KPMG

CALIFORNIA EARTHQUAKE AUTHORITY

Financial Statements

December 31, 1999 and 1998

(With Independent Auditors' Report Thereon)

KPMG

Three Embarcadero Center
San Francisco, CA 94111

Independent Auditors' Report

The Board of Directors
California Earthquake Authority:

We have audited the accompanying balance sheets of the California Earthquake Authority (the Authority) as of December 31, 1999 and 1998, and the related statements of income, equity and comprehensive income, and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the California Earthquake Authority as of December 31, 1999 and 1998, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in Schedules 1 through 3 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

March 10, 2000

CALIFORNIA EARTHQUAKE AUTHORITY

Balance Sheets

December 31, 1999 and 1998

Assets		1999	1998
Investments and cash:			
Cash and cash equivalents (note 8)	$	546,642,398	418,192,812
Available for sale investment securities, at fair value (amortized cost of $113,193,830 and $33,580,141 at December 31, 1999 and 1998, respectively)		113,203,185	33,507,459
Total investments and cash		659,845,583	451,700,271
Premiums receivable		34,107,872	31,103,313
Assessments receivable		17,001,172	23,781,333
Interest receivable (note 8)		2,988,546	1,343,428
Unearned ceded premiums		148,067,310	164,912,180
Prepaid reinsurance premiums		130,610,872	244,116,815
Prepaid line of credit fees		2,151,500	1,882,382
Reinsurance premiums receivable		80,651,271	997,642
Equipment, net		361,052	313,563
Deferred policy acquisition costs		28,129,807	28,375,622
Other assets		37,247	29,088
Total assets	$	1,103,952,232	948,555,637
Liabilities and Equity			
Unearned premiums, net	$	219,764,114	208,644,270
Claims and claim expense reserves		742,772	—
Reinsurance premiums payable		2,882,995	—
Accounts payable and accrued expenses (note 8)		1,617,784	1,953,661
Accrued liability for estimated policy refunds		—	1,027,610
Total liabilities		225,007,665	211,625,541
Commitments and contingencies (notes 1, 4, 5 and 8)			
Equity:			
Contributed capital		700,028,490	700,028,490
Additional paid-in capital		21,602,438	13,074,350
Mitigation Fund (note 8)		2,624,367	1,723,295
Retained earnings		154,679,917	22,176,643
Accumulated other comprehensive income (loss)		9,355	(72,682)
Total equity		878,944,567	736,930,096
Total liabilities and equity	$	1,103,952,232	948,555,637

See accompanying notes to financial statements.

CALIFORNIA EARTHQUAKE AUTHORITY

Statements of Income

Years ended December 31, 1999 and 1998

	1999	1998
Underwriting income:		
Premiums written	$ 417,507,589	393,874,333
Less premiums ceded – reinsurance	(194,942,098)	(353,547,982)
Net premiums written	222,565,491	40,326,351
Change in unearned premiums	(11,119,844)	29,679,356
Change in unearned premiums ceded – reinsurance	(16,844,870)	18,207,094
Net unearned premiums	(27,964,714)	47,886,450
Policy refunds	—	(21,748,157)
Net premiums earned	194,600,777	66,464,644
Expenses:		
Claims and claim expenses	824,719	235,014
Participating insurer commissions	40,707,276	38,938,367
Participating insurer operating costs	13,945,562	14,006,203
Reinsurance broker commissions	10,850,000	10,850,000
Pro forma premium taxes	8,528,088	9,605,663
Line of credit fees	5,224,720	3,938,588
Policy refund expenses	—	823,192
Other underwriting expenses	9,198,349	6,555,543
Total expenses	89,278,714	84,952,570
Underwriting profit (loss)	105,322,063	(18,487,926)
Net investment income	26,880,760	27,426,238
Supplemental commission income, net	819,785	—
Other income	381,738	309,643
Net income	$ 133,404,346	9,247,955

See accompanying notes to financial statements.

