



CALIFORNIA EARTHQUAKE AUTHORITY [CEA]

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

Report for Calendar Year 2015

[Pursuant to California Insurance Code section 10089.13, subdivision (a)]

Date of Report: August 1, 2016

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 and with CEA operations in full swing, 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-2015 data once again indicate a slight increase in policy numbers in the statewide residential property insurance market: In 2015, insurers sold 11.25 million policies compared to the previous year's 11.22 million. (*See Attachment A: California Department of Insurance, Summary of 2015 Residential Market Totals.*)

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

- *Residential Homeowners (Dwelling) Policies totaled 6,305,973*
- *Residential Condominium Unit Policies totaled 862,150*
- *Mobilehome Policies totaled 275,717*
- *Rental Policies totaled 1,947,435*
- *Dwelling Fire Policies totaled 1,855,707*

California's Residential Earthquake Insurance Market – 2015

Based on the total number of residential earthquake insurance policies written in 2015, CEA and non-CEA companies together accounted for 1.15 million earthquake insurance policies statewide—an increase from 2014's 1.14 million.

CEA Earthquake Response in 2015

The year 2015 was a quiet year with respect to loss-producing earthquakes in California. In 2015, the CEA received 149 claims for earthquake damage, and on a net basis as of June 2016, made payments totaling \$5,878 for those claims.

The most notable California earthquake in 2015 was a 4.0 Richter magnitude earthquake on August 17, 2015, centered in the Northern California city of Piedmont (East Bay area).

The CEA continued its active training efforts: In October 2015, the CEA held its annual meeting and seminar for participating insurance company claim and product managers. Over the course of a full day, the CEA executives and staff clearly laid out claim-handling expectations and product-coverage and deductible options for the 65 participating insurer executives and claim and operations professionals in attendance.

CEA Operational Developments in 2015

CEA Policy Growth and Development

The CEA ended 2015 with 879,540 policies-in-force, which represents a 1.67% increase compared to year-end 2014. The continued growth in the number of Californians who purchase residential earthquake insurance is largely attributed to the CEA's introduction of

a new single-family-dwelling product (“Homeowners Choice”) and new optional coverage limits in July 2012, supported by related marketing and advertising initiatives.

At year-end 2015, the CEA had written coverage for 41,195 Homeowners Choice policyholders, up from 25,627 at year-end 2014. When they buy that new product, Homeowners Choice policyholders are actually customizing their policies by purchasing only the coverages they need. It is a trend worth noting that more policyholders are selecting *lower* deductibles on their personal-property coverage but *higher* limits of protection for additional living expense coverage.

Background: Homeowners Choice Product

The CEA began offering its innovative Homeowners Choice product on July 1, 2012.

The product offers consumers considerable choice, offering completely new options in earthquake coverage—and it can deliver more immediate policy benefits after a moderate earthquake for those who own a house or a manufactured home (mobilehome).

The Choice policy includes:

- The option to buy dwelling (structural) coverage alone, without other coverages.
- An option to add personal property coverage or additional living expense coverage, or both.
- A separate deductible of either 15% or 10% for structure coverage and the same choice for personal property coverage—that choice is achievable because the deductible for personal-property losses is no longer tied to the (usually higher) structure deductible.
- CEA introduced an option to buy an increased \$25,000 limit for post-earthquake additional living expenses in direct response to consumer feedback. This coverage pays for shelter and food if a policyholder and family are forced from their home as a result of an earthquake.

Finally, the CEA ended 2015 with 100,283 policyholders choosing the lower 10% deductible option on their dwelling structure (up nearly 7% from year-end 2014).

By offering more choice in coverage options, including both limit and deductible, consumers are more empowered to manage their residential earthquake insurance premium, meaning that the new features enhance both availability and affordability.

Rate and Coverage Changes

In May 2015, the California Insurance Commissioner approved CEA’s rate application, which sought an average statewide rate decrease of -10%, beginning with new and renewal policies effective on and after January 1, 2016.

