or components are subject to a specified deductible and the claim must be reported during the contract period.

Buyer's Home Protection Plan

This policy arises from either the conversion of a Seller's Home Protection Plan to a Buyer's Home Protection Plan upon sale of a unit or the direct purchase of a Buyer's Home Protection Plan by the homebuyer. The terms, definitions and conditions parallel those of the Seller's Home Protection Plan outlined above including the provision for a deductible and a listing of eligible equipment and systems, each containing specific

exclusions. The Buyer's Home Protection Plan is effective at 12:01 AM on the date of the close of sale and continues for one year from that date. Payment is due at close of sale and must be received by the Corporation within ten working days after close of sale in order for coverage to be in force.

GROWTH OF THE CORPORATION

The following data, obtained from the Annual Statement filed with the Bureau, indicates the growth of the Corporation from its inception to December 31, 2004:

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Paid-In Capital</u>	<u>Unassigned Funds</u>
2001	\$297,505	\$20,000	\$302,718	(\$25,213)
2002	338,160	23,033	302,718	12,409
2003	393,136	76,228	322,718	(5,810)
2004	567,405	275,361	322,718	(30,674)

<u>Year</u>	<u>Premiums Earned</u>	<u>Loss and Loss Adjustment Expenses Incurred</u>	<u>Other Underwriting Expenses</u>	<u>Net Underwriting Gains or (Losses)</u>
2001	\$0	\$0	\$3,846	(\$3,846)
2002	1,772	956	1,513	(697)
2003	78,344	19,571	36,445	22,328
2004	260,761	141,444	136,325	(17,008)

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, 2002 through December 31, 2004. Assets were verified and liabilities were established at December 31, 2004. 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.

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

History
Corporate Records
Management and Control
Territory and Plan of Operation
Contracts and Underwriting
Fidelity Bond
Accounts and Records
Financial Statements

FINANCIAL STATEMENTS

There follows a statement of financial condition as of December 31, 2004, a statement of income for the period ending December 31, 2004, a reconciliation of surplus for the period under review, a statement of cash flow for the year ended December 31, 2004, and a statement of Examiners' changes in surplus. 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	\$155,272		\$155,272
Common stocks	151,734		151,734
Cash and short-term investments	246,954		246,954
Investment income due and accrued	1,903		1,903
Uncollected premiums and agents' balances in the course of collection	13,724		13,724
Receivables from parent, subsidiaries and affiliates	<u>13,521</u>	<u>13,521</u>	
Totals	<u>\$583,108</u>	<u>\$13,521</u>	\$569,587
Deduct Category 2 investments in excess of amount allowed by Section 38.2-1403 of the Code of Virginia			<u>2,182</u>
			<u>\$567,405</u>

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses		\$15,491
Commissions payable, contingent commissions and other similar charges		5,520
Other expenses		665
Unearned premiums		234,565
Payable to parent, subsidiaries and affiliates		<u>19,120</u>
 Total liabilities		 \$275,361
 Common capital stock	 \$300,000	
Gross paid in and contributed surplus	22,718	
Unassigned funds (surplus)	<u>(30,674)</u>	
 Surplus as regards policyholders		 <u>292,044</u>
 Totals		 <u><u>\$567,405</u></u>

UNDERWRITING AND INVESTMENT EXHIBIT
STATEMENT OF INCOME

UNDERWRITING INCOME

Premiums earned	<u>\$260,761</u>
Deductions:	
Losses incurred	\$123,486
Loss expenses incurred	17,958
Other underwriting expenses incurred	50,608
Aggregate write-ins for underwriting deductions	<u>85,717</u>
Total underwriting deductions	<u>\$277,769</u>
Net underwriting gain	<u>(\$17,008)</u>

INVESTMENT INCOME

Net investment income earned	<u>\$7,847</u>
Net investment gain	<u>\$7,847</u>

OTHER INCOME

Aggregate write-ins for miscellaneous income	<u>(\$22,869)</u>
Total other income	<u>(\$22,869)</u>
Net income	<u><u>(\$32,030)</u></u>

