

REPORT OF EXAMINATION  
OF  
AMERICAN HOME SHIELD OF CALIFORNIA, INC.  
AS OF  
DECEMBER 31, 2015

Filed on March 6, 2017

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San Francisco, California  
November 25, 2016

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 home office located at 889 Ridge Lake Boulevard, Memphis, Tennessee 38120.

#### SCOPE OF EXAMINATION

We have performed our single-state examination of the Company. The previous examination of the Company was as of December 31, 2010. This examination covered the period from January 1, 2011 through December 31, 2015.

The examination was conducted in accordance with the National Association of Insurance Commissioners *Financial Condition Examiners Handbook* (Handbook). The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, assess corporate governance, identify current and prospective risks, and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause a Company's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made

by management and evaluating management’s compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination, an adjustment is identified, the impact of such adjustment will be documented separately following the Company’s financial statements.

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 the Company.

### COMPANY HISTORY

The Company was formed under the laws of the state of California on September 13, 1973. It was licensed to operate as a home protection writer on December 30, 1980 and is part of the ServiceMaster Global Holdings, Inc. group.

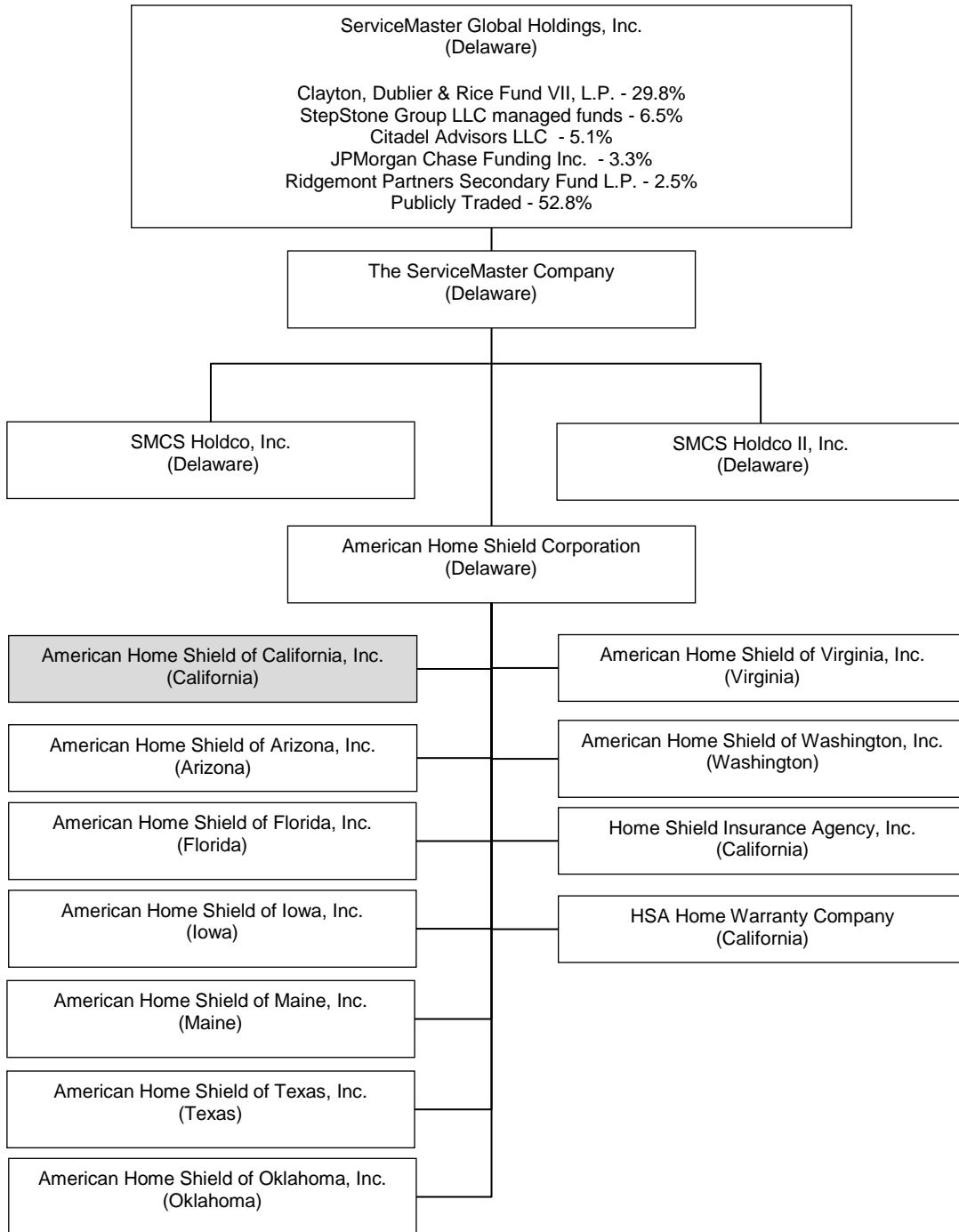
During and subsequent to the examination period, the Company paid ordinary and extraordinary cash dividends to its immediate parent, American Home Shield Corporation (AHSC), as follows:

Year	Amount	Type of Dividend
2011	\$25,000,000	Extraordinary
2012	\$17,000,000	Ordinary
2013	\$13,500,000	Ordinary
2014	\$15,000,000	Extraordinary
2016	\$6,500,000	Ordinary
Total	\$77,000,000	

The extraordinary dividends in 2011 and 2014 were approved by the California Department of Insurance pursuant to California Insurance Code Section 1215.5(g) on December 11, 2011 and July 30, 2014, respectively.

## MANAGEMENT AND CONTROL

The Company is a member of a holding company system of which ServiceMaster Global Holdings, Inc. (SVMGHI) is the ultimate parent. SVMGHI is a publicly traded holding company encompassing several household brands, such as ServiceMaster Clean, ServiceMaster Restore, Terminix, American Home Shield, Merry Maids, and others. The following abridged organizational chart depicts the interrelationship of the Company and its affiliates within the holding company system as of December 31, 2015 (all ownership is 100% unless otherwise indicated).



Management and control of the Company is vested in a three-member board of directors elected annually. As of December 31, 2015, the directors and principal officers were as follows:

Board of Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Timothy M. Haynes Memphis, Tennessee	President American Home Shield Corporation
Thomas E. Courtney Memphis, Tennessee	Secretary The ServiceMaster Company, LLC
Marisol Natera Memphis, Tennessee	Treasurer American Home Shield Corporation

Principal Officers

<u>Name</u>	<u>Title</u>
Timothy M. Haynes	President
Thomas E. Courtney	Secretary
Marisol Natera	Treasurer

Management Agreements

Intercompany Affiliated Management Agreement (American Home Shield Corporation): Effective October 1, 2012, the Company and its immediate parent, American Home Shield Corporation (AHSC), rescinded and restated the Intercompany Affiliated Management Agreement that was dated November 4, 2009 and which had an effective date of November 12, 2009. Under the terms of the restated agreement, AHSC agrees to make available its resources and services to the Company for conducting its operations, including but not limited to: claims adjustment and paying; contractors; underwriting and finance; real estate brokers/agents and agency development; administrative services; and advertising, sales promotion and marketing. Compensation

for providing these services is based on actual cost without a profit factor being built into that cost. The restated agreement was approved by the California Department of Insurance (CDI) on September 13, 2012 pursuant to California Insurance Code (CIC) Section 1215.5(b)(4).

Intercompany Affiliated Management Agreement (The ServiceMaster Company): Effective October 1, 2012 the Company and The ServiceMaster Company (SVM) rescinded and restated the Intercompany Affiliated Management Agreement dated November 4, 2009 and which had an effective date of November 12, 2009. Under the terms of the restated agreement, SVM agrees to make available its resources and services to the Company for conducting its operations, including but not limited to: investment; accounting, tax and auditing; insurance; and functional support services. Compensation for providing services is based on actual cost without a profit factor being built into that cost. This restated agreement was approved by the CDI on September 13, 2012 pursuant to CIC Section 1215.5(b)(4).

Tax Sharing Agreement: Effective December 31, 2012, a restated tax sharing agreement was entered into between the Company and AHSC and each wholly owned subsidiary of AHSC. This agreement replaces the previous tax sharing agreement between the parties that was effective December 31, 2004. The purpose of the restatement was to clarify the tax allocation procedure under the tax sharing agreement between AHSC and its subsidiaries and to appoint ServiceMaster Global Holdings, Inc. (SVMGHI) to replace SVM under AHSC's tax sharing agreement with SVMGHI because the consolidated tax return for the affiliated group is now being filed by SVMGHI. Under the terms of this agreement, a consolidated federal income tax return will be filed by SVMGHI on behalf AHSC and its subsidiaries. The federal tax amount for each subsidiary is determined based on each subsidiary's separate taxable income. AHSC will compensate each subsidiary for any net tax benefit recorded by the respective subsidiary. The net effect of all tax-sharing will be revenue neutral to the Company, SVMGHI, ASHC and its subsidiaries. The amount of tax charged to each subsidiary shall not exceed the amount that each subsidiary would pay if the federal and state tax



returns were filed separately. This agreement was approved by the CDI pursuant to CIC Section 1215.5(b)(4) on September 12, 2012.