CALIFORNIA EARTHQUAKE AUTHORITY

Statements of Equity and Comprehensive Income

Years ended December 31, 1999 and 1998

		Contributed capital	Additional paid-In capital	Mitigation Fund (note 8)	Retained earnings	Accumulated other comprehensive (loss) income	Total equity
Balances at December 31, 1997	$	700,028,490	3,468,687	—	14,651,983	(9,288)	718,139,872
Comprehensive income:							
Net income		—	—	—	9,247,955	—	9,247,955
Other comprehensive loss:							
Unrealized holding losses arising during the year		—	—	—	—	(63,394)	(63,394)
Comprehensive income							9,184,561
Contribution to the Mitigation Fund		—	—	1,882,872	(1,882,872)	—	—
Allocations of Mitigation Fund costs		—	—	(159,577)	159,577	—	—
State of California premium tax contribution		—	9,605,663	—	—	—	9,605,663
Balances at December 31, 1998		700,028,490	13,074,350	1,723,295	22,176,643	(72,682)	736,930,096
Comprehensive income:							
Net income		—	—	—	133,404,346	—	133,404,346
Other comprehensive income:							
Unrealized holding gains arising during the year		—	—	—	—	82,037	82,037
Comprehensive income							133,486,383
Contribution to the Mitigation Fund		—	—	1,214,130	(1,214,130)	—	—
Allocations of Mitigation Fund costs		—	—	(313,058)	313,058	—	—
State of California premium tax contribution		—	8,528,088	—	—	—	8,528,088
Balances at December 31, 1999	$	700,028,490	21,602,438	2,624,367	154,679,917	9,355	878,944,567

See accompanying notes to financial statements.

CALIFORNIA EARTHQUAKE AUTHORITY

Statements of Cash Flows

Years ended December 31, 1999 and 1998

		1999	1998
Cash flows from operating activities:			
Net income	$	133,404,346	9,247,955
Adjustment to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and accretion		(734,193)	(2,405,247)
Pro forma premium tax expense		8,528,088	9,605,663
Gain on sales of investment securities		—	(1,180)
Loss on disposal of equipment		853	8,837
Changes in operating assets and liabilities:			
Premiums receivable		(3,004,559)	(1,594,170)
Interest receivable		(1,645,118)	(346,503)
Unearned ceded premiums		16,844,870	(18,207,094)
Prepaid reinsurance premiums		113,505,943	(111,972,245)
Prepaid line of credit fees		(269,118)	1,230,505
Reinsurance premiums receivable		(79,653,629)	(997,642)
Deferred policy acquisition costs		245,815	4,086,893
Other assets		(8,159)	(8,444)
Unearned premiums, net		11,119,844	(7,931,201)
Reinsurance premiums payable		2,882,995	(15,536,857)
Claims and claim expense reserves		742,772	—
Accounts payable and accrued expenses		(335,877)	965,078
Accrued liability for estimated policy refunds		(1,027,610)	(37,154,880)
Net cash provided by (used in) operating activities		200,597,263	(171,010,532)
Cash flows from investing activities:			
Proceeds from maturities of available for sale investment securities		546,082,959	826,553,935
Proceeds from sales of available for sale investment securities		—	4,544,627
Purchases of available for sale investment securities		(624,784,070)	(795,920,970)
Purchases of equipment		(226,727)	(102,952)
Net cash (used in) provided by investing activities		(78,927,838)	35,074,640
Cash flows provided by financing activities – assessments received from participating insurers		6,780,161	44,292,801
Net increase (decrease) in cash and cash equivalents		128,449,586	(91,643,091)
Cash and cash equivalents, beginning of period		418,192,812	509,835,903
Cash and cash equivalents, end of period	$	546,642,398	418,192,812

See accompanying notes to financial statements.

(1) Organization and Summary of Significant Accounting Policies

(a) Organization

The California Earthquake Authority (CEA) is a privately financed, publicly managed authority that provides insurance coverage for earthquake damage to residential property owners, condominium owners, mobile homeowners and renters in the State of California. Effective July 1, 1999, the CEA also provides supplemental insurance coverage for earthquake damage.

In September 1996, legislation to create the CEA was approved by the California State Legislature. On November 26, 1996, the State of California Insurance Commissioner certified that all statutory conditions necessary for the CEA to become operational had been met, and the CEA began writing earthquake policies on December 1, 1996.

The CEA is overseen by a 3-member governing board consisting of designees of the Governor, the Treasurer, and the Insurance Commissioner. Designees of the Speaker of the Assembly and the Chairperson of the Senate Rules Committee serve on the governing board as nonvoting members. The governing board is advised by an 11-member advisory panel, consisting of consumer and insurance industry representatives.

