

REPORT OF EXAMINATION
OF THE
FIRST AMERICAN HOME WARRANTY CORPORATION
AS OF
DECEMBER 31, 2020

Insurance Commissioner

A handwritten signature in blue ink, appearing to read "P. DeLo" or similar, written over a faint horizontal line.

FILED on February 15, 2022

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Los Angeles, California
January 31, 2022

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

FIRST AMERICAN HOME WARRANTY CORPORATION

(hereinafter also referred to as the Company) the home office is located at 8521 Fallbrook Avenue, Suite 340, West Hills, California 91304.

SCOPE OF EXAMINATION

We have performed an examination of the Company. The previous examination of the Company was as of December 31, 2015. This current examination covered the period from January 1, 2016 through December 31, 2020.

The examination included a review of the Company's practices and procedures, an examination of management records, test and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2020, as deemed necessary under the circumstances.

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 February 8, 1984 and began transacting home warranty business on March 31, 1984. The Company is a wholly-owned subsidiary of First American Financial Corporation (FAFC), a publicly traded company.

Effective November 1, 2016, the Company submitted a request to the California Department of Insurance (CDI) to change its name from First American Home Buyers Protection Corporation to First American Home Warranty Corporation. The name change was approved by the CDI effective November 16, 2016.

Dividends Paid to Parent

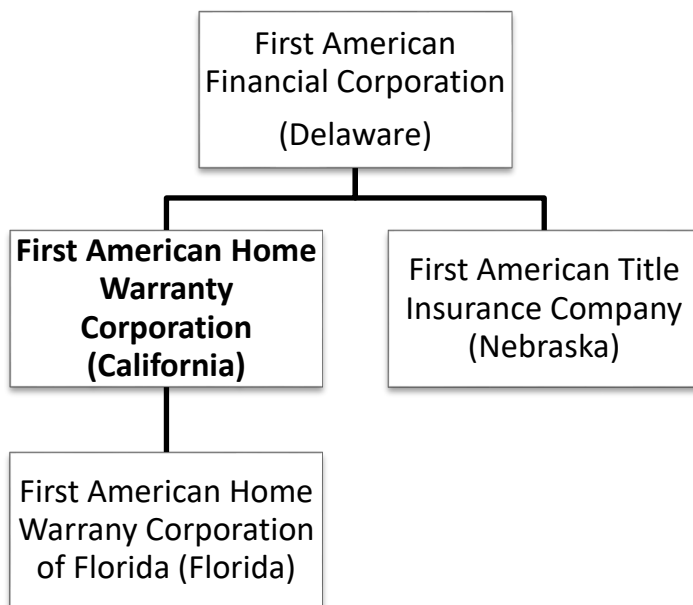
The Company paid the following ordinary cash dividends to FAFC during the examination period:

<u>Year</u>	<u>Amount</u>
2016	\$ 16,000,000
2017	15,300,000
2018	31,100,000
2019	32,298,700
2020	<u>30,000,000</u>
Total	<u>\$124,698,700</u>

On December 1, 2021, subsequent to the examination date, the Company declared and paid an ordinary cash dividend in the amount of \$15,930,000 to FAFC.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system of which First American Financial Corporation is the ultimate controlling entity. Following is an abridged organizational chart. All ownership is 100%.



The six-member board of directors, who are elected annually, manage the business and affairs of the Company. Following are members of the board and principal officers of the Company serving as of December 31, 2020:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Gerald Bumbaugh Moorpark, California	Chief Financial Officer and Vice President First American Home Warranty Corporation
Larry Davidson Dana Point, California	Chief Executive Officer First American Home Warranty Corporation
Dennis Gilmore ^(a) Corona Del Mar, California	Chief Executive Officer First American Financial Corporation
Jeffrey Powell ^(b) Incline Village, Nevada	President First American Home Warranty Corporation

Name and Location

Principal Business Affiliation

Mark Seaton
Newport Beach, California

Executive Vice President and Chief
Financial Officer
First American Financial Corporation

Greg Smith
Laguna Niguel, California

Corporate Deputy General Counsel
First American Financial Corporation

Principal Officers

Name

Title

Larry Davidson
Jeffrey Powell ^(b)
Matthew Wendl

Chief Executive Officer
President
Chief Operating Officer and Vice President
Field Operations

Gerald Bumbaugh
Eric Gleason
James Rogers
Tracy Berger
Carla Roupe
Barry Miles
Andrew Hand
Zachary Zaharek

Chief Financial Officer and Vice President
Chief Information Officer and Vice President
Chief Investment Officer
Senior Vice President Sales
Vice President, Controller, and Treasurer
Vice President Service Operation
Vice President Marketing and Strategy
Secretary

