

REPORT OF EXAMINATION  
OF THE  
AMERICAN HOME  
SHIELD OF CALIFORNIA, INC.  
AS OF  
DECEMBER 31, 2010

Filed: June 26, 2012

TABLE OF CONTENTS

|   | <u>PAGE</u> |
|---|-------------|
| SCOPE OF EXAMINATION.....   | 1           |
| COMPANY HISTORY .....   | 2           |
| MANAGEMENT AND CONTROL: .....   | 2           |
| Management Agreements .....   | 4           |
| TERRITORY AND PLAN OF OPERATION .....   | 5           |
| REINSURANCE.....  | 6           |
| ACCOUNTS AND RECORDS:.....  | 6           |
| Information Systems Controls .....  | 6           |
| FINANCIAL STATEMENTS:.....  | 7           |
| Statement of Financial Condition as of December 31, 2010 .....  | 8           |
| Underwriting and Investment Exhibit for the Year Ended December 31, 2010.....                                   | 9           |
| Reconciliation of Surplus as Regards Contract Holders from December 31, 2007 through<br>December 31, 2010 ..... | 10          |
| COMMENTS ON FINANCIAL STATEMENT ITEMS:.....   | 11          |
| Bonds .....   | 11          |
| Common Stocks .....   | 11          |
| Claims Service Expenses .....   | 11          |
| SUMMARY OF COMMENTS AND RECOMMENDATIONS:.....   | 12          |
| Current Report of Examination.....  | 12          |
| Previous Report of Examination.....   | 13          |
| ACKNOWLEDGEMENT .....   | 15          |

San Francisco, California  
May 11, 2012

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

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

(hereinafter also referred to as the Company) at its financial accounting office located at 860 Ridge Lake Boulevard, Memphis, Tennessee 38120. The Company's statutory home office and main administrative home office is located at 889 Ridge Lake Boulevard, Memphis, Tennessee 38120.

**SCOPE OF EXAMINATION**

We have performed our single-state examination of American Home Shield of California, Inc. The previous examination of the Company was made as of December 31, 2007. This examination covers the period from January 1, 2008 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, 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; pensions, stock ownership and insurance plans; growth of company; loss experience; statutory deposits; and sales and advertising.

### COMPANY HISTORY

During and subsequent to the examination period, the Company paid ordinary and extraordinary cash dividends to its parent, American Home Shield Corporation (AHSC), as follows:

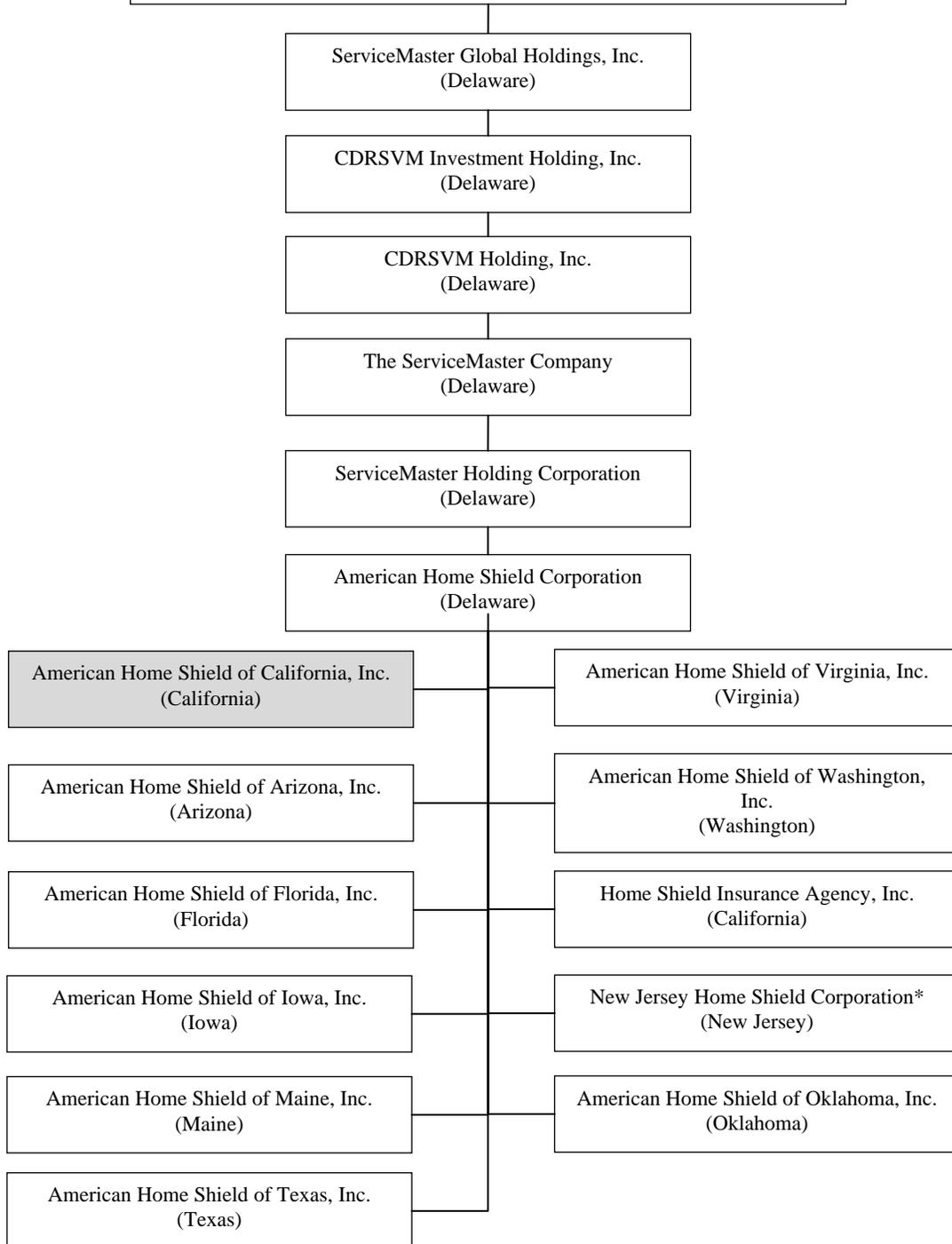
| <u>Year</u> | <u>Amount</u>         | <u>Type of Dividend</u> |
|-------------|-----------------------|-------------------------|
| 2008        | \$16.0 million        | Ordinary                |
| 2009        | 12.4 million          | Ordinary                |
| 2010        | 45.0 million          | Extraordinary           |
| 2011        | 24.0 million          | Extraordinary           |
| Total       | <u>\$97.4 million</u> |                         |

The extraordinary dividends in 2010 and 2011 were approved by the California Department of Insurance pursuant to California Insurance Code Section 1215.5(g) in September 2010 and November 2011, respectively.

### MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system, of which majority control is held by Clayton, Dubilier & Rice Fund VII, L.P. (CDR Fund). CDR Fund has a 62.29% ownership interest in ServiceMaster Global Holdings, Inc., the Company's ultimate parent. The remaining ownership is held by four investment funds and Company employees. The following abridged organization chart depicts the interrelationship of the Company and its affiliates within the holding company system as of December 31, 2010 (all ownership is 100% unless otherwise indicated):

|   |        |
|---|--------|
| Clayton, Dubilier & Rice Fund VII, L.P. and related funds | 62.29% |
| Citigroup Capital Partners II Employee Master Fund, L.P.  | 3.55%  |
| BAS Capital Funding Corporation and related funds         | 12.03% |
| JPMorgan Chase Funding Inc.                               | 6.87%  |
| StepStone Group LLC Managed Funds                         | 13.64% |
| Company Employees   | 1.62%  |



\*New Jersey Home Shield Corporation is pending dissolution.

Management of the Company is under the control of a one-member board of director. The sole board member and principal officers serving as of December 31, 2010 were as follows:

Board of Directors

| <u>Name and Residence</u>                  | <u>Principal Business Affiliation</u>                                     |
|--|---|
| David J. Crawford<br>Germantown, Tennessee | President and Chief Operating Officer<br>American Home Shield Corporation |

Principal Officers

| <u>Name</u>       | <u>Title</u>                          |
|-------------------|---------------------------------------|
| David J. Crawford | President and Chief Executive Officer |
| Mark F. Lightfoot | Secretary and Senior Vice President   |
| Laura J. Clark    | Treasurer and Vice President, Finance |