CEA policies are sold to policyholders by participating insurance carriers of the CEA. Insurance companies admitted to write residential property insurance in California and who elected to become participating members of the CEA signed Insurer Participation Agreements with the CEA. Under these agreements, participating insurers act as independent contractor agents on behalf of the CEA by performing policy and claims services which include underwriting, policy issuance, premium collection, and claims adjustment.

Under the agreements, the CEA reimburses participating insurers for non-claims related operating costs incurred by these companies in servicing CEA policies. The operating cost reimbursement is equal to 3.65% of premiums written for CEA policies for the period from inception through April 30, 1999 and 2.80% of premiums written for the period from May 1, 1999 through December 31, 1999. Additionally, participating insurers receive reimbursement for expenses associated with servicing CEA claims equal to 9% of the paid claim, as well as a producer commission equal to 10% of premiums written for CEA policies. As of December 31, 1999, there were 15 participating insurance carriers of the CEA, who have commenced writing CEA policies.

(b) Basis of Presentation

The accompanying financial statements are prepared on the accrual basis of accounting in accordance with generally accepted accounting principles. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenue and expenses for the period, as well as the disclosure of contingent assets and liabilities. Actual results could differ from those estimates applied in the preparation of the accompanying financial statements.

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(c) ***Revenue Recognition***

The CEA's premium rates are required to be actuarially sound and are based on the modeling of potential loss scenarios due to a major earthquake event. Premiums are recognized as earned on a pro rata basis over the contract period. Unearned premiums represent amounts collected which relate to coverage in future periods.

Premiums paid or accrued by the CEA under reinsurance agreements, net of estimated return premiums, are accounted for as a reduction in the related premium revenue earned and are amortized over the remaining contract period in proportion to the amount of insurance protection provided.

(d) ***Cash and Cash Equivalents***

For purposes of the statement of cash flows, the CEA considers investments in certificates of deposits, U.S. government money market accounts, banker's acceptances, repurchase agreements and commercial paper with original maturities of three months or less, to be cash equivalents. In order to reduce counterparty exposure, the CEA maintains collateral of generally 105% on repurchase agreements.

(e) ***Investments***

The CEA accounts for investments in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. All of the CEA's investments are classified as available-for-sale securities and are carried at fair value with the corresponding unrealized gains and losses excluded from earnings and reported in other comprehensive income. Declines in market value considered to be other than temporary are charged to realized losses. Net realized investment gains and losses on sales of investments are reported in the statements of income based on the specific identification method.

(f) ***Deferred Policy Acquisition Costs***

Acquisition costs, consisting of participating insurer commissions and operating costs, are deferred and amortized ratably over the terms of the underlying policies. Deferred acquisition costs are limited to the estimated realizable value of such costs. The determination of estimated realizable value gives effect to the premium to be earned, losses and loss adjustment expenses incurred, investment income to be earned, and certain other costs expected to be incurred as the premium is earned.

(g) ***Claims and Claim Expense Reserves***

Reserves for insurance claims and claim adjustment expenses include the accumulation of case estimates for claims reported, claims incurred but not reported, and estimates of expenses for investigating and adjusting all incurred claims. The reserve is established at a level that management estimates to be sufficient to satisfy those claims. Estimations are revised as more information becomes available.

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(h) Reinsurance

The CEA applies SFAS No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* to its reinsurance contracts. This statement establishes the conditions required for a contract with a reinsurer to be accounted for as reinsurance and prescribes accounting and reporting standards for those contracts. It also requires reinsurance receivables (including amounts related to losses incurred but not reported) and prepaid reinsurance premiums to be reported as assets. Estimated reinsurance receivables are recognized in a manner consistent with the liabilities relating to the underlying reinsured contracts.

