

# CALIFORNIA EARTHQUAKE AUTHORITY

## ANNUAL REPORT TO THE LEGISLATURE AND INSURANCE COMMISSIONER ON PROGRAM OPERATIONS

### Report Covering Calendar Year 2009

(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 an 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 requires insurers to offer earthquake insurance to their applicants 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 65% of the residential-earthquake-insurance market; CEA participating insurers are responsible for almost 80% of California's residential property insurance.

#### **Current Market Conditions**

##### Residential Property Insurance Market

California Department of Insurance (CDI) year-end-2009 data provided to the CEA again indicates a slight increase in policy numbers in the statewide residential property insurance market: In 2009, 9.5 million policies were sold compared to the previous year's 9.2 million. (See Attachment A: *California Department of Insurance, Summary of 2008 Residential & Commercial Market Totals.*)

The following totals are statewide, for all insurers writing residential property insurance in California:

- *Residential Homeowners (Dwelling) Policies* totaled 6,116,682
- *Residential Condominium Unit Policies* totaled 656,601
- *Manufactured Home (Mobilehome) Policies* totaled 273,262
- *Rental Policies* totaled 1,116,287
- *Dwelling Fire Policies* totaled 1,327,132

## Earthquake Insurance Market – 2009

Based on the total number of residential earthquake insurance policies written in 2009, CEA and non-CEA companies together accounted for 1.14 million earthquake policies statewide.

### **CEA Earthquake Response in 2009**

In 2009, the CEA and its participating insurers responded to 127 earthquake claims. These events had relatively low magnitudes and caused little residential damage.

<b>Date</b>	<b>Magnitude</b>	<b>Location</b>	<b>Number of Claims</b>	<b>Total of claim payments</b>
January 8, 2009	4.5	San Bernardino	2	\$0
May 17, 2009	4.7	Los Angeles	34	\$1,414
October 1, 2009	5.1	Keeler – (Owens Lake, Inyo County)	1	\$0
December 30, 2009	5.8	Calexico – in Mexico, 26 miles south of US border	7	\$0
Claims not related to specific earthquake*	NA	California – all locations	83	\$0
<b>Total</b>	<b>NA</b>	<b>NA</b>	<b>127</b>	<b>\$1,414</b>

\*The CEA regularly receives earthquake claims from CEA policyholders who have felt small earthquakes and then noticed small cracks in some part of their houses. Each claim is fully investigated by a CEA participating insurance company—in some instances, an engineer is used to determine the cause of the cracking. For all such claims reported in 2009, the cracks were determined to be minor, non-structural cracks, or caused by other than earthquake shaking.

### **2009 – CEA Operational Developments**

#### **New Rating Plan – Completion of Two-Year Implementation**

During 2009, the CEA completed a two-year implementation of an overall statewide rate increase that affected new and renewal policies that incepted June 1, 2008, or later. The 2009 change affected only condominium loss-assessment premiums, which were increased over two years to ease the impact on policyholders. The CEA Governing Board approved a rate plan in August 2007, and the new plan received CDI approval in November 2007. As a result of the overall change, rates for the CEA's Base-Limits Program increased 3.5% while rates for the CEA's Supplemental-Limits Program increased 1.5%, both on a statewide average basis.

In April 2008, the CEA received notification of approval of a regulation change that was required to implement a new \$75,000 optional limit for CEA condominium earthquake loss assessment coverage. Because rates for the new optional limit were part of the new rate plan approved by CDI in November 2007, the CEA proceeded to implement the new limit effective October 1, 2008. As a result, the CEA now offers limit options of \$25,000, \$50,000, and \$75,000 for condominium earthquake loss assessment coverage.

The law requires that CEA rates be actuarially sound and based on the best available science. Accordingly, the CEA developed the new rating structure using the best available scientific information for assessing earthquake frequency, severity, and loss. The resulting rate application was based on the most current version of the EQECAT/CEA earthquake model, as well as the significant and continuing knowledge gained from the unprecedented scientific, engineering, and actuarial review of the CEA's ratemaking process, including all components of the EQECAT earthquake model, completed in 2005.

