



CALIFORNIA EARTHQUAKE AUTHORITY [CEA]

ANNUAL REPORT TO THE LEGISLATURE AND THE CALIFORNIA INSURANCE COMMISSIONER ON CEA PROGRAM OPERATIONS

Report for Calendar Year 2013 [Pursuant to California Insurance Code section 10089.13, subdivision (a)]

Brief Background: California Earthquake Authority

The California Earthquake Authority (CEA) was formed through legislation in 1995 and 1996 to address primarily a homeowners-insurance-availability crisis that followed the 1994 Northridge earthquake. After that earthquake, many homeowners found it difficult, and in some cases impossible, to find basic homeowners insurance. Many others were faced with the prospect of having their homeowners insurance non-renewed as insurance companies tried to shed their exposure to earthquake risk. Because state law required (and still requires) insurers to offer earthquake insurance to their applicants for and holders of residential policies, the insurers' retreat from the California market resulted in an availability crisis for both homeowners and earthquake insurance. The California Department of Insurance ("CDI") reported in the summer of 1996, at the height of the crisis, that 95 percent of the homeowners insurance market had either stopped, or severely restricted, sales of new homeowners policies.

After the CEA began operations on December 2, 1996, the recovery of the California homeowners-insurance market was dramatic and swift. A Department of Insurance report noted that at the peak of the availability crisis, 82 insurers had restricted the sale of new homeowners policies—by contrast, by October 1997 only three insurers were restricting the sale of new policies.

The CEA is the largest earthquake insurer in California, with over 75% of the residential-earthquake-insurance market. CEA participating insurers are responsible for almost 80% of California's residential property insurance.

Current Market Conditions

California's Residential Property Insurance Market

The CDI year-end-2013 data once again indicate an increase in policy numbers in the statewide residential property insurance market: In 2013, insurers sold more than 11 million policies compared to the previous year's 10.6 million. (*See Attachment A: California Department of Insurance, Summary of 2012 Residential & Commercial Market Totals.*)

Statewide totals, for all insurers that write residential property insurance in California:

- *Residential Homeowners (Dwelling) Policies totaled 6,350,365*
- *Residential Condominium Unit Policies totaled 810,084*
- *Manufactured Home (including Mobilehome) Policies totaled 283,058*
- *Rental Policies totaled 1,774,130*
- *Dwelling Fire Policies totaled 1,798,213*

California's Residential Earthquake Insurance Market – 2013

Based on the total number of residential earthquake insurance policies written in 2013, CEA and non-CEA companies together accounted for 1.11 million earthquake policies statewide, apparently down slightly from 2012's 1.12 million.

CEA Earthquake Response in 2013

The year 2013 was a quiet earthquake year for California. The largest earthquake was a 5.7 Richter Magnitude earthquake that occurred on May 23, 2013, in Northern California in the Canyon Dam/Greenville area close to Lake Almanor, Plumas County.

The affected area is mostly rural and does not have many CEA policies in force. The Authority received nine claims from this earthquake and made one payment of \$1,500 (emergency repairs to a house). The \$1,500 emergency-repairs coverage without application of any deductible is a new product offering for the CEA's homeowner and mobilehome-owner policies. The CEA expects it to be frequently accessed after a larger earthquake in a more populated area.

The CEA in 2013 also received some 173 miscellaneous claims for earthquake damage. This is a typical annual volume in a quiet year, and these claims are typically submitted by policyholders who feel small earthquakes or notice cracks that they believe may have been caused by previous earthquakes. Every claim is thoroughly investigated by our participating insurance companies, but in each of these cases, none of the 173 claims exceeded its policy deductible.

During 2013 the CEA conducted on-going CEA specific claim handling training with participating insurers as well as with independent adjusting companies that would be available to adjust claims after a catastrophic California earthquake.

In addition, the CEA held its annual meeting and seminar for participating insurance company claim managers. Over the course of a day, the CEA executives and staff clearly laid out claim-handling expectations for the 110 participating insurer executives and claim professionals in attendance.