RECONCILIATION OF CAPITAL AND SURPLUS
FOR PERIOD UNDER REVIEW

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Surplus as regards policyholders, December 31, previous year *	<u>\$277,505</u>	<u>\$315,127</u>	<u>\$316,908</u>
Adjustment for previous examination changes	\$39,172		
Net income	(1,550)	4,650	(32,030)
Change in non-admitted assets		(22,869)	7,166
Capital changes: Paid in		<u>20,000</u>	
Change in surplus as regards policyholders for the year	<u>\$37,622</u>	<u>\$1,781</u>	<u>(\$24,864)</u>
Surplus as regards policyholders, December 31, current year	<u><u>\$315,127</u></u>	<u><u>\$316,908</u></u>	<u><u>\$292,044</u></u>

* Adjusted surplus from previous examination

CASH FLOW**Cash From Operations**

Premiums collected net of reinsurance	\$413,526
Net investment income	7,223
Total	<u>\$420,749</u>
Benefit and loss related payments	\$111,884
Commissions, expenses paid and aggregate write-ins for deductions	147,159
Total	<u>\$259,043</u>
Net cash from operations	<u>\$161,706</u>

Cash From Investments

Proceeds from investments sold, matured or repaid:	
Bonds	\$155,000
Total investment proceeds	<u>\$155,000</u>
Cost of investments acquired (long-term only):	
Bonds	\$156,453
Stocks	150,000
Total investments acquired	<u>\$306,453</u>
Net cash from investments	<u>(\$151,453)</u>
Net change in cash and short-term investments	<u>\$10,253</u>

RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS

Net change in cash and short-term investments	\$10,253
Cash and short-term investments:	
Beginning of year	<u>236,701</u>
End of year	<u>\$246,954</u>

EXAMINERS' CHANGES IN SURPLUS

	<u>Amount per Corporation</u>	<u>Amount per Examiners</u>	<u>Increase (Decrease) in Surplus</u>
<u>Liabilities:</u>			
Unearned premiums	\$185,339	\$234,565	<u>(\$49,226)</u>
Examiners' net decrease in surplus			<u>(\$49,226)</u>
Surplus as regards policyholders per Examiners			\$292,044
Surplus as regards policyholders per Corporation			<u>341,270</u>
Examiners' net decrease in surplus			<u>(\$49,226)</u>

RECOMMENDATIONS FOR CORRECTIVE ACTION

Management and Control

1. Code of Virginia § 38.2-1408 states, in part:

No domestic insurer shall make any loan, investment, or any sale or exchange of a loan or investment,...unless authorized or approved. Authorization or approval shall be made by (i) its board of directors, or other governing body, or (ii) a committee authorized by the governing body or bylaws, to make investments, loans, sales or exchanges. The minutes of the committee shall be recorded, and reports of the investments, loans, sales, or exchanges authorized or approved shall be submitted to the board or other governing body at its next meeting.

A review of the minutes of the board of directors meeting indicated that the Corporation's investments were not approved by the board for the period under review. A similar recommendation was included in the previous examination report. The Examiners recommend that the Corporation implement procedures to ensure compliance with the provisions of Code of Virginia § 38.2-1408.

2. In order to demonstrate compliance with Code of Virginia Sections 38.2-210 and 38.2-211, the Corporation's directors and officers should complete conflict of interest statements on an annual basis. The Corporation could not produce all required executed conflict of interest statements for two officers. The Corporation should implement procedures to ensure that each director and each officer completes a conflict of interest statement on an annual basis.

Accounts and Records

3. Unearned Premium Reserve \$234,565

The above liability is \$49,226 more than the amount reported by the Corporation in its 2004 Annual Statement. This increase resulted from the following:

- A. SSAP No. 53 of the NAIC *Accounting Practices and Procedures Manual* (AP&P) states that the unearned premium reserve shall be calculated using the daily pro rata method or the monthly pro rata method. The Examiners utilized the monthly

pro rata method to determine the unearned premium reserve, which resulted in an increase of \$42,815.

