CALIFORNIA EARTHQUAKE AUTHORITY

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

Report for Calendar Year 2021
(Pursuant to California Insurance Code section 10089.13, subdivision (a))

Date of Report: August 1, 2022

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 both residential policy applicants and current residential policyholders, the insurers' retreat from the California market resulted in an availability crisis for homeowners earthquake insurance. The California Department of Insurance ("CDI") reported in summer 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 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 homeowners policies.

Today, CEA is the largest earthquake insurer in California with over 65% of the residential-earthquake-insurance market. CEA participating insurers are responsible for over 75% of California's residential property insurance.

2021 Market Conditions

California's Residential Property Insurance Market

The CDI year-end-2021 data indicate an increase in policy numbers in the statewide residential property insurance market. In 2021, insurers sold almost 12.8 million homeowners policies, which is an increase from the previous year's 12.3 million. (See Attachment A: *Earthquake Premium and Policy Count Data Call, Summary of 2021 Residential Totals* – prepared by the California Department of Insurance)

Statewide residential totals, for all insurers that wrote residential property insurance in California in 2021:

- Homeowners Policies: 6,517,445
- Rental Policies: 2,965,279
- Condominium Policies: 1,026,766
- Dwelling Fire Policies: 1,984,514
- Mobilehome Policies: 285,727

California's Residential Earthquake Insurance Market

Based on the total number of residential earthquake insurance policies written in 2021, CEA and non-CEA companies together accounted for 1.68 million earthquake insurance policies statewide—a slight decrease from 2020's 1.69 million.

CEA Policy Development

CEA ended 2021 with 1,111,314 policies in force, a 2.3% decrease over year-end 2020.

At year-end 2021:

- There were 178,875 Homeowners Choice policyholders, an increase of 7.15%.
    - *CEA earthquake insurance for homeowners allows you to choose between two policies. The standard Homeowners bundled coverage or the Homeowners Choice where you can purchase separate policy options.*
- Coverage A Deductible Options have seen the following increases:
    - 6.9% for 25% Deductible
    - 7.7% for 20% Deductible
    - 6.4% for 5% Deductible
- More policyholders continue to select higher coverage limits on their personal-property coverage.
- Additional living expense (ALE) coverage, also known as Loss of Use coverage, is seeing an increase in higher coverage limits:
    - $50K – 6.3% increase
    - $75K – 8.7% increase
    - $100K – 17.5% increase

Approval of Rate Changes

In March 2021, CEA's Governing Board directed staff to file a revised Rate Application with the CDI. On September 15, 2021, the CDI approved an average statewide rate increase of 2.9% across all territories, beginning with new and renewal policies effective on and after April 1, 2022. There were no changes to rating factors with this rate filing.

Mitigation Program Development

California Insurance Code section 10089.37 directs the CEA Governing Board to annually set aside five percent of the CEA's investment income (as long as the set-aside is actuarially sound) up to five million dollars, to be used for activities that mitigate seismic risks of vulnerable residential structures in California. This includes program activities that mitigate against seismic risks.

In 2021, the CEA mitigation program coordinated projects in three focused areas:

1. <u>Guidelines Development</u>

   The ATC 110 earthquake-guidelines-development project, first phase, completed on June 20, 2018. Now called FEMA P-1100, Vulnerability-Based Seismic Assessment and Retrofit of One- and Two-Family Dwellings, the bulk publication consists of three volumes:
   - Volume 1, Prestandard publication (published October 2019)
   - Volume 2, FEMA plan set (published November 2019)
   - Volume 3, background documents (completed November 2019)

   The second phase of this project consists of developing a training program for Contractors, Building Officials, and Engineers. A training outline has been drafted and the program is currently being developed. This phase has been stalled due to COVID-19 and is now projected to be completed in Q4 2023.