CEA Operational Developments in 2013

CEA Policy Growth and Development

The CEA ended 2013 with 841,836 policies in force, which represents a .04% increase compared to year-end 2012. Although the CEA policy count remained relatively flat, some trends

developed in 2013 that were a direct result of the CEA's introduction of a new product (*Homeowners Choice*) and new optional coverage limits in July 2012.

At year-end 2013, the CEA had 15,480 Homeowner Choice policyholders – up from approximately 6,000 at year-end 2012. By accessing the new product, the CEA's *Choice* policyholders are customizing their policies by purchasing only the coverages they need. In addition, they are trending toward selecting lower deductibles on their personal-property coverage.

Background: *Choice* Product

The CEA implemented its innovative *Homeowners Choice* product on July 1, 2012. This new product offers consumers considerable choice, offering completely new options in earthquake coverage. And it delivers more immediate policy benefits after an earthquake for those who own a house or a manufactured home (mobilehome).

The *Choice* policy includes:

- The option to buy dwelling (structural) coverage only.
- An option to add personal property coverage or additional living expense coverage, or both.
- A *separate* deductible of either 15% or 10% is now available for structure coverage and personal property coverage (the deductible applicable to personal-property losses is no longer tied to the usually higher structure deductible).
- In addition an option to buy an increased \$25,000 limit for post-earthquake additional living expenses was introduced in direct response to consumer feedback—this coverage provides for shelter and food if a policyholder and family are forced from their home as a result of an earthquake. The CEA was pleased with the enthusiastic response to this new limit option: over 56,000 policyholders are now protected with the new limit, up from about 30,000 at year-end 2012.

Finally, the CEA ended 2013 with 81,315 policyholders opting for the lower deductible option of 10% (up 11% from year-end 2012). By offering more choice in coverage options, consumers are much more empowered to manage their residential earthquake insurance premium, meaning that the new features enhance both availability and affordability.

Communications

CEA marketing in 2013 produced results that aligned well with social-science recommendations on how to effectively motivate more California residents to prepare for earthquakes and buy earthquake insurance. Responding to the needs of a large majority of California consumers who said they wanted more information about earthquake risk and insurance, CEA directed its advertising through many outlets:

- Television advertising in 2013 was delivered through six markets, 21 stations, and 19 different news reporters.
- TV advertising for 2013 saw a 95.6 percent increase over 2012 impressions (97.30 million).

- Radio advertising in 2013 was delivered through nine markets, 52 stations, and two celebrities.
- Radio advertising for 2013 produced a 35.6 percent increase over 2012 impressions (404.70 million).
- Online advertising was placed in static formats for 99 newspapers and was combined with static, flash, and rich formats delivered through display, search, and re-targeting strategies.
- Online impressions in 2013 decreased because of CEA’s decision to reduce expenditures for online placements (343.07 million).
- Advertising in ethnic markets and with ethnic sources focused on 42 ethnic print and online publications. Impressions in the ethnic market were comparable to recent years (at 3.2 million).

Refreshing the Themes

Numerous CEA research studies supported the creative concepts used through 2013. After completing its successful run lasting three years, however, the CEA’s “Blueprint” theme campaign will change in 2014, with a new creative concept and a new, expanded strategy.

Marketing Value Program

CEA’s Marketing Value Program (MVP) completed its third year of implementation in 2013. Ongoing implementation of the MVP focused on introducing the CEA brand, generating awareness for CEA among consumers, renewing existing CEA policies, and engaging participating-insurer agents and producers in selling new CEA policies.

The 2013 MVP offered two rounds of up to 500 pieces of direct mail in three languages to produce an eight percent increase in direct mail distributed compared to 2012, resulting in nearly three million direct-mail pieces reaching potential policyholders in 2013.

Cooperative Marketing

The Cooperative Marketing Venture (CMV), designed to allow CEA to digitally link consumers considering earthquake insurance with the participating insurers that transact the sale, was approved by the CEA Governing Board in February 2013.

California *Rocks!*

CEA developed a new campaign for rollout in 2014 that will feature a double entendre: California *rocks* as a cool place to live, but it rocks with earthquakes, too. This campaign to encourage the purchase of residential earthquake insurance was found by CEA (through concept-testing of four campaigns in four markets) to have the most effective messaging.