### TERRITORY AND PLAN OF OPERATION

The Company is authorized to provide home warranties for household systems and appliances in California. The Company provides residential customers with home warranty contracts that cover the repair or replacement of electrical, plumbing, central heating, and air conditioning systems, water heaters and other household systems and appliances. During 2015, the Company issued 208,869 home warranty contracts and wrote \$106.5 million in total net contract fees.

Approximately 64 percent of the Company's business comes from its direct-to-consumer distribution channel (via its website). The remainder is generated by the traditional real estate transaction channel through its account executives.

American Home Shield Corporation (AHSC) has three call centers located in Memphis, Tennessee; Carroll, Iowa; and LaGrange, Georgia which provide inbound call service to the Company's contract holders. The Company services its contracts through a network of independent repair contractors who are overseen by AHSC.

### REINSURANCE

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

### ACCOUNTS AND RECORDS

#### Information Technology Controls

California Insurance Code (CIC) Section 734 provides that every company or person from whom information is sought, and its officers, directors, employees, and agents, shall provide to the examiners appointed pursuant to this article, timely, convenient, and

free access at all reasonable hours at its offices to all books, records, accounts, papers, documents, and any or all computer or other recordings relating to the property, assets, business, and affairs of the company being examined. During the information technology (IT) controls review portion of this examination, the examiners encountered significant delays in obtaining the information and documents that were requested to complete the IT controls review timely. As such, the Company was not in compliance with CIC Section 734. It is recommended that the Company inform its officers, directors, employees, and agents about the requirements of CIC Section 734 to ensure compliance in future examinations.

#### Fair Claims Settlement Practices Regulations

The Company was not in full compliance with California Code of Regulation (CCR), Title 10, Chapter 5, Sub-chapter 7.5, Article 1, Section 2695.6(b), which requires that a licensee's adjusters undergo annual Fair Claims Practices Regulations training. While the Company has provided training annually to its adjusters, the Company was unable to provide the annual certifications pursuant to Section 2695.6(b), paragraph (3) for the years 2011 through 2015 as required by Section 2695.6(b), paragraph (4). In addition, it was observed that some adjusters did not complete the annual training by September 1<sup>st</sup> as required by Section 2695.6(b), paragraph (5). It is recommended that the Company implement procedures to ensure full compliance with CCR Title 10, Chapter 5, Sub-chapter 7.5, Article 1, Section 2695.6(b).

## FINANCIAL STATEMENTS

The following financial statements are based on the annual 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, 2015. The accompanying comments to the amounts reported in the financial statements should be considered an integral part of the financial statements. No examination adjustments were made to the financial statements as a result of the examination.

Statement of Assets, Liabilities, Surplus and Other Funds as of  
December 31, 2015

Statement of Income for the Year Ended December 31, 2015

Reconciliation of Surplus as Regards Contract Holders from January 1, 2011  
through December 31, 2015

Statement of Assets, Liabilities, Surplus and Other Funds  
as of December 31, 2015

<u>Assets</u>		<u>Notes</u>
Bonds	\$ 6,537,455	(1)
Common stocks	8,194,352	(1)
Cash and cash equivalent on hand and on deposit	37,674,314	
Home protection contract fees receivable	34,056,520	
Interest, dividends and real estate income due and accrued	95,437	
Other receivables and recoverables	<u>2,306,041</u>	
 Total assets	 <u>\$88,864,119</u>	
 <u>Liabilities, Surplus and Other Funds</u>		
Claims adjusted and unpaid or in process of adjustment	\$ 7,396,275	
Claims service expenses	1,660,287	
Other expenses	565,789	
Taxes, licenses and fees	264,953	
Unearned home protection contract fees	43,373,213	
Payable to parent, subsidiaries and affiliates	6,379,015	
Deferred tax	820,214	
Advanced premiums	<u>520,005</u>	
 Total liabilities	 60,979,751	
Common capital stock	\$ 1	
Gross paid-in and contributed surplus	6,442,858	
Unassigned funds (surplus)	<u>21,441,508</u>	
 Surplus as regards contract holders	 <u>27,884,368</u>	
 Total liabilities and surplus	 <u>\$88,864,119</u>	