(i) Participating Insurer Capital Contributions

Each insurer that elected to participate in the CEA during its first year of operations was required to contribute as its share of the CEA's initial operating capital, an amount equal to $1,000,000,000 multiplied by the percentage representing that insurer's residential earthquake insurance market share as of January 1, 1994. Participating insurers retained the risk of earthquake losses on individual earthquake policies until the polices were renewed into the CEA. Participating insurers were given the option to pay capital contribution assessments in 12 or 60 monthly installments, depending on their residential property insurance market share percentage. Installments are payable on the first day of each successive calendar month after the insurer begins to transfer risk of earthquake losses on individual earthquake polices to the CEA. In the event of a major earthquake and if the CEA's available funds are inadequate to meet claims liabilities, the entire amount of capital contributions will become due and payable within 30 days after notification by the CEA.

Insurers that elect to participate in the CEA after December 1, 1996 are required to make an initial capital contribution calculated using their residential earthquake insurance market share as of January 1, 1994, or the latest date for which such market share information is available to the CEA, whichever contribution amount is greater.

A minimum of $700,000,000 in capital commitments was required in order for the CEA to become operational. As of December 31, 1999 and 1998, participating insurer capital contributions totaled $700,028,490, of which $17,001,172 and $23,781,333 were unfunded and are classified as assessments receivable in the accompanying financial statements as of December 31, 1999 and 1998, respectively.

(j) Equipment

Equipment is stated at cost less accumulated depreciation of $431,028 and $257,930 as of December 31, 1999 and 1998, respectively. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets. Amortization of leasehold improvements is calculated using the straight-line method over the lives of the related assets, not to exceed the lease term. Maintenance and repairs are charged against income.

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(k) ***Income taxes***

In a private letter ruling dated November 8, 1996, the Internal Revenue Service determined the CEA to be an integral part of the State of California for federal income tax purposes. As such, the CEA is exempt from federal income tax.

(l) ***State of California Premium Tax Contribution***

For California tax purposes, California Insurance Code Section 10089.44 provides that "premiums collected by the CEA shall be exempt from collection of the state's insurance premium tax, and the amount of tax foregone by the state shall be considered for all purposes, a contribution by the state and its citizens to the capital and operating revenues of the CEA." As a result, an amount equivalent to the 2.35% California premium tax is included in the premium rate base for CEA policies collected from policyholders. As premiums are earned, the associated premium tax equivalent is recorded as pro forma premium tax expense and as a capital contribution from the State of California.

(m) ***Reclassifications***

Certain reclassifications have been made to prior period balances to conform to current year classifications.

(2) Investments and Fair Value of Financial Instruments

Interest income for the years ended December 31, 1999 and 1998 was as follows:

	1999	1998
Certificates of deposit	$ 5,590,871	5,947,951
U.S. agency securities and government money market accounts	1,578,071	885,586
Repurchase agreements	10,445,130	11,612,634
Corporate bonds	1,396,351	—
Other short-term investments	8,545,360	9,421,034
Interest income	27,555,783	27,867,205
Less investment expenses	(675,023)	(440,967)
Net investment income	$ 26,880,760	27,426,238

The amortized cost and estimated fair values of available for sale investment securities as of December 31 are as follows:

		Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
1999:					
U.S. Agency securities	$	44,551,374	1,597	(19)	44,552,952
Corporate bonds		53,656,809	7,777	—	53,664,586
Certificates of deposit		11,996,766	—	—	11,996,766
Bankers' acceptances		2,988,881	—	—	2,988,881
Total available for sale investment securities	$	113,193,830	9,374	(19)	113,203,185
1998:					
U.S. Agency securities	$	33,580,141	—	(72,682)	33,507,459
Total available for sale investment securities	$	33,580,141	—	(72,682)	33,507,459

All of the U.S. agency securities are due, by contractual maturity, within one year or less. Fair values for U.S. agency securities are based on quoted market prices.

Proceeds from maturities of available for sale U.S. agency securities during the years ended December 31, 1999 and 1998 were $546,082,959 and $826,553,935, respectively. Proceeds from sales of available for sale securities during 1999 and 1998 were $0 and $4,544,627, respectively. Gross gains of $0 and $1,180, respectively, were realized on those sales and are included in net investment income in the accompanying statements of income.

The fair value of assessments receivable from participating insurers as of December 31, 1999 and 1998, of $16,574,560 and $22,568,137, respectively, is determined as the discounted value of expected future cash flows. The discount rate is estimated using rates currently offered on notes with similar characteristics. The recorded value of other receivables and payables which are financial instruments approximates fair value due to the short-term nature of these assets and liabilities.