Supporting the Great California ShakeOut™

CEA continued to play a significant role in the Great California ShakeOut™ statewide earthquake drill, which in 2013 exceeded a record-breaking 9.60 million participants – a 2.1 percent increase in ShakeOut™ participants compared to 2012.

CEA delivered more than 76 million media impressions to support the ShakeOut in 2013 through TV and radio earthquake-preparedness PSAs delivered by news reporters and celebrities, combined with direct mail.

Joining Forces with the American Red Cross

CEA completed its second year of “Joined Forces” programming with the American Red Cross through the *Get Prepared, California!* annual auction at www.GetPreparedCalifornia.org. The 2013 auction generated \$160,000 to benefit Red Cross, and more than 106 million media impressions promoting earthquake preparedness.

Results from CEA’s collaboration with earthquake preparedness stakeholders 2008–2013 include:

- Delivering 504 million impressions statewide through paid media.
- Distributing news releases, media advisories, and public service announcements.
- Coordinating statewide media spokespersons and a media database.
- Hosting seven press availabilities for preparedness stakeholders.
- Delivering about six million impressions through in-store merchandising displays.
- Distributing more than 8.1 million pieces of direct mail in English, Spanish, and Chinese.
- Hosting information booths at ethnic-community festivals.
- Sponsoring a “preparedness team” at community events, statewide.

Awards

Numerous awards were accepted by CEA in 2013 for 2012 programming. Also in 2013, for its public education, mitigation, and research activities, CEA was awarded the Western States Seismic Policy Council’s *Award in Excellence for Educational Outreach*, accepted in 2014.

Mitigation Program Development

The CEA law directs the CEA Governing Board to set aside annually five percent of the CEA’s investment income (as long as the set-aside is actuarially sound and up to a limit of five million dollars) to be used for activities that mitigate seismic risks of vulnerable residential structures in California. This includes programs to provide financial assistance to those who mitigate their homes against seismic risk.

In 2013, the CEA mitigation program coordinated projects in three focus areas:

- Guideline Development
 - Current guidelines, adopted into California’s existing-building code through CEA efforts in 2010, address but one type of seismic retrofit to single-family dwellings. More guidelines are needed to provide direction for additional types of seismic retrofits necessary for additional types of houses that are vulnerable to damage from seismic activity.
 - The CEA and the Applied Technology Council (<https://www.atcouncil.org/>) contracted in November 2013 to collaborate on “ATC-110,” to develop a

prestandard for the evaluation and retrofit of one- and two-family light-frame residential buildings.

- The work is co-funded by the CEA and the Federal Emergency Management Agency (“FEMA”).

- Mitigation Research
 - By law, a five-percent earthquake-insurance premium discount is available from the CEA for bolting a foundation, bracing a cripple wall, and strapping a water heater.
 - Any increase in this discount will depend on credible research that links the reduction of earthquake damage to specified seismic retrofits.
 - Current research is limited to the effectiveness of seismic retrofits on raised-foundation, cripple-walled, single-family dwellings.
 - To address these research needs and gaps, the CEA is funding research on the effects of specified retrofits, using numerical modeling, component testing, and possibly shake-table testing of seismically strengthened and un-strengthened single-family dwellings.

- Incentive Program
 - Through the joint powers authority established by the CEA (a public instrumentality) and the Governor’s Office of Emergency Services (a state agency), the California Residential Mitigation Program developed and executed a pilot mitigation-incentive program called *Earthquake Brace + Bolt* (EB+B), offering Californians funds to strengthen their houses.

EB+B launched the pilot, competitively selecting houses situated in two ZIP Codes in Los Angeles and two ZIP Codes in Oakland. The program began with ten qualifying houses in LA.

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Financial Report

Revenue Bonds

In 2006, the CEA issued \$315,000,000 in investment-grade (non-full-faith-and-credit) revenue bonds, marking the CEA's first entry into the private debt market.

During 2013, the CEA redeemed \$31,500,000 in outstanding bonds from that issuance, and at year-end 2013 the CEA had \$94,500,000 in revenue bonds outstanding.