Statement of Income  
for the Year Ended December 31, 2015

Underwriting Income

Home protection contract fees earned \$101,733,289

Deductions

Claims incurred	\$ 50,819,578	
Claims service expenses incurred	8,530,303	
Other expenses incurred	<u>34,388,316</u>	
Total deductions		<u>93,738,196</u>

Net underwriting gain 7,995,093

Investment Income

Net investment income earned	\$ 899,762	
Net realized capital gain	<u>5,398,877</u>	
Net investment gain		6,298,639

Total other income 137,952

Net income before federal income taxes 14,431,683

Federal income taxes incurred 5,130,704

Net income \$ 9,300,979

Capital and Surplus Account

Surplus as regards contract holders,  
December 31, 2014 \$ 21,944,474

Net income	\$ 9,300,979	
Change in non-admitted assets	301,580	
Change in unrealized gains	<u>(3,662,665)</u>	

Change in surplus as regards contract holders for the year 5,939,894

Surplus as regards contract holders,  
December 31, 2010 \$ 27,884,368

Reconciliation of Surplus as Regards Contract Holders  
from December 31, 2010 through December 31, 2015

Surplus as regards contract holders, December 31, 2010 per examination			\$ 35,552,087
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$60,994,006	\$	
Change in net unrealized capital gains or (losses)	751,879		
Change in nonadmitted assets	1,086,396		
Dividends to stockholders	<u>                    </u>	<u>70,500,000</u>	
 Total gains and losses	 <u>\$62,832,281</u>	 <u>\$ 70,500,000</u>	
 Net decrease in surplus as regards contract holders			 <u>(7,667,719)</u>
 Surplus as regards contract holders, December 31, 2015, per examination			 <u>\$ 27,884,368</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Bonds and Common Stocks

At December 31, 2015, the Company reported \$6,537,455 in bonds and \$8,194,352 in common stocks. As of April 7, 2016, the Company liquidated and divested all its holdings in bonds and stocks.

## SUBSEQUENT EVENTS

On June 27, 2016, American Home Shield Corporation (AHSC), the Company's immediate parent, acquired OneGuard Home Warranties ("OneGuard") for a total purchase price of \$65 million. During the second quarter of 2016, AHSC recorded goodwill of \$42 million and other intangibles (primarily customer relationships) of \$23 million related to the acquisition of OneGuard. OneGuard sells warranties in Arizona, Texas and Nevada. The purchase price allocation for this acquisition was finalized during the third quarter of 2016. As a result, AHSC recorded revised goodwill of \$57 million and other intangibles (primarily customer relationships) of \$15 million. The acquisition of OneGuard Home Warranties by AHSC did not have a direct impact on the Company.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Accounts and Records (Page 7): It is recommended that the Company inform its officers, directors, employees, and agents about the requirements of California Insurance Code Section 734 to ensure compliance in future examinations.

Fair Claims Settlement Practices Regulations (Page 8): It is recommended that the Company implement procedures to ensure full compliance with California Code of Regulations, Title 10, Chapter 5, Sub-chapter 7.5, Article I, Section 2695.6(b).

#### Previous Report of Examination

Management and Control – Management Arrangements (Page 4): It was 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). The Company has complied with this recommendation.

Management and Control – Restated Tax Sharing Agreement (Page 5): It was 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). The Company has complied with this recommendation.

Accounts and Records – Information Systems Controls (Page 6): The Company should evaluate the recommendations and make appropriate changes to strengthen its information systems controls. The Company has addressed some of the recommendations made in the prior examination. However, due to the significant delays encountered in obtaining the information and documents that were requested to complete the information technology review on this examination as discussed on Page 7 of this report, the examiners were unable to verify compliance with the remaining recommendations.



Comment on Financial Statement Items – Bonds (Page 11): It was 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. The Company has complied with this recommendation.

Comment on Financial Statement Items – Common Stocks (Page 11): It was 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. The Company has complied with this recommendation.

Comment on Financial Statement Items – Claims Service Expenses (Page 11): It was 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. The Company has complied with this recommendation.

ACKNOWLEDGMENT

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

Respectfully submitted,

/S/

Ber Vang, CFE, AES, CISA  
Senior Insurance Examiner, Supervisor  
Department of Insurance  
State of California

/S/

Anne Tong, CFE, AIC  
Supervising Insurance Examiner  
Department of Insurance  
State of California