The new rating structure was also significantly influenced by an additional, unprecedented development, where a CEA-led collaboration between EQECAT and Foremost Insurance Company (a CEA participating insurer and a market leader in insuring manufactured homes (mobilehomes)) led EQECAT to modify its CEA earthquake model with new vulnerability curves for manufactured-home risks.

### **CEA Supported Research Projects**

Because California law requires the CEA to base its rates on the best scientific information, the CEA continued its commitment to supporting research that promotes the ongoing development of science that is relevant to CEA operations. Most recently, the CEA supported Uniform California Earthquake Rupture Forecast (UCERF), which was completed in 2008. UCERF provides for the first time a uniformly prepared earthquake-fault-rupture forecast for all of California based on an adequate time-dependent methodology.

As a result of this project, the CEA's loss modeler, EQECAT, updated its model to incorporate the results of UCERF. Because EQECAT added these authoritative results into EQECAT's CEA earthquake model, the CEA is assured its rates and rate structure are based on uniform statewide seismic-hazard estimates that represent the best available scientific information. Upon completion of the project, the United States Geological Survey (USGS) also used UCERF in development of new hazard maps.

In 2009, CEA staff identified two new research projects — Uniform California Earthquake Rupture Forecast, Version 3 (UCERF3), and Near-Source Ground Motion Characterization (NGA-West 2)—which the CEA Governing Board approved for support and funding.

As with previous CEA-funded research, these projects represent the CEA's ongoing need and commitment to advancing the evolution of earthquake science that supports the loss-modeling on which the CEA is highly dependent. The UCERF3 and NGA-West 2 projects are continuation of previous research and will provide clear benefit to the CEA, its policyholders and partners, by substantially improving the loss-modeling required for both financial analysis and ratemaking.

### **Consumer and Agent Outreach**

- In 2009, the CEA trained 1,329 agents – 875 in person and 476 online. CEA staff is working with CEA participating insurers throughout 2010 to increase the number of agents trained in 2011 through company-sponsored training sessions, combined with new methodologies such as Webinars.

- In 2009, the CEA trained 2,680 claims adjusters as part of its ongoing commitment to ensure that its claims are adjusted promptly, fairly and consistently.

The CEA worked in 2009 as the primary statewide marketer of the first annual Great California ShakeOut, the largest earthquake drill in United States history. Similar marketing strategies were part of what was called the Great Southern California ShakeOut in 2008. The CEA's ShakeOut marketing strategies in 2008 and 2009 combined to generate 76 million gross (paid-media) impressions, which contributed significantly to drill participation by more than 12.3 million Californians in all 58 counties.

#### CEA Policy Growth

The CEA ended 2009 with 800,930 policies-in-force which represents a 2.8% increase compared to year-end 2008. The growth is attributable, in part, to the addition of new policies resulting from Safeco Insurance Company of America becoming a CEA participating insurer following its acquisition by (CEA participant) Liberty Mutual.

#### Financial Stability Ratings

During 2009, CEA continued its A-Minus (Excellent) rating from the A.M. Best Co., and the rating has a "stable" outlook. As important, 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."

#### **Financial Report**

In 2006, the CEA issued \$315,000,000 in investment-grade revenue bonds, marking the CEA's first entry into the capital markets. During 2009, the CEA redeemed \$31,500,000 in outstanding bonds; therefore, as of the end of 2009 the CEA had \$220,500,000 outstanding in revenue bonds.