The rate change was made possible by CEA’s successfully working to secure lower risk-transfer costs.

(Given that the rate decrease describes an *average* statewide rate impact, some policyholders could see their rates increase while some would see a decrease—the individual impacts depend on the CEA product purchased, location of the risk, and application of other publicly approved rating factors.)

The approved rate application also included:

- New editions of the CEA policy forms, which provide new coverage enhancements and refine and clarify policy language.
- New deductible options: In addition to current 10% and 15% Homeowners deductible options, *all* policies now have a number of new options: 5%, 10%, 15%, 20%, or 25% of the structure-coverage limit.
- New Personal Property limit options: Longstanding limit options of \$5,000, \$25,000, \$50,000, \$75,000, and \$100,000 are joined by new \$150,000 and \$200,000 limit options.
- New Loss of Use limit options: In addition to current limit options of \$1,500, \$10,000, \$15,000, and \$25,000, new \$50,000, \$75,000, and \$100,000 limit options will become available. (“Loss of use” coverage also pays for additional living expenses incurred when a policyholder must live outside his/her home after an earthquake.)
- New “breakage” coverage: CEA now offers an option to buy coverage for personal property breakage (e.g., for breakable items such as dishes and collectibles).

Communications

CEA marketing and advertising in 2015 again responded through many outlets, reaching out to a majority of California consumers who say they want more information about earthquake risk and insurance:

- Television advertising, which produced 78 million impressions, was delivered in five markets: San Francisco, Monterey, Santa Barbara, Los Angeles, and San Diego.
- Radio advertising, which produced 414 million gross impressions, was delivered through in nine markets, through 52 stations, using services of two celebrities.
- Online advertising, which produced 243 million impressions, was delivered in static and Flash forms, through display, search, and re-targeting strategies.
- Ethnic advertising, which delivered 3.2 million impressions, was delivered through 42 ethnic print and online publications.

The Earthquake Risk is Real

In 2015, CEA evolved its advertising creative approach from the “California Rocks” of the past few years to “The Earthquake Risk is Real,” responding to further consumer research conducted by CEA and a desire to shift the focus from preparedness to recovery.

The “Earthquake Risk is Real” campaign has three key goals: to drive home the message that the risk of damaging earthquakes is real, to educate Californians about new, more flexible and affordable policy offerings, and to encourage Californians to buy earthquake insurance to protect their family finances and aid in their family’s recovery.

Marketing Value Program

CEA’s Marketing Value Program (MVP), which delivered about 2.1 million pieces of direct mail through agents trained to sell CEA policies, completed its fifth year of implementation in 2015.

Custom-fulfilled direct mail in the name of CEA participating-insurance-company agents focused on generating new CEA policy sales and renewal of existing CEA policies. CEA offered agent training in-person, online, and through webinars, and held two successful agent forums, training a total of 1,707 agents and qualifying 154 agents for the MVP.

Cooperative Marketing Venture

The CEA’s Cooperative Marketing Venture (CMV), created to link potential CEA policyholders visiting a co-branded *California Rocks!* website with their participating insurance company website to facilitate selling a CEA policy, was taken up by two of CEA’s participating insurance companies, which ran co-branded online advertising.

Supporting the *Great California ShakeOut*TM

CEA continued its significant role in promoting participation in the *Great California ShakeOut*TM statewide earthquake drill—participation in 2015 was a record-breaking 10.5 million Californians.

CEA delivered more than 75 million media impressions to promote *ShakeOut*TM participation in 2015 through TV and radio PSA messages from news reporters and celebrities.

Get Prepared, California!

CEA joined forces with the American Red Cross again in 2015 to promote its third annual statewide auction at GetPreparedCalifornia.org, which delivered more than 110 million media impressions promoting earthquake preparedness and generated \$174,000 to benefit Red Cross and earthquake-preparedness in California.

