

REPORT OF EXAMINATION  
OF THE  
AMERICAN HOME  
SHIELD OF CALIFORNIA, INC.  
AS OF  
DECEMBER 31, 2007

Filed December 19, 2008

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San Francisco, California  
October 14, 2008

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of

**AMERICAN HOME SHIELD OF CALIFORNIA, INC.**

(also referred to as the Company) at its main administrative and statutory home office located at 889 Ridge Lake Boulevard, Memphis, Tennessee 38120. The Company's registered agent in California is Jere Keprios c/o CT Corporation, 818 West Seventh Street, 2<sup>nd</sup> Floor, Los Angeles, California 90017.

**SCOPE OF EXAMINATION**

The previous examination of the Company was made as of December 31, 2003. This examination covers the period from January 1, 2004 through December 31, 2007. The present examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions, and an evaluation of 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: fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

## COMPANY HISTORY

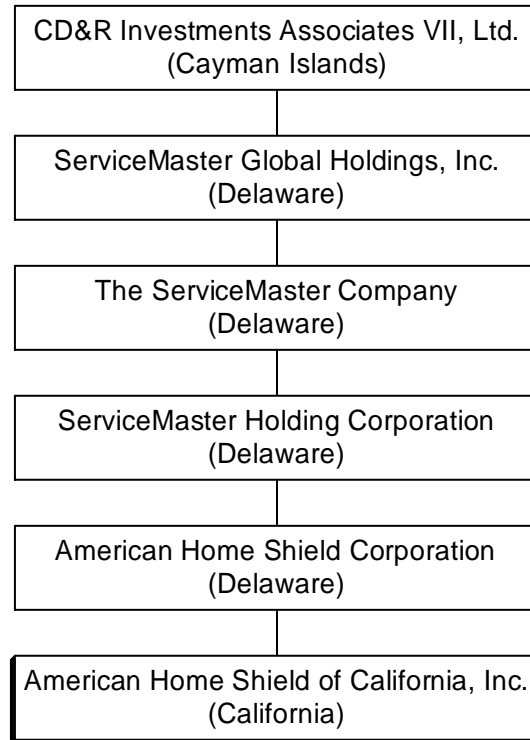
American Home Shield of California, Inc. (the Company), is a wholly-owned subsidiary of American Home Shield Corporation (AHSC). AHSC was formerly a wholly-owned subsidiary of The ServiceMaster Company (ServiceMaster), a publicly-traded company incorporated in Delaware.

On July 24, 2007, ServiceMaster and its affiliates were acquired by ServiceMaster Global Holdings, Inc., (formerly known as CDRSVM Topco). Pursuant to an Agreement and Plan of Merger, CDRSVM Acquisition Co., an entity indirectly owned by ServiceMaster Global Holdings, Inc. merged with and into ServiceMaster with ServiceMaster as the surviving corporation. The shareholders of ServiceMaster received cash in exchange for their shares and ServiceMaster became a privately held corporation. CD&R Investment Associates VII, Ltd. is the ultimate controlling entity of ServiceMaster Global Holdings, Inc.

During the period of this examination, the Company declared and paid ordinary dividends to its parent, AHSC, in the amounts of \$12 million in 2004, \$14 million in 2005 and \$12 million in 2006. Subsequent to the examination date, the Company also declared and paid ordinary dividends of \$16 million on May 20, 2008 to AHSC.

## MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which CD&R Investment Associates VII, Ltd., Cayman Islands, is the ultimate controlling entity. 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 as of December 31, 2007.



Management of the Company is under the control of a sole (one)-member board of director(s) and the officers of the Company. The director and principal officers as of December 31, 2007 were as follows:

Director

Name and Residence

Principal Business Affiliation

David J. Crawford  
Germantown, Tennessee

President and Chief Operating Officer  
American Home Shield Corporation

Principal Officers

Name

Title

David J. Crawford  
Brian L. Rupiper

President and Chief Operating Officer  
Senior Vice President, Chief Financial  
Officer and Treasurer