Financial-Stability Ratings

During 2013, CEA remained rated as "A-Minus (Excellent)" by the A. M. Best Co., with a "stable" outlook.

Best's rating framework continues to recognize the CEA's "excellent risk-adjusted capitalization, financial flexibility, extensive risk modeling capabilities, sophisticated management practices, and conservative investment policy."

Attachment A: California Department of Insurance Summary: 2013 Residential & Commercial Market Totals

EARTHQUAKE PREMIUM AND POLICY COUNT DATA CALL SUMMARY OF 2013 RESIDENTIAL & COMMERCIAL MARKET TOTALS

2013 Experience Year	Written Prem Excluding EQ	No. of Policies Excluding EQ	Exposure (\$) Excluding EQ	Avg Prem Per Policy	Avg Rate Per Policy	Market Share *	EQ Premiums	No. of EQ Policies	Exposure (\$) Including CEA	Avg Prem Per Policy	Avg Rate Per Policy	Market Share *	% with EQ **
Total CEA Companies***	5,976,538,634	8,762,462	2,268,267,626,831	\$ 682.06	\$ 2.63	79.54%	569,331,874	841,836	320,536,765,240	\$ 676.30	\$ 1.78	75.85%	9.61%
Total Residential Mkt (Excluding CEA)	1,842,476,926	2,253,388	766,158,330,069	\$ 817.65	\$ 2.40	20.46%	327,527,669	267,986	163,334,838,802	\$ 1,222.18	\$ 2.01	24.15%	11.89%
Total Residential Mkt (Including CEA)	7,819,015,560	11,015,850	3,034,425,956,900	\$ 709.80	\$ 2.58	100.00%	896,859,543	1,109,822	483,871,604,042	\$ 808.11	\$ 1.85	100.00%	10.07%
Total Homeowners Market	6,175,451,818	6,350,365	2,471,367,412,047	\$ 972.46	\$ 2.50	57.65%	782,724,510	758,397	435,722,094,604	\$ 1,032.08	\$ 1.80	68.34%	11.94%
Total Rental Market	334,707,600	1,774,130	54,707,894,753	\$ 188.66	\$ 6.12	16.11%	8,095,000	78,704	2,908,329,686	\$ 102.85	\$ 2.78	7.09%	4.44%
Total Condominium Market	364,484,999	810,084	47,414,976,485	\$ 449.93	\$ 7.69	7.35%	49,341,065	126,722	12,501,416,612	\$ 389.36	\$ 3.95	11.42%	15.64%
Total Dwelling Fire Market	799,721,619	1,798,213	437,073,962,920	\$ 444.73	\$ 1.83	16.32%	48,846,615	94,435	27,793,638,870	\$ 517.25	\$ 1.76	8.51%	5.25%
Total Mobilehome Market	144,649,525	283,058	23,861,710,695	\$ 511.02	\$ 6.06	2.57%	7,852,353	51,564	4,946,124,270	\$ 152.28	\$ 1.59	4.65%	18.22%
Total Residential Mkt (Including CEA)	7,819,015,560	11,015,850	3,034,425,956,900	\$ 709.80	\$ 2.58	100.00%	896,859,543	1,109,822	483,871,604,042	\$ 808.11	\$ 1.85	100.00%	10.07%
California FAIR Plan	63,115,952	126,660	40,322,134,191	\$ 498.31	\$ 1.57	7.04%	4,446,370	4,825	2,177,997,113	\$ 921.53	\$ 2.04	5.11%	3.81%
Total Dwelling Fire (Excluding CA FAIR Plan)	736,605,667	1,671,553	396,751,828,729	\$ 440.67	\$ 1.86	92.96%	44,400,245	89,610	25,615,641,757	\$ 495.48	\$ 1.73	94.89%	5.36%
Total Dwelling Fire Market	799,721,619	1,798,213	437,073,962,920	\$ 444.73	\$ 1.83	100.00%	48,846,615	94,435	27,793,638,870	\$ 517.25	\$ 1.76	100.00%	5.25%

* Market share represents the percentage of policies to total residential market.
** Percent with EQ represents the percentage of policies that also have EQ coverage.