Results from CEA’s 2008–2015 stakeholder outreach include:

- 864 million impressions delivered statewide through paid media.
- Distributing news releases, media advisories, and public service announcements.
- Coordinating statewide media spokespersons and a media database.
- Hosting press availabilities for preparedness stakeholders.
- Distributing direct mail in English, Spanish, and Chinese.
- Hosting information booths at ethnic-community festivals.
- Sponsoring a “preparedness team” at community events.

Marketing Award

CEA received a *Best of Show* award presented by the Insurance Marketing & Communications Association for its *California Rocks!* initiative at the Wango Tango concert in Southern California.

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) 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 2015, the CEA mitigation program coordinated projects in four focused areas:

Guidelines Development

Current guidelines—adopted into California’s existing-building code through CEA efforts in 2010—address one basic type of prescriptive seismic retrofit to single-family dwellings (other retrofits may come under that code provision, but only with guidance from a design professional (architect or engineer)).

More guidelines are needed for additional seismic-retrofit types, to benefit other types of houses equally (or more) vulnerable to earthquake damage.

- 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”).
- The project team has delivered a detailed outline for research and content-development for the next three years of the project.

Research Projects

- Consistent with the CEA 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. Based on available data and information surveyed by CEA and actuarial computations and authorization—supported by regulatory approval—certain single-family dwellings in the CEA’s insured portfolio presently may warrant earthquake-insurance premium discounts of up to 20 percent. Increasing the discount beyond what is presently provided, however, would depend on credible research that links specified seismic-retrofit techniques to specified structural elements to achieve greater reduction of earthquake damage. Current research is limited to the effectiveness of basic seismic retrofits on raised foundation, cripple-walled, single-family dwellings of a certain configuration and located on no or minimal slope. To address these research needs, the CEA will fund research on the effects of specified retrofit techniques, using numerical modeling, component testing, and possibly shake-table testing of seismically strengthened and un-strengthened single-family dwellings. Contract negotiations for this project are underway, and it is hoped the research activities will commence in 2016.
- CEA in February 2015 surveyed selected Napa homeowners concerning their experiences during the August 2014 earthquake epicentered in that area. An expert consultant oversaw the survey on behalf of CEA and analyzed the results; the same consultant will coordinate a second phase of the study for CEA, inspecting homes identified as retrofitted for structural damage, to verify they were retrofitted. The study is to conclude in 2016.

Earthquake Brace + Bolt Program

Through the joint powers authority established by the CEA (a public instrumentality of the state) and the California Governor’s Office of Emergency Services (a state agency), the California Residential Mitigation Program developed and executed a mitigation-incentive program called Earthquake Brace + Bolt (EBB), offering Californians up to \$3,000 to strengthen their houses’ foundations.

In 2013, EBB launched the pilot program, competitively selecting houses situated in two ZIP Codes in Los Angeles and two ZIP Codes in Oakland. Between the two areas, eight houses completed seismic retrofits by April 2014, in whole or in part using EBB grants.

Plans to expand the program were developed and implemented by year-end, adding six cities as of January 2015.

- In 2015, EBB expanded from 4 ZIP Codes to 28 ZIP Codes and completed about 530 retrofits.

- EBB benefitted from \$3 million appropriated to the Department of Insurance that was earmarked for a grant to CEA, which in turn was expected to fund an additional 1,000 retrofits in 2016 for houses in 100-plus ZIP Codes.
- CEA also secured \$300,000 through FEMA’s Hazard Mitigation Grant Program to retrofit 100 houses in Napa in 2016.

Verification Program

In 2011/2012, CEA supported developing FEMA P-50 (*Simplified Seismic Assessment of Detached, Single-Family, Wood-Frame Dwellings*) and FEMA P-50-1 (*Seismic Retrofit Guidelines for Detached, Single-Family, Wood-Frame Dwellings*).

FEMA P-50 provides an evaluation system and tool for use by home inspectors in evaluating seismic and structural vulnerabilities of a house. The evaluation incorporates geological risks determined through Cal OES’s *My Plan* and the USGS-assigned Regional Hazard Score. It then evaluates the structural components of the house to determine a “Structural Score.” Both are then used to determine the “Seismic Performance Grade.”