(3) Line of Credit

The CEA has available up to $716,810,000 of loans and/or letters of credit through a committed catastrophe contract entered into on July 1, 1999 with a consortium of insurance and reinsurance companies. Available borrowings under this contract will be provided if claims paid by the CEA following an earthquake exhaust the total of the CEA's available capital, the maximum amount of all participating insurer capital contributions and the first aggregate level of reinsurance available and under contract to the CEA.

These borrowings were previously available under a credit agreement with a consortium of banks administered by Chase Manhattan Bank. The CEA capitalized expenses relating to the arrangement of the line of credit, which it amortized over the three-year term of the agreement.

Prepaid line of credit fees are $2,151,500 and $1,882,382 as of December 31, 1999 and 1998, respectively. The total amount of expense associated with the committed catastrophe contract and credit agreement, including arrangement, commitment, and administrative fees, was $5,224,720 and $3,938,588 during the years ended December 31, 1999 and 1998, respectively. There were no amounts outstanding under these arrangements as of December 31, 1999 and 1998.

(4) Reinsurance

The CEA cedes insurance to reinsurers under two catastrophe excess of loss reinsurance contracts and a supplemental policy reinsurance contract, for purposes of limiting its maximum exposure on any one loss. All contracts provide coverage for losses as well as allocated loss adjustment expenses. Although the ceding of insurance does not discharge the CEA from its primary responsibility to its policyholders, the insurance company that assumes the coverage assumes responsibility to reimburse the CEA for the related liability. Management believes that its reinsurers are and will continue to be able to satisfy their obligations under the reinsurance agreements. No losses have been ceded under these contracts as of December 31, 1999.

The first aggregate excess reinsurance contract expired on December 31, 1998 and was extended for three years to expire on December 31, 2001. The contract provides coverage of a maximum of $1.434 billion in excess of the CEA's claims paying ability, representing $2 billion multiplied by the total residential property insurance market share of CEA's participating insurers of 71.681%. Additionally, effective January 1, 1999, a reinstatement provision allows an additional limit of liability equal to the amount of reinsurance exhausted, subject to an aggregate maximum limit of $1.434 billion.

The second aggregate excess reinsurance contract is a four-year contract, expiring March 31, 2001. The contract provides maximum coverage of $1.075 billion, equal to $1.5 billion multiplied by the total residential property insurance market share of CEA's participating insurers of 71.681%.

The CEA also entered into a supplemental policy quota share reinsurance contract effective July 1, 1999, expiring on June 30, 2002. Under the terms of this contract, the CEA cedes 100% of its gross liability under supplemental insurance policies to the reinsurer, in return for ceding 100% of premiums written on this business. The reinsurer allows the CEA a 20% commission on all premiums ceded.

The first aggregate excess reinsurance contract requires the CEA to pay minimum premiums of $397,308,200 payable in installments over the three-year life of the contract. The minimum payments remaining under this contract as of December 31, 1999 are $239,610,000. There were no minimum payments remaining under the second aggregate excess reinsurance contract as of December 31, 1999.

Effective January 1, 1999, the first aggregate excess reinsurance contract allows for an adjustment of premium, based on the average aggregate insurance in force (AAIIF) and the exposure adjustment limit (EAL), as defined in the contract. The EAL is $203.6 billion in 1999 and $178.8 billion for 2000 and 2001. If the AAIIF is less than 90% of the EAL, the CEA will receive a return premium equal to the percentage point difference between the AAIIF and 90% of the EAL, multiplied by the original ceded premium for that

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year and subject to a maximum return premium of 10% of the ceded premium. If the AAIIF is more than 110% of the EAL, the CEA will pay an additional premium equal to the percentage point difference between the AAIIF and 110% of the EAL, multiplied by the original ceded premium for that year and subject to a maximum additional premium of 10% of the ceded premium. Additionally, the reinsurance contract was amended in 1999 to provide for a 'no claims bonus' for 1997, 1998 and 1999. Since the reinsurer sustained no loss under the contract as a result of loss occurrences commencing on or before December 31, 1999, the CEA was entitled to additional return premiums representing a 'no claims bonus' for 1997, 1998 and 1999, equal to 12.5% of the total reinsurance premium ceded for those years.