**EARTHQUAKE PREMIUM AND POLICY COUNT DATA CALL**  
**SUMMARY OF 2009 RESIDENTIAL & COMMERCIAL MARKET TOTALS**

2009 Experience Year	Written Premiums	No. of Policies	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	5,066,418,266	7,206,504	1,785,741,316,870	\$ 703.03	\$ 2.84	75.94%	579,235,021	800,391	253,869,465,663	\$ 723.69	\$ 2.28	70.35%	11.11%
Total Residential Mkt (Excluding CEA)	2,049,003,639	2,283,460	789,760,128,745	\$ 897.32	\$ 2.59	24.06%	373,036,386	337,399	162,873,662,134	\$ 1,105.63	\$ 2.29	29.65%	14.78%
<b>Total Residential Mkt (Including CEA)</b>	<b>7,115,421,905</b>	<b>9,489,964</b>	<b>2,575,501,445,615</b>	<b>\$ 749.78</b>	<b>\$ 2.76</b>	<b>100.00%</b>	<b>952,271,407</b>	<b>1,137,790</b>	<b>416,743,127,797</b>	<b>\$ 836.95</b>	<b>\$ 2.29</b>	<b>100.00%</b>	<b>11.99%</b>
Total Homeowners Market	5,795,825,422	6,116,682	2,155,671,852,775	\$ 947.54	\$ 2.69	64.45%	850,373,574	847,505	388,102,881,660	\$ 1,003.39	\$ 2.19	74.49%	13.86%
Total Rental Market	244,994,113	1,116,287	37,636,014,335	\$ 219.47	\$ 6.51	11.76%	8,418,212	73,289	1,827,784,194	\$ 114.86	\$ 4.61	6.44%	6.57%
Total Condominium Market	263,574,590	656,601	37,971,723,131	\$ 401.42	\$ 6.94	6.92%	48,082,861	120,169	5,863,563,073	\$ 400.13	\$ 8.20	10.56%	18.30%
Total Dwelling Fire Market	670,993,779	1,327,132	323,301,276,454	\$ 505.60	\$ 2.08	13.98%	37,586,592	55,763	16,983,469,966	\$ 674.04	\$ 2.21	4.90%	4.20%
Total Mobilehome Market	140,034,001	273,262	20,920,578,921	\$ 512.45	\$ 6.69	2.88%	7,810,170	41,064	3,965,428,904	\$ 190.19	\$ 1.97	3.61%	15.03%
<b>Total Residential Mkt (Including CEA)</b>	<b>7,115,421,905</b>	<b>9,489,964</b>	<b>2,575,501,445,615</b>	<b>\$ 749.78</b>	<b>\$ 2.76</b>	<b>100.00%</b>	<b>952,271,407</b>	<b>1,137,790</b>	<b>416,743,127,797</b>	<b>\$ 836.95</b>	<b>\$ 2.29</b>	<b>100.00%</b>	<b>11.99%</b>
California FAIR Plan	68,454,628	148,714	40,075,578,647	\$ 460.31	\$ 1.71	11.21%	4,464,016	5,913	2,237,951,922	\$ 754.95	\$ 1.99	10.60%	3.98%
Total Dwelling Fire (Excluding CA FAIR Plan)	602,539,151	1,178,418	283,225,697,807	\$ 511.31	\$ 2.13	88.79%	33,122,576	49,850	14,745,518,044	\$ 664.45	\$ 2.25	89.40%	4.23%
<b>Total Dwelling Fire Market</b>	<b>670,993,779</b>	<b>1,327,132</b>	<b>323,301,276,454</b>	<b>\$ 505.60</b>	<b>\$ 2.08</b>	<b>100.00%</b>	<b>37,586,592</b>	<b>55,763</b>	<b>16,983,469,966</b>	<b>\$ 674.04</b>	<b>\$ 2.21</b>	<b>100.00%</b>	<b>4.20%</b>

