

## **FITCH AFFIRMS CALIFORNIA EARTHQUAKE AUTHORITY'S RATINGS AT 'A'; OUTLOOK STABLE**

Fitch Ratings-Chicago-12 May 2015: Fitch Ratings has affirmed all ratings for The California Earthquake Authority (CEA), including the IDR at 'A', and the outstanding series 2006 and 2014 revenue bonds at 'A'. The Rating Outlook is Stable.

### **KEY RATING DRIVERS**

CEA's ratings reflect the maintenance of claims-paying resources targeted to cover at least a 1-in-450-year earthquake loss. The CEA had \$11.8 billion in sources of funds to pay claims at March 31, 2015. Included was \$4.8 billion in available capital, as well as the proceeds from the revenue bonds, reinsurance and other risk transfer, and prospective post-earthquake assessments of participating insurers.

The CEA's principal risk is a catastrophic earthquake large enough to exhaust its claims-paying resources and requiring it to access the capital markets or other sources in order to pay claims. The total claims-paying resources are estimated to cover a 1-in-561-year earthquake loss, or a probability of (resource) exhaustion of 0.18% at March 31, 2015. This compares to the pro forma claims-paying resources estimate of a 1-in-524-year earthquake loss at the time the 2014 revenue bonds were issued.

In Fitch's assessment, the CEA's capital quality is 'adequate'. Fitch reviewed the probability of exhaustion from three independent modeling firms (EQE, AIR and RMS) and from the CEA's survivability scenarios, against the insurance-linked security (ILS) calibration matrix for this assessment.

The CEA's ratings also reflect Fitch's belief that the CEA's financial flexibility is much stronger than similarly rated private insurers that insure catastrophe risk. The state of California, the insurance industry in California and policyholders in California all have an interest in the CEA's continuance as an organization in Fitch's view.

There are potential public policy or industry initiatives that would contribute to the CEA's ability to recapitalize following a large earthquake that exhausted its claims-paying resources. Also contributing to the CEA's financial flexibility are its strong capital formation rate and the ability to access capital markets to issue additional revenue bonds.

Additional strengths include the CEA's stable pledged revenue and performance on debt service covenants that result in part from its highly profitable operations and significant market share. The quality of the CEA's investment portfolio is very high, consisting solely of U.S. government and agency securities, 'AAA'-rated commercial paper, and cash and equivalents.

### **RATING SENSITIVITIES**

Key ratings triggers that could lead to a downgrade include changes in claims-paying resources that reduced covered losses to a one-in-400-year event. However, a timely demonstration of the CEA's ability to access capital markets or recapitalize by other means, following a reduction in claims-paying capacity, could mitigate downgrade pressure.

Fitch may also downgrade the ratings if the quality of its investment portfolio or the financial strength of its industry members or reinsurers declined materially.

The key rating trigger that could lead to an upgrade is an increase in claims-paying resources to a one-in-1,000-year event.

The CEA is a privately financed, publicly managed entity that offers basic residential earthquake insurance in California. The CEA was created by the California Legislature in 1996 to assure availability of earthquake coverage for homeowners following the Northridge Earthquake.

Fitch has affirmed the following ratings:

The California Earthquake Authority  
--2006 series revenue bonds due 2016 at 'A';  
--2014 series revenue bonds due 2019 'A'.  
--IDR at 'A'.

The Rating Outlook is Stable.

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Additional information is available at '[www.fitchratings.com](http://www.fitchratings.com)'.

Applicable Criteria and Related Research:

--'Insurance Rating Methodology' (Sept. 4, 2014);  
--'Insurance-Linked Securities' (Aug. 8, 2014).

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Insurance Rating Methodology

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=756650](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=756650)

Insurance-Linked Securities Methodology

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=752532](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=752532)

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