- B. Policies reported as assets in the Premium Receivable line were not included in the Corporation's inforce listing. Including these item in the Examiners' calculation resulted in an increase of \$6,411.

The Examiners recommend that the Corporation calculate its liabilities in accordance with the AP&P.

SUBSEQUENT EVENT

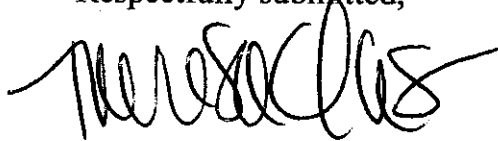
On March 10, 2005, 600 of the 1,800 shares of HSC were converted to non-voting common stock. Of the 600 shares transferred, 120 were put into the David R. Lehmann Trust and 80 were put into the Lehmann Grandchildren Trust. Robert J. Lehmann retained the remaining 400 issued shares of non voting stock.

CONCLUSION

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

In addition to the undersigned, Sheila E. Freeman of the Bureau participated in the examination.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Theresa C. Lewis', written in a cursive style.

Theresa C. Lewis, CFE
Senior Insurance Examiner
Commonwealth of Virginia
Representing the Southeastern Zone, NAIC



STATE COURT COMMISSION
BUREAU OF INSURANCE
05 NOV -3 AM 9: 20

October 12, 2005

David H. Smith
Chief Examiner
Commonwealth of Virginia
PO Box 1157
Richmond, Virginia 23218

Re: Home Security Association of Virginia, Inc.
Examination Report as of December 31, 2004

Dear Mr. Smith;

As requested, the following are in response to the "Recommendations for Corrective Action" section of the Association Examination Report as of December 31, 2004.

Management and Control-

1. The authorization and approval of investments was delegated to the three Senior Officers of the Company, "a committee authorized by the governing body to make investments, loans, sales or exchanges." This was stated in Company's minutes dated April 7, 2004 as follows:

"The Board of Directors authorizes and approves delegating investing activities, through the Bank One Trust Company, N.A., to the President, Chief Operations Officer and Chief Financial Officer of the Company."

The current investments held by the Bank One Trust Company, N.A. were approved by the President and Chief Operations Officer, who represent two of three directors on the Board, as well as, the Chief Financial Officer.

However; the Company did not submit reports of the investments to the Board at "its next meeting". The Company's current investments have now been recorded as part of the Board minutes and this will be done so in the future when changes to investments are made.

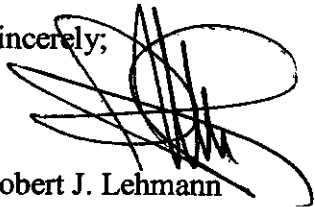
2. We agree with the Examiners finding; however, it should be pointed out that for year ended December 31, 2004, the most recent year under review, the conflict of interest statements for all Directors and Officers were completed and provided to the Examiners. The Company's Human Resources manager will ensure that conflict of interest statements are completed annually by all Directors and Officers beginning with year ending December 31, 2005.

Accounts and Records-

3. The Company computed its reserves based on the minimum level set by Virginia Code Section 38.2-2606 which states "the reserve account shall be calculated according to sound actuarial principles, but shall equal at a minimum fifty percent of the premiums received from all contracts in force in the Commonwealth, net of applicable reinsurance and any amounts paid on account of liabilities incurred under the contracts". It was the Company's believe that the reserve calculation required by Virginia Code was actuarial sound and was appropriate for Home Protection companies. None-the-less, beginning the Third Quarter, 2005 the Company will compute the unearned premium reserve in accordance with the AP&P.

As requested, please send 3 copies of the final report. I have also included a correction to the History Section of the report which should be made for accuracy purposes.

Sincerely;

A handwritten signature in black ink, appearing to read "Robert J. Lehmann", written over a large, stylized scribble.

Robert J. Lehmann
President
Home Security Association of Virginia, Inc.