Management Agreements

*Intercompany Affiliated Management Agreement:* During the initial months of the exam period, the Company operated under a Management Agreement with its parent, American Home Shield Corporation (AHSC), dated September 12, 1994. The agreement was filed with the California Department of Insurance (CDI) pursuant to California Insurance Code (CIC) Section 1215.5(b)(4) on December 9, 2008. Per the CDI request, the Company revised the agreement with AHSC and renamed it as Intercompany Affiliated Management Agreement, dated November 4, 2009. The agreement authorizes AHSC to manage the Company's daily operations, including underwriting, marketing, claims handling, managing contractors, real estate, administrative services, accounting, insurance, and other functional support services. In return, the Company reimburses AHSC for direct and overhead expenses. The expenses are allocated based on the Company's percentage of home protection contracts written by AHSC. In addition, the Company is required to pay AHSC six percent (6%) of all recognized home protection contract fees. The revised agreement is still pending approval.

Subsequent to the filing of the above revised agreement, AHSC delegated some of its business functions and services, such as financial, investment, tax and human resources, to The ServiceMaster Company (ServiceMaster). The Company continued to pay AHSC directly for the services which AHSC was obligated to provide, even though the services were actually performed by ServiceMaster. It is noted that the Company does not have a written agreement with ServiceMaster for the above arrangement. It is recommended that the Company again amend its agreement with AHSC to delete these delegated services and then enter into a new written agreement with ServiceMaster for the above arrangement. The new and amended agreements should be submitted to the CDI for approval pursuant to CIC Section 1215.5(b)(4).

*Restated Tax Sharing Agreement:* AHSC and its subsidiaries (including the Company) are participants in a Restated Tax Agreement with ServiceMaster, effective April 1, 2004. Under the terms of the agreement, the tax liability of AHSC and each of its subsidiaries are computed on a separate stand-alone basis. ServiceMaster is responsible for filing the consolidated return on behalf of the participants. This agreement was submitted to the CDI on January 29, 2009 and was approved on March 8, 2012.

The consolidated federal income tax return was reviewed and it was noted that the consolidated tax return was filed by ServiceMaster Global Holdings, Inc. (SVMGH) instead of ServiceMaster as stated in the Restated Tax Sharing Agreement above. SVMGH is not a party to the agreement. It is also recommended that the Restated Tax Sharing Agreement be revised to include SVMGH and any other affiliates that may be filing a consolidated tax return under this agreement and that the agreement be submitted to the CDI for approval pursuant to CIC Section 1215.5(b)(4).

#### TERRITORY AND PLAN OF OPERATION

The Company is licensed to issue home protection contracts in fifty-eight (58) counties in the State of California. The Company is authorized to write home protection contracts for single-family homes, new construction homes, condominiums, town homes, and mobile homes. Residential contracts provide for the repair or replacement of household systems including plumbing, heating,

ventilation, electrical, air conditioning, water heaters, and other systems and appliances. The total direct contract fees written in California were \$89.5 million in 2010.

At December 31, 2010, the Company had 28 Account Executives that work with real estate agents in California. The Account Executives are employees of American Home Shield Corporation (AHSC). AHSC has three call centers located in Memphis, Tennessee; Carroll, Iowa; and LaGrange, Georgia. For claims servicing, the Company utilizes independent contractors who are approved and overseen by AHSC in California.

### REINSURANCE

The Company did not assume or cede any reinsurance during the examination period.

### ACCOUNTS AND RECORDS

#### Information Systems Controls

During the course of the examination, a review was made of the Company's general controls over its information systems. Based on this review, weaknesses were noted in the following areas: physical security, business continuity planning and disaster recovery, vendor management, and operations. These findings were presented to the Company along with recommendations to strengthen its controls. The Company should evaluate the 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, 2010

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

Reconciliation of Surplus as Regards Contract Holders from December 31, 2007  
through December 31, 2010