   The third phase will involve CEA working closely with FEMA and the International Code Council (ICC) to adopt the guidelines as industry standards, which paves the way for adoption into California's building code. Additionally, by creating a uniform seismic-retrofit-design method for homeowners, contractors, and engineers, the new guidelines will help the CEA and others (1) establish and expand incentive programs to encourage seismic retrofits, such as that of the California Residential Mitigation Program (CRMP), and (2) enhance the CEA's ability to develop and provide suitable mitigation discounts for CEA-insured homeowners.

2. <u>Earthquake Brace + Bolt Program (EBB)</u>

   In 2011, the CEA and the California Governor's Office of Emergency Services established a joint powers authority (JPA) called the California Residential Mitigation Program (CRMP) to help California homeowners strengthen their houses with the help of seismic retrofit grants offered via the Earthquake Brace + Bolt program and other types of assistance and incentive programs.

The EBB program was developed to help homeowners lessen the potential for damage to their houses during an earthquake. A residential seismic retrofit strengthens an existing older house, making it more resistant to earthquake activity. The seismic retrofit involves bolting the house to its foundation and adding bracing around the perimeter of the crawl space. EBB offers eligible Californians a grant of up to $3,000 to help pay for a seismic retrofit.

The 2021 EBB program included 395 ZIP Codes and by end of 2021 had completed more than 16,000 retrofits.

In addition to CEA's mitigation funding, EBB has received $6 million (provided through two appropriations from the State of California) and a $300,000 federal grant (provided through FEMA's Hazard Mitigation Grant Program (HMGP)). CRMP also has applied for numerous additional HMGP grants and has been awarded $24 million in two grants to retrofit up to 8,000 houses statewide. Most recently, CRMP applied for $20 million under the FEMA Building Resilient Infrastructure and Communities (BRIC) grant for multi-family residences.

3. Supplemental Grant Program Development

   CRMP has completed the development of an income-eligible supplementary grant, available to homeowners registered in the 2021 EBB program. As additional funding over and above the EBB $3,000 grant to homeowners, this supplemental grant should cover most of the cost of a retrofit.

All EBB grants funded by anything other than federal dollars are subject to federal income tax. The CEA has been advocating for legislation in Congress for several years to obtain a federal tax exemption for financial incentives given to homeowners by a qualified public entity for the purpose of earthquake loss mitigation.

Research Program Development

- CEA Research Forum

  The 5th Annual Research Forum was held virtually on Monday, September 20 and Tuesday, September 21, 2021. CEA's Annual Research Forum invited subject matter experts across risk and resiliency disciplines to come together and discuss groundbreaking ways to improve the safety and security of our communities. The 2021 forum concentrated on Equitable Residential Earthquake Resilience in California, with the focus on translating research into action.

  As the world transitions out of the COVID-19 pandemic, the CRMP launched a low- income supplemental grant in conjunction with the Earthquake Brace and Bolt program. Recent experience with health science communication and the inequitable impacts of a disaster on vulnerable communities can inform and improve the proposed grant program.

- <u>Modeling Committee and Best Available Science Committee</u>

  The CEA recently formed a Modeling Committee and Best Available Science Subcommittee (BASC) to investigate the hazard models used for rate making. CEA's rates must be "actuarially sound" and must be "established based on the best available scientific information for assessing the risk of earthquake frequency, severity, and loss." (Cal. Ins. Code § 10089.40(a)). While this CEA statute states general principles related to "best available science" that must guide the establishment of CEA's rates, CEA is empowered to exercise sound, objective discretion to evaluate and apply the ever-developing area of earthquake science when establishing rates.

  Utilizing scientific objectivity and operating to further ensure CEA's compliance with the noted requirements of the Insurance Code, the goal of BASC is to assess the current fault, deformation, earthquake-rate, and probability model used to establish CEA earthquake insurance premium rates to inform risk transfer purchasing decisions and make recommendations to the CEA Modeling Committee.