P-50-1 also provides guidelines for loss-mitigation steps that would improve the Seismic Performance Grade for houses with elements that could be retrofitted.

In 2015, CEA collaborated with Cal OES, FEMA, ATC, the California Real Estate Inspection Association, and Simpson Strong-Tie (a private business active in manufacturing retrofit supplies) to present six training sessions in the use of P-50 and P-50-1. Participants exceeded the goal of 200.

- The goal of training home inspectors is to use their services to make a seismic-related risk evaluation available to homeowners:
 - when selling a house,
 - when considering a seismic retrofit, and
 - for insurance-related verifications.
- Participants from other areas of endeavor (contractors, engineers, architects, emergency-management personnel, and local building officials) stated their reasons for attending were:
 - an interest in the topic,
 - desire to add services to their portfolio, and
 - the opportunity to earn professional development hours towards their continuing-education requirements.
- Some funding for the training was provided through FEMA’s National Earthquake Technical Assistance Program, coordinated through Cal OES.

Financial Report

Revenue Bonds

In 2006, the CEA issued \$315,000,000 in investment-grade (non-full-faith-and-credit of the State of California) revenue bonds, marking the CEA's first entry into the private debt market. The outstanding balance of \$31,500,000 matured July 1, 2016.

During 2014, the CEA issued \$350,000,000 in investment-grade (non-full-faith-and-credit of the State of California) revenue bonds. On July 1, 2016, \$40,000,000 of the \$350,000,000 in outstanding bonds matured.

Financial-Stability Ratings

During 2015, CEA continued to be rated by the A. M. Best Co. as "A-Minus (Excellent), 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."

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Attachment A: California Department of Insurance Summary: 2014 Residential Market Totals

EARTHQUAKE PREMIUM, EXPOSURE AND POLICY COUNT DATA CALL

SUMMARY OF 2015 RESIDENTIAL MARKET TOTALS

2015 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***	6,137,780,797	9,067,529	2,447,002,265,278	\$ 676.90	\$ 2.51	80.62%	632,509,421	879,537	356,424,204,968	\$ 719.14	\$ 1.77	76.42%	9.70%
Total Residential Mkt (Excluding CEA)	1,965,512,400	2,179,453	855,842,122,916	\$ 901.84	\$ 2.30	19.38%	351,962,095	271,431	166,791,565,784	\$ 1,296.69	\$ 2.11	23.58%	12.45%
Total Residential Mkt (Including CEA)	8,103,293,197	11,246,982	3,302,844,388,194	\$ 720.49	\$ 2.45	100.00%	984,471,516	1,150,968	523,215,770,752	\$ 855.34	\$ 1.88	100.00%	10.23%
Total Homeowners Market	6,361,808,628	6,305,973	2,642,004,387,946	\$ 1,008.85	\$ 2.41	56.07%	858,959,456	778,742	470,456,757,235	\$ 1,103.01	\$ 1.83	67.66%	12.35%
Total Rental Market	390,279,288	1,947,435	58,877,006,001	\$ 200.41	\$ 6.63	17.32%	9,928,227	99,659	3,510,057,850	\$ 99.62	\$ 2.83	8.66%	5.12%
Total Condominium Market	423,344,092	862,150	51,482,014,531	\$ 491.03	\$ 8.22	7.67%	50,359,518	129,335	13,441,591,181	\$ 389.37	\$ 3.75	11.24%	15.00%
Total Dwelling Fire Market	766,697,009	1,855,707	526,545,590,139	\$ 413.16	\$ 1.46	16.50%	56,151,039	88,888	29,828,297,601	\$ 631.71	\$ 1.88	7.72%	4.79%
Total Mobilehome Market	161,164,181	275,717	23,935,389,577	\$ 584.53	\$ 6.73	2.45%	9,073,276	54,344	5,979,066,885	\$ 166.96	\$ 1.52	4.72%	19.71%
Total Residential Mkt (Including CEA)	8,103,293,197	11,246,982	3,302,844,388,194	\$ 720.49	\$ 2.45	100.00%	984,471,516	1,150,968	523,215,770,752	\$ 855.34	\$ 1.88	100.00%	10.23%
California FAIR Plan	70,531,869	125,984	43,837,064,916	\$ 559.85	\$ 1.61	6.79%	4,560,407	4,561	2,204,980,208	\$ 999.87	\$ 2.07	5.13%	3.62%
Total Dwelling Fire (Excluding CA FAIR Plan)	696,165,140	1,729,723	482,708,525,223	\$ 402.47	\$ 1.44	93.21%	51,590,632	84,327	27,623,317,393	\$ 611.79	\$ 1.87	94.87%	4.88%
Total Dwelling Fire Market	766,697,009	1,855,707	526,545,590,139	\$ 413.16	\$ 1.46	100.00%	56,151,039	88,888	29,828,297,601	\$ 631.71	\$ 1.88	100.00%	4.79%