Statement of Financial Condition  
as of December 31, 2010

| <u>Assets</u>  | <u>Assets</u>        | <u>Notes</u> |
|--|----------------------|--------------|
| Bonds  | \$ 28,409,420        | (1)          |
| Common stocks  | 23,828,522           | (2)          |
| Cash/Cash equivalent on hand and on deposit                | 8,487,207            |              |
| Home protection contract fees receivable                   | 21,887,007           |              |
| Interest, dividends and real estate income due and accrued | 338,406              |              |
| Other receivables  | <u>(1,450)</u>       |              |
| Total assets   | <u>\$ 82,949,112</u> |              |
| <br><u>Liabilities, Surplus and Other Funds</u>            |                      |              |
| Claims adjusted and unpaid or in process of adjustment     | \$ 3,905,210         |              |
| Claims service expenses                                    | 100,000              | (3)          |
| Other expenses   | 896,678              |              |
| Taxes, licenses and fees                                   | (62,888)             |              |
| Federal income taxes                                       | 446,034              |              |
| Unearned home protection contract fees                     | 36,371,144           |              |
| Payable to parent, subsidiaries and affiliates             | 4,868,515            |              |
| Deferred tax   | 54,024               |              |
| Advanced premiums  | <u>818,308</u>       |              |
| Total liabilities  | 47,397,025           |              |
| Common capital stock                                       | \$ 1                 |              |
| Gross paid-in and contributed surplus                      | 6,442,858            |              |
| Unassigned funds (Surplus)                                 | <u>29,109,228</u>    |              |
| Surplus as regards contract holders                        | <u>35,552,087</u>    |              |
| Total liabilities and surplus                              | <u>\$ 82,949,112</u> |              |

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

Statement of Income

Underwriting Income

|                                      |                   |                   |
|--------------------------------------|-------------------|-------------------|
| Home protection contract fees earned |                   | \$ 90,840,424     |
| Deductions:                          |                   |                   |
| Claims incurred                      | \$ 37,573,482     |                   |
| Claims service expenses incurred     | 6,568,148         |                   |
| Other expenses incurred              | <u>22,944,539</u> |                   |
| Total deductions                     |                   | <u>67,086,169</u> |
| Net underwriting gain                |                   | 23,754,255        |

Investment Income

|  |                  |                      |
|--|------------------|----------------------|
| Net investment income earned           | \$ 1,964,300     |                      |
| Net realized capital loss              | <u>(464,448)</u> |                      |
| Net investment gain                    |                  | <u>1,499,852</u>     |
| Net income before federal income taxes |                  | 25,254,107           |
| Federal income taxes incurred          |                  | <u>8,737,646</u>     |
| Net income                             |                  | <u>\$ 16,516,461</u> |

Capital and Surplus Account

|  |                     |                      |
|--|---------------------|----------------------|
| Surplus as regards contract holders,<br>December 31, 2009  |                     | \$ 61,888,744        |
| Net income   | \$ 16,516,461       |                      |
| Change in net unrealized capital gains                     | 2,138,807           |                      |
| Change in non-admitted assets                              | 8,075               |                      |
| Dividends to stockholders                                  | <u>(45,000,000)</u> |                      |
| Change in surplus as regards contract holders for the year |                     | <u>(26,336,657)</u>  |
| Surplus as regards contract holders,<br>December 31, 2010  |                     | <u>\$ 35,552,087</u> |

Reconciliation of Surplus as Regards Contract Holders  
from December 31, 2007 through December 31, 2010

|  |                             |                           |                      |
|--|-----------------------------|---------------------------|----------------------|
| Surplus as regards contract holders,<br>December 31, 2007 per examination  |                             |                           | \$ 70,276,811        |
|  | Gain in<br><u>Surplus</u>   | Loss in<br><u>Surplus</u> |                      |
| Net income   | \$ 37,978,420               | \$                        |                      |
| Net unrealized capital gains   | 729,952                     |                           |                      |
| Change in non-admitted assets  |                             | 33,096                    |                      |
| Dividends to stockholders  | <u>                    </u> | <u>73,400,000</u>         |                      |
| Total gains and losses   | <u>\$ 38,708,372</u>        | <u>\$ 73,433,096</u>      |                      |
| <br>   |                             |                           |                      |
| Net decrease in surplus as regards contract holders                        |                             |                           | <u>(34,724,724)</u>  |
| <br>   |                             |                           |                      |
| Surplus as regards contract holders,<br>December 31, 2010, per examination |                             |                           | <u>\$ 35,552,087</u> |

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Bonds

The Company reports bond acquisitions and disposals on the settlement date instead of on the trade date as required by Statement of Statutory Accounting Principles (SSAP) 26, paragraph 4. The improper recording of the securities had no impact on the financial statements as of December 31, 2010. It is recommended that the Company report bond acquisitions and disposals on the trade date pursuant to SSAP No. 26, paragraph 4. This is a repeat finding from the last examination.