Mark F. Lightfoot  
James L. Coggin

Senior Vice President and Secretary  
Assistant Secretary

## Management Agreements

*Intercompany Tax Sharing Agreement:* Effective April 1, 2004, the Company entered into a new tax sharing agreement with American Home Shield Corporation (AHSC) and its wholly-owned subsidiaries. The purpose of the agreement was to clarify the tax allocation method and include AHSC and its affiliates in the consolidated federal income tax return of The ServiceMaster Company. Under the new agreement, the tax liability of the AHSC and its subsidiaries are computed as if each subsidiary or member filed a separate stand-alone return. The ServiceMaster Company is the party primarily responsible for filing on behalf of the Company and its subsidiaries. The Company submitted the agreement to the California Department of Insurance (CDI) pursuant to California Insurance Code (CIC) Section 1215.4 (b) and later rescinded the application. As such, the Company is not in compliance with CIC 1215.4(b). It is recommended that the Company submit the Tax Sharing agreement for review and approval by the CDI in accordance with CIC Section 1215.4(b). This is a repeat finding from the previous examination.

*Intercompany Management Agreement:* The Company has a management agreement with its parent, AHSC. Under this agreement, AHSC manages the Company's home warranty business, which includes collecting contract fees, issuing home protection contracts, paying expenses, settling claims, performing accounting functions, and filing regulatory reports. All expenses are paid by AHSC and settled through inter-company accounts. The Company is to bear its equitable share of pooled overhead expenses actually incurred and reported by AHSC. The equitable share is based on the Company's percentage of home protection contracts written through AHSC each accounting period. In 2004, 2005, 2006, and 2007, the Company paid \$28,052,149, \$26,670,430, \$25,325,249, and \$24,740,353, respectively, for these services. The agreement was effective as of September 12, 1994 and has not been submitted to the CDI for review and approval pursuant to CIC 1215.4 (b). It is recommended that the Company submit the intercompany management agreement to the CDI for review and approval in accordance with CIC Section 1215.4. (b).

Additionally, the Company did not list the aforementioned management agreements in its 2004, 2005, 2006, and 2007 Form B filings in compliance with CIC Section 1215.4. It is recommended that the Company disclose all related party agreements in its Form B filings in accordance with CIC Section 1215.4.

### CORPORATE RECORDS

The Company is not in compliance with California Insurance Code (CIC) Section 735 which states that the Company must inform the board members of the receipt of the examination report. The board should be informed of the report both in the form first formally prepared by the examiners and in the form as finally settled and officially filed by the commissioner. The board must also enter these facts in the board minutes. A review of the board minutes disclosed that, neither the officially filed report nor the first formally prepared draft by the examiners was presented to the board members after the last financial examination. It is recommended the Company inform the board of the receipt of the examination report and record this action in the board minutes in accordance with CIC Section 735.

The Company is not in compliance with CIC Section 1200 which require the board to authorize and approve investments. The Company's minutes failed to document the authorization or approval of its investments in a timely manner. It is recommended the Company authorize and approve investments in accordance with CIC Section 1200.

### TERRITORY AND PLAN OF OPERATION

The Company is licensed to issue home protection contracts only in the State of California. The Company issues service contracts on a direct basis through American Home Shield Corporation employees, as sales representatives, for production and marketing. The Company uses independent Company approved building contractors throughout California for servicing claims, subject to the oversight and monitoring by the Company's staff. The Company's products are offered through approximately 177 sales representatives who market the contracts through real estate and personal line agencies affiliated with financial institutions. The Company also sells

directly to the public through its web site and its service centers in Memphis, Tennessee, Lagrange, Georgia, and Carroll, Iowa. The net contract fees written in California totaled \$99.2 million in 2007.

During the examination period, the Company maintained a branch office located in Santa Rosa, California. In February, 2008, the Santa Rosa office was closed.

### REINSURANCE

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

### ACCOUNTS AND RECORDS

The Annual Statement amount for premium written could not be traced to the general ledger accounts and supporting reports. The Company accounts for premiums written and earned through a series of deferred revenue and deferred revenue clearing accounts. Two of the deferred revenue account balances are the cumulated balance of at least 6 years of deferred revenue activity. As a result, the examiner had to rely on previous years balances to arrive at the current year's premium written. Additionally, the supporting reports for the deferred revenue activity could not be readily traced back to the financial statement accounts. It is recommended the Company prepare reconciliations for the general ledger accounts and Annual Statement premium accounts and amend the supporting reports to provide information on the premium written by the effective policy year.