The following changes in management occurred subsequent to the examination period:

(a) Replaced by Lisa Cornehl, effective January 4, 2022

(b) Replaced by Matthew Wendl as Director and President, effective January 4, 2022

Management Agreements

Affiliated Companies Service Agreement: The Company and its affiliates are parties to an Affiliated Companies Service Agreement with First American Title Insurance Company (FATICO), effective December 31, 2010. The agreement was approved by the California Department of insurance (CDI) on December 17, 2012. The agreement was amended effective November 1, 2014, to reflect the change in the state of domicile of the FATICO from California to Nebraska and to update the parties to the agreement. Effective

March 6, 2015, the agreement was amended to, among other things, add its affiliates, First American Property & Casualty Insurance Company and First American Specialty Insurance Company. The latest amendment was approved by the CDI on October 29, 2015. Under the terms of the agreement, FATICO provides services to its affiliates that include, but are not limited to, accounting and auditing, information technology, and other functional support services as further defined in the agreement. Services and use of facilities provided by FATICO to the affiliates is based on actual cost without a profit factor being built into that cost. The cost or expense for services by FATICO allocated to the affiliates shall be paid by the affiliates to FATICO within thirty days after the end of each calendar year. Expenses are allocated in accordance with a method in conformity with Statement of Statutory Accounting Principles (SSAP) No. 7 of the National Association of Insurance Commissioners Accounting Practices and Procedures Manual. Payment to FATICO for 2016, 2017, 2018, 2019, and 2020, were \$1,897,428, \$1,845,156, \$3,348,000, \$3,348,000, and \$3,348,000, respectively.

During the review of the allocation of the expenses from FATICO to the Company, it was observed that the Company paid the same expense amount for the years 2018, 2019, and 2020. According to the Company, during this period, expenses remained static, rather than the actual allocation based on the actual cost as stated in the agreement. It is recommended that the Company evaluate its procedures to ensure that expense allocations are in conformity with the terms of the executed agreement.

Federal Tax Sharing Agreement: Effective September 1, 2012, the Company is party to a Federal Tax Sharing Agreement with its parent, First American Financial Corporation (FAFC), and specified other affiliates within the holding company system. The agreement was approved by the CDI on August 23, 2012. The agreement provides for participants to file a consolidated federal income tax return with FAFC. Allocation of taxes is based upon separate return calculations with tax balances payable or receivable being settled in amounts equal to the amounts which would be due to or from federal tax authorities if separate returns were filed. During the examination period, the Company paid federal

taxes of \$8,157,454, \$14,349,000, \$9,519,578, \$14,715,048, and \$13,123,678 in 2016, 2017, 2018, 2019, and 2020, respectively.

Investment Management Agreement

Investment Management Agreement: A portion of the investment portfolio of the Company is managed by Wellington Management Company LLP, Guggenheim Partners Investment Management LLC (GPIM), and Wells Capital Management, all of which are unaffiliated companies. Under the terms of the agreements, the companies manage a trading account and perform management and other duties in accordance with the investment guidelines. They are paid a quarterly fee based on the market value of assets in the account.

TERRITORY AND PLAN OF OPERATION

The Company provides home protection service contracts that cover residential systems, such as heating and air conditioning, and certain appliances against failures that occur as the result of normal usage during the coverage period. Coverage is typically for one year and is renewable annually at the option of the contract holder and upon Company's approval.

The Company currently operates in all states and the District of Columbia, except Florida, where its subsidiary, First American Home Warranty Corporation of Florida, writes home protection business.

In 2020, the Company wrote \$376.3 million of direct premiums. Of this amount, \$152.7 million (40.6%) was written in California; \$53.5 million (14.2%) was written in Texas; \$18.1 million (4.8%) was written in Arizona; and \$152.0 million (40.4%) was written in the remaining states, and the District of Columbia. Home protection contract renewals represent approximately 58% of the Company's premium revenue.

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 to the amounts reported in the annual statements should be considered an integral part of the financial statements. There were no adjustments made as a result of the examination.