### (2) Common Stocks

The Company's Schedule D – Part 2, Common Stocks Owned, was reviewed and it was noted that the book value and fair value reported for several common stocks were incorrect. However, the carrying value reported on the balance sheet assets page was correctly stated. As such, there is no impact to surplus and no examination adjustment is necessary. It is recommended that the Company implement procedures to ensure that the book value and fair value for securities reported in its Schedule D – Part 2 are correct.

### (3) Claims Service Expenses

A review was made of the Company's claims service expenses for reasonableness. The Company reported an unpaid reserve for claims service expenses of \$0.1 million at the end of each year of the examination period and an unpaid reserve for other expenses of \$1.0 million, \$1.1 million and \$0.9 million at the end of 2008, 2009 and 2010, respectively. However, the Company's claims service expenses incurred during the examination period were \$7.6 million, \$7.6 million and \$6.6 million in 2008, 2009 and 2010, respectively, and the Company's other expenses were \$25.3 million, \$24.9 million and \$22.9 million in 2008, 2009 and 2010, respectively. As such, the Company's allocation between accrued claims service expenses and other expense do not appear reasonable. It is

recommended that the Company establish a method to allocate accrued liabilities between claims service expenses and other expenses that is reasonable and reflects its historical claims experience.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Management and Control – Management Arrangements (Page 4): It is recommended that the Company enter into a new written agreement with The ServiceMaster Company (ServiceMaster) for the services provided, amend the existing management agreement with American Home Shield Corporation (AHSC) deleting the services performed by ServiceMaster, and submit both agreements to the California Department of Insurance (CDI) for approval pursuant to California Insurance Code (CIC) Section 1215.5(b)(4).

Management and Control – Restated Tax Sharing Agreement (Page 5): It is also recommended that the Restated Tax Sharing Agreement be revised to include ServiceMaster Global Holdings, Inc. and any other affiliates that may be filing a consolidated tax return under this agreement and submit the agreement with the CDI for approval pursuant to CIC Section 1215.5(b)(4).

Accounts and Records – Information Systems Controls (Page 6): The Company should evaluate the recommendations and make appropriate changes to strengthen its information systems controls.

Comment on Financial Statement Items – Bonds (Page 11): It is recommended that the Company report bond acquisitions and disposals on the trade date pursuant to Statement of Statutory Accounting Principles (SSAP) No. 26, paragraph 4.

Comment on Financial Statement Items – Common Stocks (Page 11): It is recommended that the Company implement procedures to ensure that the book value and fair value for securities reported in its Schedule D – Part 2 are correct.

Comment on Financial Statement Items – Claims Service Expenses (Page 11): It is recommended that the Company establish a method to allocate accrued liabilities between claims service expenses and other expenses that is reasonable and reflects its historical claims experience.

#### Previous Report of Examination

Management and Control – Management Arrangements (Page 4): It was 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 1215.5(b) and disclose these agreements in its Form B filings pursuant to CIC Section 1215.4. The Company has complied with this recommendation.

Corporate Records (Page 5): It was 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. The Company has complied with this recommendation.

Corporate Records (Page 5): It was recommended that the Company comply with CIC Section 1200 and authorize and approve investments in a timely manner. The Company has complied with this recommendation.

Accounts and Records (Page 6): It was 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 was also recommended that the Company comply with the Annual Statement instructions and disclose the required investment activity. The Company has complied with these recommendations.

Comments on Financial Statement Items – Bonds, Common Stocks, Cash and Short-Term Investments, and Other Invested Assets (Page 12): It was recommended that the Company amend its custodial agreements to meet the standards and submit them to the CDI for review and approval. The Company has complied with the recommendation.

It was also recommended that the Company review transactions pending at year-end to ensure proper recording of sales and purchases on the trade date as prescribed by SSAP No. 26, paragraph 4. The Company has not complied with this recommendation.

Comments on Financial Statement Items – Claims Service Expense (Page 12): It was recommended that the Company record claims service expenses on the appropriate Annual Statement line. The Company has complied with the recommendation.

ACKNOWLEDGEMENT

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

Respectfully submitted,

\_\_\_\_\_/S/\_\_\_\_\_  
Mei Gu, CFE  
Examiner-In-Charge  
Associate Insurance Examiner  
Department of Insurance  
State of California