It was noted the Company was not in compliance with the National Association of Insurance Commissioner's (NAIC) Annual Statement Instructions regarding investment activity disclosure. General Interrogatory 6 requires the Company provide the detailed data of all investments listed under Lines 1 through 6 of the Annual Statement Assets Page that were either acquired, sold or adjusted. It is recommended the Company comply with the NAIC Annual Statement Instructions and disclose the required investment activity.

## 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 Contract Holders from December 31, 2003  
through 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	\$ 18,628,289	\$	\$ 18,628,289	(1)
Preferred stocks	3,797,233		3,797,233	
Common stocks	52,621,899		52,621,899	(1)
Cash and short-term investments	27,134,631		27,134,631	(1)
Other invested assets	5,973,344		5,973,344	(1)
Home protection contract fees in course of collection	19,764,014	960,034	18,803,980	
Interest, dividends and real estate income due and accrued	309,415		309,415	
Inventory	63,786	63,786		
Other receivables	<u>(988)</u>	<u>          </u>	<u>(988)</u>	
Total assets	<u>\$128,291,623</u>	<u>\$ 1,023,820</u>	<u>\$127,267,803</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Claims adjusted and unpaid or in process of adjustment			\$ 4,410,700	
Claims service expense			0	(2)
Other expenses			2,348,219	
Taxes, licenses and fees			(81,647)	
Federal income taxes			12,530,802	
Unearned home protection contract fees			37,539,494	
Payable to affiliates			451,033	
Deferred federal income tax due			<u>(207,610)</u>	
Total liabilities			56,990,991	
Common capital stock		\$ 1		
Gross paid-in and contributed surplus		6,442,857		
Unassigned funds (surplus)		<u>63,833,954</u>		
Surplus as regards contract holders			<u>70,276,812</u>	
Total liabilities, surplus and other funds			<u>\$127,267,803</u>	

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

Statement of Income

Underwriting Income

Home protection contract fees earned		\$ 95,080,391
Deductions:		
Claims incurred	\$ 38,098,274	
Claims service expenses incurred	7,422,106	
Other expenses incurred	<u>30,061,407</u>	
Total underwriting deductions		<u>75,581,787</u>
Net underwriting gain		19,498,604

Investment Income

Net investment income earned	\$ 3,071,235	
Net realized capital gains	<u>11,578,347</u>	
Net investment gain		<u>14,649,582</u>
Net income before federal income taxes		34,148,186
Federal income taxes incurred		<u>11,581,500</u>
Net income		<u>\$ 22,566,686</u>

Capital and Surplus Account

Surplus as regards contract holders, December 31, 2006		\$ 53,585,163
Net income	\$ 22,566,686	
Change in nonadmitted assets	45,635	
Net change in unrealized gain on equity securities	<u>(5,920,672)</u>	
Change in surplus as regards contract holders		<u>16,691,649</u>
Surplus as regards contract holders, December 31, 2007		<u>\$ 70,276,812</u>

Reconciliation of Surplus as Regards Contract Holders  
from December 31, 2003 through December 31, 2007

Surplus as regards contract holders, December 31, 2003 per Examination			\$ 41,646,041
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 69,972,516	\$	
Change in net unrealized capital gains		3,968,547	
Change in nonadmitted assets	626,802		
Dividends to stockholders (cash)	<u>                    </u>	<u>38,000,000</u>	
Total gains and losses	<u>\$ 70,599,318</u>	<u>\$ 41,968,547</u>	
Increase in surplus as regards contract holders			<u>28,630,771</u>
Surplus as regards contract holders, December 31, 2007, per Examination			<u>\$ 70,276,812</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Bonds, Common Stocks, Cash and Short-Term Investments, and Other Invested Assets

The Company maintains five custodial agreements with Union Bank of California. Only one of the custodial agreements meets the California Department of Insurance (CDI) standards for approval. The remaining four custodial agreements can not be approved per California Insurance Code (CIC) 1104.9 because they do not meet CDI standards for approval. It is recommended that the Company amend the agreements to meet the standards and submit them to the CDI for review and approval.

The Company records securities based on the settlement date and not the trade date as required by Statements of Statutory Accounting Principles (SSAP) 26, paragraph 4. The overall financial effect from the improper recordings of the securities was \$116,474 and is not considered material. Therefore, no examination adjustment was made. However, it is recommended that the Company review transactions pending at year end to ensure proper recording of sales/purchases per trade date as prescribed by SSAP No.26 paragraph 4.

