REPORT OF EXAMINATION

OF THE

SERVICE LINE WARRANTIES OF AMERICA, INC.

AS OF

DECEMBER 31, 2020

*Insurance Commissioner*

FILED on May 13, 2022

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Los Angeles, California
March 25, 2022

Honorable Ricardo Lara
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

SERVICE LINE WARRANTIES OF AMERICA, INC.

(hereinafter also referred to as the Company). The Company's statutory home office address is located at 818 West 7th Street, Los Angeles, California 90017 and its administrative office located at 4000 Town Center Boulevard, Suite 400, Canonsburg, Pennsylvania, 15317.

## SCOPE OF EXAMINATION

We have performed our single-state examination of the Company. The previous qualifying examination of the Company was as of April 18, 2013. This examination covered the period from April 19, 2013 through December 31, 2020.

This examination report includes findings of fact and general information about the Company and its financial condition. There might be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), were not included within the examination report, but separately communicated to other regulators and/or the Company.

## COMPANY HISTORY

The Company was incorporated in the state of California on June 8, 2012 and commenced business to operate as a home warranty business on July 10, 2013 and was a wholly-owned subsidiary of Utility Service Partners, Inc., a Delaware Company, and ultimately owned by Macquarie Water Heater Rental Holdings 2 LLC. (Macquarie), a Delaware limited liability company.

On March 30, 2016, the Company and HomeServe USA Corp (HomeServe), a Pennsylvania corporation, entered into a Membership Interest Purchase Agreement (Agreement). Pursuant to the Agreement, HomeServe committed to purchase all of the issued and outstanding membership interest of Macquarie and its subsidiaries, including the Company, for the aggregate purchase price of $75 million. On April 20, 2016, HomeServe submitted an application to acquire the Company pursuant to the Agreement. The California Department of Insurance (CDI) approved the transaction on June 20, 2016.

### Capitalization

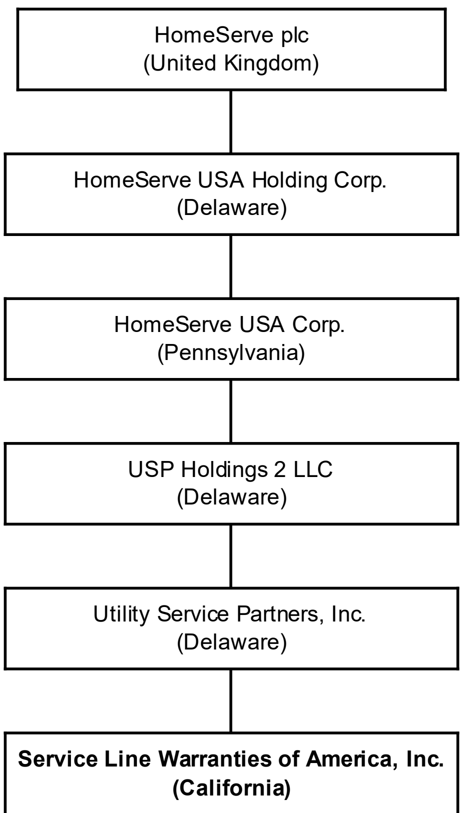
The Company is authorized to issue 25,000 shares of common stock with a par value of $50 per share. As of December 31, 2020, there were 8,500 shares outstanding.

In June 2016, the Company issued a Certification of Contribution to its affiliate Utility Service Partners Private Label, Inc. in the amount of $675,000. The CDI approved the transaction on June 16, 2016.

In December 2020, the Company received a cash capital contribution in the amount of $2,000,000.

## MANAGEMENT AND CONTROL

The Company is a member of a holding company system of which HomeServe plc is the ultimate controlling entity. The following abridged organizational chart depicts the Company relationship within the holding company system as of December 31, 2020. All ownership is 100%.




Management and control of the Company is vested in a three-member board of directors. As of December 31, 2020, the directors were as follows:

### Directors

| Name and Location | Principal Business Affiliation |
|---|---|
| Richard Gannon<br>Fairfield, Connecticut | Treasurer and Chief Financial Officer<br>HomeServe USA Holding, Corp. |
| John Kitzie<br>Englewood, New Jersey | Executive Director<br>HomeServe USA Holding, Corp. |

| Name and Location | Principal Business Affiliation |
|---|---|
| Thomas J. Rusin<br>Wilton, Connecticut | President and Chief Executive Officer<br>HomeServe USA Holding, Corp. |

Principal Officers

| Name | Title |
|---|---|
| Debra Dulsky | President |
| Thomas J. Rusin | Chief Executive Officer |
| Richard Gannon | Chief Financial Officer |
| Hilary Glassman | Secretary |
| Lynn Gefen | Assistant Secretary |