Financial Report

<u>Revenue Bonds</u>

On March 17, 2020, the CEA issued Series 2020A revenue bonds totaling $400,000,000, summarized as follows:

Principal Amount	Interest Rate	Price or Yield	Maturity Date
$ 400,000,000	1.3%	1.3%	July 1, 2020

The CEA made a debt service deposit for the Series 2020A bonds that prefunded principal and interest payments due upon maturity and were invested in Treasury money market funds. The Series 2020A bonds were repaid in July 2020 by pledged revenue, which consisted of pledged policyholder premiums (defined as premiums for basic residential earthquake policies net of participating insurer costs) and interest and other income from investment of funds held by the trustee and debt service deposits. The proceeds of the revenue bonds were deposited in the 2020A claims paying account and the interest earnings helped to offset the interest costs on the 2020A revenue bonds.

On November 24, 2020, the CEA issued Series 2020B revenue bonds totaling $300,000,000, summarized as follows:

Principal Amount	Interest Rate	Price or Yield	Maturity Date
$ 50,000,000	1.127%	1.127%	January 1, 2021
50,000,000	1.227%	1.227%	July 1, 2021
100,000,000	1.327%	1.327%	July 1, 2022
100,000,000	1.477%	1.477%	July 1, 2023

The bonds bear interest from their date of delivery at the rates shown above, payable semiannually on January 1 and July 1, commencing on January 1, 2021. The Series 2020B bonds are not subject to optional redemption prior to maturity and are payable from future pledged policyholder premiums.

The Series 2020B revenue bonds are used to enhance claims paying capacity. The net proceeds from the revenue bonds were deposited into their respective claims paying accounts and were used to purchase investments according to the CEA's investment policy. The proceeds will only be used for future payments of earthquake policyholder claims and related loss adjustment expenses and may not be used to repay principal and interest of the debt. Revenue bond proceeds may be used for payment of claims after the CEA exhausts its capital available for claims and any capacity made available by reinsurance contracts. Repayment of debt does not affect the level of the claims paying account.

On October 28, 2021, the CEA issued Series 2021A revenue bonds totaling $225,000,000, summarized as follows:

Principal Amount	Interest Rate	Price or Yield	Maturity Date
$ 225,000,000	0.2%	0.2%	December 1, 2021

The CEA made a debt service deposit for the Series 2021A bonds that prefunded principal and interest payments due upon maturity and were invested in Treasury money market funds. The Series 2021A bonds were repaid in December 2021 by pledged revenue, which consisted of pledged policyholder premiums (defined as premiums for basic residential earthquake policies net of participating insurer costs) and interest and other income from investment of funds held by the trustee and debt service deposits. The proceeds of the revenue bonds were deposited in the 2021A claims paying account and the interest earnings helped to offset the interest costs on the 2021A revenue bonds.

The table below is the future scheduled debt service payments for the CEA's long-term debt as follows as of December 31, 2021:

Principal Amount	Interest	Total
$ 100,000,000	$ 2,804,000	$ 102,804,000
100,000,000	1,477,000	101,477,000
$ 200,000,000	$ 4,281,000	$ 204,281,000

This schedule includes the mandatory sinking fund payments of $100 million due on July 1, 2022, and July 1, 2023. The sinking fund balance was $51.4 million as of December 31, 2021.

With the issuance of the Series 2020B revenue bonds, the CEA was required to deposit $50,409,158 on November 25, 2020, in a trust account that was used to make the first principal and interest debt service payment on January 1, 2021. Starting on December 15, 2020, the CEA also was required to deposit one twelfth of the annual principal and interest payment by the 15th of each month into a trust account. Such amounts are held in restricted cash, cash equivalents, and investments.

Interest paid during the year for the Series 2020 revenue bonds was $2,159,158.

<u>Financial-Stability Ratings</u>

During 2021, CEA continued to be rated by A. M. Best Co. as “A-Minus (Excellent), with a stable outlook.”

The Outlook statement from A.M. Best is as follows, “The stable outlooks reflect the CEA’s strongest level of risk-adjusted capitalization as measured by BCAR as well as strong operating performance, and the expectation that these trends will continue in the absence of significant earthquake activity.”