Commercial Fire	360,903,065	175,375	597,589,988,537	\$ 2,057.89	\$ 0.60	19.53%	285,220,962	44,230	127,685,002,138	\$ 6,448.59	\$ 2.23	52.73%	25.22%
Commercial Multiple Peril (Non-Liab.)	2,367,115,123	722,401	2,093,158,342,656	\$ 3,276.73	\$ 1.13	80.47%	56,559,778	39,651	41,717,854,373	\$ 1,426.44	\$ 1.36	47.27%	5.49%
Total Commercial Lines:	2,728,018,188	897,776	2,690,748,331,193	\$ 3,038.64	\$ 1.01	100.00%	341,780,740	83,881	169,402,856,511	\$ 4,074.59	\$ 2.02	100.00%	9.34%

California Department of Insurance

Release Date: 6/10/2014

**Attachment B: 2013 Financial Statement
California Earthquake Authority: Annual Financial Report**

In accordance with California Insurance Code sec. 10089.13, subdivision (b), the California Earthquake Authority reports its finances as of December 31, 2013:

Assets	
Cash on hand	\$315,967,639
Stocks or bonds	4,702,559,934
Premiums receivable	45,192,923
Assessments receivable	-
Interest receivable	14,108,686
Securities receivable	-
Unearned ceded premium	-
Prepaid reinsurance premiums	5,367,911
Reinsurance premium deposit	14,661,400
Prepaid reinsurance maintenance premium	350,859
Equipment, net of depreciation	1,017,092
Deferred participating-insurer commissions and operating costs	39,807,893
Reinsurance premium receivable	-
Other assets	357,090
Liabilities	
Losses due and unpaid	-
Claims for losses resisted by the CEA	-
Losses in the process of adjustment or suspense	-
Reported losses	39,513
Supposed losses	-
Revenue bonds Payable	94,500,000
Revenue bonds Interest Payable	2,914,853
Other debt financing	-
Unearned premium	296,410,225
Unearned commissions	-
Accounts payable	7,809,243
Securities payable	-
Accrued reinsurance premium expense	6,103,759
Income	
Premiums received	574,507,234
Interest money received	19,088,468
Installment fees	464,260
Supplemental commissions	-
Expenses	
Loss adjustment expenses paid	2,197
Losses paid	346,707
Participating insurer commissions	56,890,741
Participating insurer operating costs	17,538,868
Reinsurance broker commissions	4,800,000
Financing expenses	7,139,566
Reinsurance premium	212,741,709
Other underwriting expenses	29,505,138

Attachment C: Summary of CEA Claim-Paying Capacity

In accordance with California Insurance Code sec. 10089.13, subdivision (c), the California Earthquake Authority reports this separate financial summary of its base-program claim-paying capacity as of December 31, 2013.

Assets		
	Cash & Investments	\$4,994,127,968
	Revenue Bond Proceeds	(314,344,017)
	Less: Debt Service	(32,101,772)
	Interest Receivable	14,108,686
	Securities Receivable	-
	Premiums Receivable	45,192,923
	Capital Contribution Receivable	-
	Other Cash-Related Assets	357,090
	Accounts Payable & Accrued Expenses	(7,809,243)
	Accrued Reinsurance Premium Expense	(6,103,759)
Liabilities		
	Unearned premium collected	215,261,817
	Securities payable	-
Total Available Capital		4,478,166,059
Assessments		
	Available for assessment in 1 st IA layer (Sunset in 2008)	-
	Assessments previously made from 1 st IA layer	-
	Available for assessment in 2 nd IA layer	1,656,000,000
	Assessments previously made from 2 nd IA layer	-
	Available for assessment in New IA layer	385,000,000
	Assessments previously made from New IA layer	-
	[IA = Industry Assessment]	
Reinsurance		
	Available in all layers	3,115,000,000
Bonds		
	Revenue bonds issued in 2006	315,000,000
	Revenue bonds outstanding 12/31/2013	94,500,000
Policyholder Surcharges		
	Surcharges assessed	-
	Surcharges outstanding	-
Capital Markets		
	Capital committed from capital markets	-
Debt		
	Line of credit available	-