Management Agreement

Intercompany Administrative Service Agreement: Effective March 29, 2019, the Company became a party to Intercompany Administrative Service Agreement with HomeServe USA Corp. (Homeserve), a Pennsylvania corporation. Under the terms of the agreement, Homeserve should assign certain designated personnel to be jointly employed by the Company for purposes of providing call center services to Homeserve. In exchange, the Company receives the following services from Homeserve: legal, tax, accounting, and financial statements/periodic reports, human resources, information and technology, and insurance management. The cost of the service is allocated based on actual cost without a profit factor according to Statements of Statutory Accounting Principle (SSAP) No. 25. The indirect and shared expenses are allocated in accordance with the method of cost allocation in conformity with SSAP No. 70. The California Department of Insurance (CDI) approved this agreement on June 3, 2019, under California Insurance Code (CIC) Section 1215.5(b)(4).

During the review of the expenses related to the agreement, it was observed that the expenses were not allocated based on the services between the two parties. According to the Company, call center services provided to Homeserve were expensed as other underwriting expenses. There was no indication that the expenses incurred were allocated as stated under the terms of this agreement. It is recommended that the

Company evaluate its procedures to ensure that expense allocations are in conformity with the terms of the executed and approved agreement.

Tax Sharing Agreement: Effective August 1, 2013, the Company entered into a Tax Sharing Agreement with its immediate parent, Utility Service Partners, Inc., where it files its federal income tax on a consolidated basis along with other affiliated companies. Allocation of taxes is based upon a separate return basis with inter-company tax balances typically settled within thirty days after filing the consolidated return. The Company incurred zero federal income taxes for all years under the examination. The agreement was approved by the CDI during the licensing process.

## TERRITORY AND PLAN OF OPERATION

The Company provides service line warranties for residential consumers in the state of California. The Company specialized in service contracts on repairing or replacing the consumer-owned portion of either the external water service line or external sewer service line. The Company has not issued any service contracts since 2018; however, expects to resume issuing service contracts with new municipal partners going forward.

## ACCOUNTS AND RECORDS

This examination experienced some delays in obtaining supporting documentation for various information reported in the Company's Annual Statement. This includes routine examination requests such as bank statements, account reconciliations, detailed supporting records, schedules, and reports. It is recommended that the Company maintain adequate documentation to support all information reported in its financial statements. The documentation should be prepared in sufficient detail to allow for a full and complete audit trail from the Company's financial statements to individual records. The Company is also reminded that all of its books and records must be made available for examination pursuant to California Insurance Code Section 734.

Unclaimed Property

California Code of Civil Procedure (CCP) Part 3, Title 10, Chapter 7, Article 3, Sections 1530 and 1532 (Unclaimed Property Law) requires that all tangible personal property located in the State of California that is held or owing in the ordinary course of business and has remained unclaimed by the owner for more than three years after it became payable or distributable, is escheated to the California State Controller's Office (SCO).

During the review of the unclaimed property filings, it could not be determined if the Company was included as part of filings made by the parent, HomeServe USA Corp since 2019, and there were no filings records provided prior to 2019. However, the unclaimed property filings provided were either incomplete or lack of detail to test the accuracy or validate the parties included in the filing. It is recommended that the Company establish an internal policy on escheating the unclaimed property to the SCO and implementing procedures to ensure future compliance with CCP Sections 1530 and 1532.

## FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Company with the California Department of Insurance and present the financial condition of the Company for the period ending December 31, 2020. The accompanying comments on financial statements reflect any examination adjustments to the amounts reported in the annual statements and should be considered an integral part of the financial statements.

Statement of Financial Condition as of December 31, 2020
Underwriting and Investment Exhibit for the Year Ended December 31, 2020
Reconciliation of Surplus as Regards Contract Holders from April 18, 2013 through December 31, 2020
Analysis of Changes to Surplus as of December 31, 2020

Statement of Financial Condition
as of December 31, 2020

| Assets | Current Year | Prior Year | Notes |
| --- | --- | --- | --- |
| Cash, cash equivalents, and short-term investments | $ 1,403,614 | $ 505,171 | (1) |
| Home protection contract fees receivable | 0 | 85 | |
| Receivable from Parent, Subsidiaries and Affiliates | 179,810 | 223,765 | |
| Total assets | $ 1,583,424 | $ 728,921 | |
| Liabilities, Surplus and Other Funds | | | |
| Other expenses | $ 8,860 | $ 9,575 | |
| Total liabilities | 8,860 | 9,575 | |
| Common capital stock | $ 425,000 | $ 425,000 | |
| Gross paid-in and contributed surplus | 2,677,500 | 677,500 | |
| Unassigned funds (surplus) | (1,527,936) | (383,154) | |
| Surplus as regards contract holders | 1,574,564 | 719,346 | |
| Total liabilities, surplus and other funds | $ 1,583,424 | $ 728,921 | |