### (2) Claims Service Expense

The Company records the claims service expenses with the claims adjusted and unpaid amounts in the Annual Statement line 1 for claims adjusted and unpaid or in process of adjustments. It is recommended the Company record claim service expense in the appropriate Annual Statement line.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Management and Control – Management Arrangements (Page 4): It is recommended that the Company submit its intercompany tax allocation and intercompany management agreement to

the California Department of Insurance (CDI) for review in compliance with California Insurance Code (CIC) Section 1215.4(b) and disclose these agreements in its Form B filings pursuant to CIC Section 1215.4.

Corporate Records (Page 5): It is recommended that the Company inform the board of the receipt of the examination report and include the facts in the board minutes pursuant to CIC Section 735. It is recommended that the Company comply with CIC Section 1200 and authorize and approve investments in a timely manner.

Accounts and Records (Page 6): It is recommended that the Company prepare reconciliations for the general ledger accounts, Annual Statement premium accounts and amend supporting reports to provide information on the premium written by the effective policy year. It is recommended that the Company comply with the Annual Statement instructions and disclose the required investment activity.

Comments on Financial Statement Items - Bonds, Common Stocks, Cash and Short-Term Investments, and Other Invested Assets (Page 12): It is recommended that the Company amend its custodial agreements to meet the standards and submit them to the CDI for review and approval. The Company is currently in the process of submitting the amended agreements to the CDI for approval. It is also recommended that the Company review transactions pending at year- end to ensure proper recording of sales/purchases per trade date as prescribed by SSAP No.26, paragraph 4.

Comments on Financial Statement Items - Claims Service Expense (Page 12): It is recommended that the Company record claim service expense in appropriate Annual Statement line.

#### Previous Report of Examination

Management and Control – Intercompany Tax Allocation Agreement (Page 3):

1. It was recommended that the Company submit the tax allocation agreement to the California Department of Insurance (CDI) for review in compliance with California

Insurance Code (CIC) Section 1215.4(b). The Company has not complied with this recommendation.

2. It was recommended that the Company recalculate the tax liability to fairly allocate Internal Revenue Service refunds pursuant to the August, 2000 Tax Sharing Agreement and CIC Section 1215.5(a) when tax refunds are received for American Home Shield Corporation and subsidiaries. The Company has complied with this recommendation.

Management and Control - Conflict of Interest (Page 4): It was recommended that the Company's conflict of interest procedures be completed by key employees. The Company has complied with this recommendation.

Accounts and Records (Page 5): It was recommended that the Company report permanent impairments in its income statement pursuant to SSAP 30 paragraph 9. The Company has complied with this recommendation.

Accounts and Records (Page 6): It was recommended that the Company evaluate the recommendations and make appropriate changes to strengthen its information systems controls. The Company has complied with this recommendation.

Comments on Financial Statement Items - Bonds, Common Stocks, Cash and Short-Term Investments, and Other Invested Assets (Page 10):

1. It was recommended that the custodial agreements between the Company and Mechanics Bank and the Company and Union Bank, in respect to investments managed by the Bank of New York and Schaffer Cullen Management, be amended to meet the CDI standards and submit them to the CDI for review and approval pursuant to CIC Section 1104.9. The Company has not complied with this recommendation.
2. It was recommended that the Company review transactions pending at year end to ensure proper recording of sales/purchases based on trade date as prescribed by SSAP No.21, paragraph 6. The Company has not complied with this recommendation.

3. It was recommended that the Company reclassify the Government backed mortgage securities from “Other invested assets” to “Bonds” and carry them at amortized value. The Company has complied with the amortization portion of this recommendation.

Comments on Financial Statement Items - Deferred Tax Asset (Page 10): It was recommended that the Company comply with SSAP 10, including paragraphs 5-7 for recording and reporting deferred tax assets. The Company has complied with this recommendation.

Comments on Financial Statement Items - Claims Service Expense (Page 11): It was recommended that the Company evaluate this reserve and establish its claims expense reserve based on reliable and defensible methods. The Company has complied with recommendation.

ACKNOWLEDGEMENT

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/\_\_\_\_\_  
Sandra K Bailey, CFE  
Senior Insurance Examiner  
Examiner-In-Charge  
Department of Insurance  
State of California