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 December 31, 2015
through December 31, 2020

Statement of Financial Condition
as of December 31, 2020

<u>Assets</u>	<u>Current Year</u>	<u>Notes</u>
Bonds	\$ 184,552,598	
Preferred stocks	750,000	
Common stocks	21,531,499	
Cash and short-term investments	34,039,509	
Home protection contract fees receivable	94,930,970	
Receivable from parent, subsidiary and affiliates		
Federal income tax recoverable	579,231	
Electronic data processing equipment and software	1,479,491	
Interest, dividends and real estate income due and accrued	<u>1,047,146</u>	
 Total assets	 <u>\$ 338,910,444</u>	
 <u>Liabilities, Surplus and Other Funds</u>		
Claims adjusted & unpaid or in process of adjustment	\$ 18,735,335	(1)
Claims service expense	175,000	
Other expenses	14,377,897	
Taxes, licenses and fees	1,018,516	
Unearned home protection contracts	157,135,193	
Deposits held escheat	1,949,611	
Intercompany	532,870	
Rebates	(76,594)	
Dividends declared and unpaid to stockholders	<u>30,000,000</u>	
 Total liabilities	 223,847,828	
Common capital stock	\$ 1,947,700	
Gross paid-in and contributed surplus	1,480,500	
Unassigned funds (surplus)	<u>111,634,416</u>	
Surplus as regards contract holders	<u>115,062,616</u>	
 Total liabilities, surplus and other funds	 <u>\$ 338,910,444</u>	

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

Statement of Income

Underwriting Income

Home protection contract fess		\$ 363,933,890
Deductions:		
Claims incurred	\$189,067,307	
Claims services expenses incurred	33,360,197	
Other underwriting expenses incurred	<u>94,460,898</u>	
Total underwriting deductions		<u>316,888,402</u>
Net underwriting gain		47,045,488
<u>Investment Income</u>		
Net investment income earned	\$ 3,800,319	
Net realized capital gains	<u>7,934,850</u>	
Net investment gain		11,735,169
Net income before federal income taxes		58,780,657
Federal income taxes incurred		<u>12,850,221</u>
Net income		<u>\$ 45,930,436</u>

Capital and Surplus Account

Surplus as regards contract holders, December 31, 2019		\$ 102,280,937
Net income	\$ 45,930,436	
Change in nonadmitted assets	(3,148,757)	
Dividends to stockholders	<u>(30,000,000)</u>	
Change in surplus as regards contract holders for the year		<u>12,781,679</u>
Surplus as regards contract holders, December 31, 2020		<u>\$ 115,062,616</u>

Reconciliation of Surplus as Regards Contract Holders
from December 31, 2015 through December 31, 2020

Surplus as regards contract holders, December 31, 2015 per Examination			\$ 68,931,815
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$173,339,398	\$	
Change in nonadmitted assets		3,012,104	
Dividends to stockholders		124,698,700	
Unrealized gain – common stock	<u>502,207</u>		
Total gains and losses	<u>\$173,841,605</u>	<u>\$127,710,804</u>	
Net increase in surplus as regards contract holders			<u>46,130,801</u>
Surplus as regards contract holders, December 31, 2020, per Examination			<u>\$115,062,616</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Claims Adjusted and Unpaid or in the Process of Adjustment

The Company does not utilize an actuary to determine reserves. Instead, the accounting department uses a model that incorporates the number of open work orders, invoices, average payment amounts, and certain assumptions, to estimate the reserve for claims adjusted and unpaid or in process of adjustment. On an annual basis, the Company performs a retrospective reserve analysis to ensure the reasonableness of the aforementioned reserving methodology. The examination team obtained and reviewed the 2020 year-end reserve analysis and deemed the reserving methodology to be adequate.

SUBSEQUENT EVENTS

On March 11, 2020, the World Health Organization declared the coronavirus disease (COVID-19) a pandemic. The pandemic has triggered unprecedented government mandates and health and safety measures, which have significantly impacted the U.S. and global financial markets. The examination reviewed the potential impact of the pandemic to the Company and noted minimal impact on the Company's business operations as of the date of this report. However, a significant uncertainty remains in the effect that the pandemic will have on the insurance industry, economy, and the Company at large. The California Department of Insurance continues to closely monitor the impact of the pandemic on the Company and will take necessary action if solvency concern arises.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Management Agreement – Affiliated Companies Service 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 agreement.

Previous Report of Examination

Management and Control – Management Agreement – Tax Allocation Agreement (Page 6): It was recommended that the Company file its amended tax allocation agreement with the California Department of Insurance for approval in accordance with the California Insurance Code Section 1215.5 (b) (4). The Company complied.

ACKNOWLEDGMENT

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

Respectfully submitted,

Beltran,
Cuauhtemoc

Digitally signed by Beltran,
Cuauhtemoc
Date: 2022.02.15 09:14:00
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Cuauhtemoc Beltran, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California

Fan, Vivien

Digitally signed by Fan, Vivien
Date: 2022.02.15 09:18:09
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Vivien Fan, CFE
Bureau Chief
Department of Insurance
State of California