## Underwriting and Investment Exhibit
## for the Year Ended December 31, 2020

### Statement of Income

| Underwriting Income | | | Notes |
|---|---|---|---|
| Home protection contract fees earned | | $ 0 | |
| Deductions: | | | |
| Other underwriting expenses incurred | $ 913,335 | | (2) |
| Total deductions | | 913,335 | |
| Net underwriting loss | | (913,335) | |
| Investment Income | | | |
| Net investment income earned | $ 34 | | |
| Net investment gain | | 34 | |
| Net loss before federal income taxes | | (913,301) | |
| Net loss | | $ (913,301) | |

### Capital and Surplus Account

| | | |
|---|---|---|
| Surplus as regards contract holders, December 31, 2019 | | $ 719,346 |
| Net loss | $ (913,301) | |
| Paid in | 2,000,000 | |
| Examination adjustment | (231,481) | |
| Change in surplus as regards contract holders for the year | | 855,218 |
| Surplus as regards contract holders, December 31, 2020, per examination | | $ 1,574,564 |

Reconciliation of Surplus as Regards Contract Holders
from April 18, 2013 through December 31, 2020

| | Gain in Surplus | Loss in Surplus | |
|---|---|---|---|
| Surplus as regards contract holders, April 18, 2013 | | | $ 512,123 |
| Net loss | $ | $ (1,381,078) | |
| Paid in | 2,675,000 | | |
| Aggregate write-ins for losses in surplus | | (231,481) | |
| Total gains and losses | $ 2,675,000 | $ (1,612,559) | |
| Net increase in surplus as regards contract holders | | | 1,062,441 |
| Surplus as regards contract holders, December 31, 2020, per Examination | | | $ 1,574,564 |

## Analysis of Changes to Surplus as of December 31, 2020

As a result of the examination, the following adjustment was made to the Company's reported balance sheet item. The Company failed to provide bank statement and other supporting document on two of the bank accounts, for the total of $231,481. The sum of the effect on surplus is shown below:

| | | | |
|---|---|---|---|
| Surplus as regards contract holders, December 31, 2020, per Annual Statement | | | $ 1,806,045 |
| | Increase | Decrease | |
| Cash | | $ 231,481 | |
| Net decrease | | | 231,481 |
| Surplus as regards contract holders, December 31, 2020 after adjustment | | | $ 1,574,564 |

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Cash, Cash Equivalents, and Short-Term Investments

Due to the management change, the Company was delayed in updating the signatory on the bank accounts held under Wells Fargo Bank and provide bank statements to support the reported balance totaling $231,481, or 12% of the assets on the 2020 annual statement. An examination adjustment was made to the asset balance; Surplus as regards contract holders decreased by the same amount to reflect the adjustment made.

### (2) Other Underwriting Expenses Incurred

As aforementioned under "Management and Control" section, the Company recorded the expenses incurred related to the Intercompany Administrative Services Agreement with its parent, HomeServe USA Corp. (HomeServe), as other underwriting expenses. The expenses incurred as the result of the call center services provided to the clients of HomeServe are not directly or indirectly related to underwriting home protection contracts as the Company has suspended its writing since 2018. It is recommended that the

Company reclassify the expenses incurred not directly or indirectly related to underwriting home protection contracts to the proper category.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Management Agreement (Page 5): It is recommended that the Company evaluate its procedures to ensure that expense allocations are in conformity with the terms of the executed and approved agreement.

Accounts and Records (Page 6): It is recommended that the Company maintain adequate documentation to support all information reported in its financial statements. The documentation should be prepared in sufficient detail to allow for a full and complete audit trail from the Company’s financial statements to individual records. The Company is also reminded that all of its books and records must be made available for examination pursuant to California Insurance Code Section 734.

Accounts and Records - Unclaimed Property (Page 7): It is recommended that the Company establish an internal policy on escheating the unclaimed property to the State Controller’s Office and implementing procedures to ensure future compliance with California Code of Civil Procedure Sections 1530 and 1532.

Comments on Financial Statement Items – Other Underwriting Expenses Incurred (Page 11): It is recommended that the Company reclassify the expenses incurred not directly or indirectly related to underwriting home protection contracts to the proper category.

### Previous Report of Examination

None.

## ACKNOWLEDGMENT

The courtesy and cooperation extended by the Company's officers and parent's employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

Fan, Vivien Digitally signed by Fan, Vivien Date: 2022.05.11 10:19:41 -07'00'

Vivien Fan, CFE
Examiner-In-Charge
Bureau Chief
Department of Insurance
State of California

Clements, Laura Digitally signed by Clements, Laura Date: 2022.05.11 10:25:06 -07'00'

Laura Clements, CFE
Division Chief
Department of Insurance
State of California