\* 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	549,355,829	233,372	594,415,133,311	\$ 2,353.99	\$ 0.92	22.84%	183,744,906	24,386	66,083,251,986	\$ 7,534.88	\$ 2.78	24.60%	10.45%
Commercial Multiple Peril (Non-Liab.)	2,367,083,665	788,247	1,555,031,195,662	\$ 3,002.97	\$ 1.52	77.16%	96,765,803	74,764	75,461,378,077	\$ 1,294.28	\$ 1.28	75.40%	9.48%
<b>Total Commercial Lines:</b>	<b>2,916,439,494</b>	<b>1,021,619</b>	<b>2,149,446,328,973</b>	<b>\$ 2,854.72</b>	<b>\$ 1.36</b>	<b>100.00%</b>	<b>280,510,709</b>	<b>99,150</b>	<b>141,544,630,063</b>	<b>\$ 2,829.16</b>	<b>\$ 1.98</b>	<b>100.00%</b>	<b>9.71%</b>

SOURCE: California Dept. of Insurance - EQ PREMIUM POLICY COUNT DATA CALL

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**Attachment A: California Department of Insurance Summary: 2009 Residential & Commercial Market Totals**

## 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, 2009:

<b>Assets</b>	
Cash on hand	\$55,153,403
Stocks or bonds	3,947,572,916
Premiums receivable	52,838,052
Assessments receivable	314,019
Interest receivable	20,543,245
Securities receivable	-
Unearned ceded premium	-
Prepaid reinsurance premiums	-
Equipment, net of depreciation	1,540,153
Deferred participating-insurer commissions and operating costs	40,154,994
Reinsurance premium receivable	-
Other assets	121,614
<b>Liabilities</b>	
Losses due and unpaid	-
Claims for losses resisted by the CEA	-
Losses in the process of adjustment or suspense	-
Reported losses	-
Supposed losses	-
Revenue bonds Payable	220,500,000
Revenue bonds Interest Payable	6,801,323
Other debt financing	-
Unearned premium	298,994,745
Unearned commissions	-
Accounts payable	1,702,036
<b>Income</b>	
Premiums received	585,520,749
Interest money received	53,827,731
Installment fees	395,699
Supplemental commissions	-
<b>Expenses</b>	
Loss adjustment expenses	11,365
Losses paid	126,272
Participating insurer commissions	59,038,013
Participating insurer operating costs	20,695,908
Reinsurance broker commissions	5,000,002
Financing expenses	14,890,983
Reinsurance premium	194,697,154
Other underwriting expenses	16,806,338

### Attachment B: 2009 Financial Statement

## California Earthquake Authority: 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, 2009.

<b>Assets</b>		
	Cash & Investments	\$3,982,740,504
	Revenue Bond Proceeds	(310,829,067)
	Less: Debt Service	(26,051,323)
	Interest Receivable	20,543,245
	Securities Receivable	-
	Premiums Receivable	52,838,052
	Capital Contribution Receivable	314,019
	Other Cash-Related Assets	121,614
	Accounts Payable & Accrued Expenses	(1,702,036)
<b>Liabilities</b>		
	Unearned premium	215,924,115
<b>Total Available Capital</b>		3,502,050,893
<b>Assessments</b>		
	Available for assessment in 1 <sup>st</sup> IA layer	-
	Assessments previously made from 1 <sup>st</sup> IA layer	-
	Available for assessment in 2 <sup>nd</sup> IA layer	1,464,840,000
	Assessments previously made from 2 <sup>nd</sup> IA layer	-
	Available for assessment in New IA layer	1,303,707,600
	Assessments previously made from New IA layer	-
	[IA = Industry Assessment]	
<b>Reinsurance</b>		
	Available in all layers	3,123,000,000
<b>Bonds</b>		
	Revenue bonds issued in 2006	315,000,000
	Revenue bonds outstanding 2007	220,000,000
<b>Policyholder Surcharges</b>		
	Surcharges assessed	-
	Surcharges outstanding	-
<b>Capital Markets</b>		
	Capital committed from capital markets	-
<b>Debt</b>		
	Line of credit available	-

### Attachment C: Summary of CEA Claim-Paying Capacity