Attachment A: California Department of Insurance Summary: 2021 Residential Market Totals

EARTHQUAKE PREMIUM AND POLICY COUNT DATA CALL

SUMMARY OF 2021 RESIDENTIAL TOTALS

2021 Experience Year	Written Premiums Excluding EQ	No. of Policies Excluding EQ	Exposure Excluding EQ	Avg Prem Per Policy Non-EQ	Avg Rate Per $1,000 Insurance Non-EQ	Market Share* Non EQ	Written Premiums EQ	No. of Policies EQ	Exposure EQ Including CEA	Avg Prem Per Policy EQ	Avg Rate Per $1,000 Insurance EQ	Market Share* EQ	% with EQ**
Insurers with EQ coverage provided by California Earthquake Authority (CEA)	$ 9,290,989,382	9,685,685	$ 3,492,102,237,559	$ 959.25	$ 2.66	75.79%	$ 888,267,632	1,111,314	$ 602,049,674,363	$ 799.29	$ 1.48	66.06%	11.47%
Insurers with EQ coverage provided by Non-CEA	2,850,046,499	3,094,046	1,140,425,293,650	921.14	2.50	24.21%	483,380,968	571,029	239,365,677,245	846.51	2.02	33.94%	18.46%
Total Residential Market	$ 12,141,035,881	12,779,731	$ 4,632,527,531,209	$ 950.02	$ 2.62	100.00%	$ 1,371,648,600	1,682,343	$ 841,415,351,608	$ 815.32	$ 1.63	100.00%	13.16%
Total Homeowners Market	$ 9,207,705,288	6,517,445	$ 3,652,773,794,915	$ 1,412.78	$ 2.52	51.00%	$ 1,198,108,979	1,002,566	$ 761,055,967,842	$ 1,195.04	$ 1.57	59.59%	15.38%
Total Renters Market	488,120,485	2,965,279	87,647,686,462	164.61	5.57	23.20%	33,642,827	391,769	13,186,246,137	85.87	2.55	23.29%	13.21%
Total Condominium Market	650,554,727	1,026,766	63,089,786,350	633.60	10.31	8.03%	71,539,601	150,283	20,813,623,445	476.03	3.44	8.93%	14.64%
Total Dwelling Fire Market	1,552,693,740	1,984,514	795,661,010,740	782.41	1.95	15.53%	55,337,009	78,076	37,770,366,529	708.76	1.47	4.64%	3.93%
Total Mobilehome Market	241,961,640	285,727	33,355,252,742	846.83	7.25	2.24%	13,020,185	59,649	8,589,147,656	218.28	1.52	3.55%	20.88%
Total Residential Market	$ 12,141,035,881	12,779,731	$ 4,632,527,531,209	$ 950.02	$ 2.62	100.00%	$ 1,371,648,600	1,682,343	$ 841,415,351,608	$ 815.32	$ 1.63	100.00%	13.16%
California FAIR Plan	$ 485,049,297	226,927	$ 115,529,025,800	$ 2,137.47	$ 4.20	11.43%	$ 4,462,262	4,349	$ 2,773,057,732	$ 1,026.04	$ 1.61	5.57%	1.92%
Total Dwelling Fire (Excluding CA FAIR Plan)	1,067,644,443	1,757,587	680,131,984,940	607.45	1.57	88.57%	50,874,747	73,727	34,997,308,797	690.04	1.45	94.43%	4.19%
Total Dwelling Fire Market	$ 1,552,693,740	1,984,514	$ 795,661,010,740	$ 782.41	$ 1.95	100.00%	$ 55,337,009	78,076	$ 37,770,366,529	$ 708.76	$ 1.47	100.00%	3.93%

* 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 2021:

Balance Sheet
As of December 31, 2021

	2021
Assets and Deferred Outflows of Resources	
Current assets:	
Cash and investments:	
Cash and cash equivalents	$ 189,467,341
Restricted cash and equivalents	62,645,274
Restricted investments	296,354,818
Investments	7,195,685,612
Total cash and investments	7,744,153,045
Premiums receivable, net of allowance for doubtful accounts of $2,140,133	102,347,614
Interest receivable	27,100,071
Prepaid reinsurance premium	95,441,317
Prepaid transformer maintenance premium	3,569,748
Other current assets	4,261,361
Total current assets	7,976,873,156
Noncurrent assets:	
Capital assets, net	49,412
Total assets	7,976,922,568
Deferred Outflows of Resources	
Related to pensions	3,808,169
Total assets and deferred outflows of resources	$ 7,980,730,737
Liabilities and Deferred Inflows of Resources	
Current liabilities:	
Unearned premiums	$ 489,268,568
Accounts payable and accrued expenses	10,320,188
Loss and loss expense reserves	500,000
Compensated absences - current portion	1,268,234
Revenue bond interest payable	1,402,000
Securities payable	6,618,235
Revenue bond payable - current portion	100,000,000
Accrued reinsurance premium expenses	3,869,291
Total current liabilities	613,246,516
Noncurrent liabilities:	
Revenue bond payable - Net of current portion	100,000,000
Net pension liability	13,469,003
Compensated absences	1,268,234
Total liabilities	727,983,753
Deferred Inflows of Resources	
Related to pensions	143,201
Total liabilities and deferred inflows of resources	728,126,954
Net Position	
Net investment in capital assets	49,412
Restricted, expendable	161,849,122
Unrestricted	7,090,705,249
Total net position	7,252,603,783
Total liabilities and deferred inflows of resources, and net position	$ 7,980,730,737

Attachment B: Financial Statement (Continued)
California Earthquake Authority: Annual Financial Report

Statement of Revenues, Expenses, and Changes in Net Position
For the Year Ended December 31, 2021

	2021
Underwriting income:	
Premiums written	$ 917,219,118
Less premiums ceded - reinsurance	(503,027,372)
Net premiums written	414,191,746
Change in unearned premiums	(40,771,661)
Net premiums earned	373,420,085
Operating expenses:	
Loss and loss adjustment expenses	(324,178)
Participating insurer commissions	91,733,499
Participating insurer operating costs	29,424,364
Reinsurance broker commissions	2,800,000
Premium taxes	21,565,248
Other underwriting expenses	46,835,352
Total operating expenses	192,034,285
Underwriting profit	181,385,800
Non-operating income and expenses:	
Net investment income	(70,315,696)
Other income	471,331
Grant revenue	8,553,165
Grant expenses	(8,553,165)
Investment income on bond proceeds, net of related expenses	(3,968,705)
Mitigation Fund expenses	(2,029,473)
State of California premium tax contribution	21,565,248
Total of nonoperating (expense) income	(54,277,295)
Increase in net position	127,108,505
Net position, beginning of year	7,125,495,278
Net position, end of year	$ 7,252,603,783

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 June 30, 2022.

Summary of Claim-Paying Capacity as of June 30, 2022

Available Capital		
		Base
	Cash & Investments	$ 7,627,416,554
	Earthquake Loss Mitigation Fund Cash & Investments	(15,206,016)
	Interest, Securities & Restricted Securities Receivable	28,487,892
	Premiums Receivable	82,675,676
	Other Assets + California Wildfire Fund (AR) + FEMA (AR)	3,662,882
	Revenue Bonds and Restricted Receivables	(1,594,320,379)
	Debt Service (Interest, Principal & Debt Service (Min. Bal.))	(101,482,562)
	Unearned Premium Collected	(344,913,738)
	Accounts & Securities Payable, and Accrued Expenses	(29,948,615)
	Loss Reserve	(273,000)
	GASB 68 Pension Plan	(9,804,035)
	Total Available Capital	**5,646,294,659**
Assessments		
	Available for assessment in 2nd IA Layer	1,663,000,000
Reinsurance		
	Risk Transfer - Available in all layers	9,270,322,560
Bonds		
	Revenue Bond Proceeds	1,594,320,379
Policyholder Surcharges		
	Surcharges assessed	1,000,000,000
	Total Capacity	$ 19,173,937,598