* Market share represents the percentage of policies to total residential market.

** Percent with EQ represents the percentage of policies that also have EQ coverage.

Attachment B: 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, 2015:

Assets		
Cash on hand		\$139,893,637
Stocks or bonds		5,777,367,079
Premiums receivable		47,897,293
Assessments receivable		-
Interest receivable		15,472,294
Securities receivable		-
Unearned ceded premium		-
Prepaid reinsurance premiums		10,004,364
Prepaid reinsurance maintenance premium		1,558,347
Equipment, net of depreciation		309,658
Deferred participating-insurer commissions and operating costs		-
Reinsurance premium receivable		-
Other assets		354,407
Liabilities		
Losses due and unpaid		-
Claims for losses resisted by the CEA		-
Losses in the process of adjustment or suspense		-
Reported losses		407,911
Supposed losses		-
Revenue bonds Payable		350,000,000
Revenue bonds Interest Payable		4,292,250
Other debt financing		-
Unearned premium		362,712,929
Unearned commissions		-
Accounts payable		11,739,796
Payable to CRMP		-
Securities payable		-
Accrued reinsurance premium expense		-
Income		
Premiums received		634,442,394
Interest money received		40,447,414
Installment fees		405,598
Supplemental commissions		-
Expenses		
Loss adjustment expenses paid		205,489
Losses paid		2,294,326
Participating insurer commissions		63,463,204
Participating insurer operating costs		19,600,543
Reinsurance broker commissions		4,500,000
Financing expenses		8,950,848
Reinsurance premium		189,085,436
Other underwriting expenses		38,860,011

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 claim-paying capacity as of December 31, 2015.

Assets		
	Cash & Investments	\$5,917,260,716
	Earthquake loss mitigation fund cash & investments	(23,429,463)
	Revenue Bond Proceeds	(667,800,805)
	Less: Debt Service	(24,292,250)
	Interest Receivable	15,472,294
	Securities Receivable	-
	Premiums Receivable	47,897,293
	Capital Contribution Receivable	-
	Other Cash-Related Assets	354,407
	Accounts Payable & Accrued Expenses	(11,019,119)
	Accrued Reinsurance Premium Expense	-
Liabilities		
	Unearned premium collected	(239,793,008)
	Loss Reserve	(407,911)
	Securities payable	-
Total Available Capital		5,014,242,154
Assessments		
	Available for assessment in 2 nd IA layer	1,656,000,000
	Available for assessment in New IA layer	238,000,000
	[IA = Industry Assessment]	
Risk Transfer		
	Available in all layers	4,091,000,000
Bonds		
	Revenue bonds issued 07/2006	315,000,000
	Revenue bonds issued 11/06/2014	350,000,000
	Revenue bonds outstanding 12/31/2013	350,000,000
Policyholder Surcharges		
	Surcharges assessed	-
	Surcharges outstanding	-
Debt		
	Line of credit available	-