For the year ended December 31, 1999, in accordance with these terms, the CEA was entitled to an amount of $81,858,610 in return premiums, which is netted against premiums ceded (reinsurance) in the statements of income and $80,651,271 of which is included in the balance sheets as receivable as of December 31, 1999.

(5) Commitments and Contingencies

(a) Operating Lease

As of December 31, 1999, the CEA occupied office space under an operating lease which extends to the year 2001; however this lease has a provision for early termination. The future minimum lease payments under the operating lease as of December 31, 1999 are as follows:

Years ending December 31:		
2000	$	184,728
2001		146,243
	$	330,971

Rental expense of approximately $204,000 and $185,000 for the years ended December 31, 1999 and 1998, respectively, have been charged to operations in the accompanying statements of income.

(b) Rate Hearing

The CEA is involved in various lawsuits and claims, which include the Matter of the Rate Hearing of the CEA, and Economic Empowerment Foundation vs. California Department of Insurance and the California Insurance Commissioner; CEA, Real Party in Interest. The CEA filed its rate application in November 1996, in anticipation of its beginning to sell policies on December 1, 1996. Although interim approval of the rates in the application was granted by the Insurance Commissioner, the application was subsequently contested by several intervenor groups. As a result of the intervention, the Department of Insurance (DOI) commenced a hearing on the CEA's rate application before an Administrative Law Judge in May 1997.

During the course of the hearing, the CEA voluntarily amended its rate application to reduce the contested rates by approximately 11.5%, effective November 1, 1997. The Commissioner approved the amended rate application in December 1998.

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In 1998, the CEA paid refunds of $33,717,465 and received refunds of participating insurer commissions and operating costs of $4,107,311. As of December 31, 1998, $1,027,610 remained unpaid and was recorded as an accrued liability in the accompanying balance sheets. This amount was paid during 1999.

Costs associated with the rate hearing, which include attorney fees, witness fees, and intervenor fees, were $34,749 and $1,236,021 for the years ended December 31, 1999 and 1998, respectively. These costs are included in other underwriting expenses in the accompanying financial statements.

(6) Statutory Compliance

The State of California Insurance Code limits CEA's "operating expenses" to 3% of its "premium income." In calculating this limitation, the CEA has determined that its premium income is its reported gross premium income and that its operating expenses do not include certain start-up expenses and certain credits and payments, including payments to reinsurers, payments to investment managers and advisors, payments to participating insurers, or payment of agent commissions. Operating expenses, as determined by the CEA, for the years ended December 31, 1999 and 1998, totaled $9,321,951 and $10,306,369, respectively and did not exceed 3% of premium income.

(7) Employee Benefit Plans

The CEA's civil service employees are eligible for benefits under the State of California's First-Tier and Second-Tier retirement plans. Both plans are managed by the California Public Employees' Retirement System. Under the First-Tier plan, both the participant and the State of California make contributions, whereas benefits under the Second-Tier plan are funded entirely by the State of California. The CEA is responsible for reimbursing the State of California for the costs associated with providing benefits to its civil service employees. The CEA incurred expenses associated with these plans of approximately $46,027 and $79,235 during the years ended December 31, 1999 and 1998, respectively.

Officers of the CEA are eligible for benefits under the CEA Retirement Plan, a defined contribution plan designed to comply with all applicable tax qualification requirements. Discretionary contributions to the plan are made semi-annually and participants are fully vested in their individual participant accounts. Contributions to the CEA Retirement Plan were $64,653 and $70,337 for the years ended December 31, 1999 and 1998, respectively.

Officers of the CEA are also eligible for benefits under the CEA Deferred Compensation Plan, an eligible deferred compensation plan as defined in section 457(b) of the Internal Revenue Code of 1986. The plan allows officers of the CEA to defer portions of their annual compensation. Officers' compensation deferred under the CEA Deferred Compensation Plan was $15,625 and $28,300 as of December 31, 1999 and 1998, respectively.

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(8) Mitigation Fund

California Insurance Code Section 10089.37 creates the Earthquake Loss Mitigation Fund (Mitigation Fund) as a subaccount of the CEA. By statute, the Mitigation Fund must be used solely for the establishment and operation of the mitigation program. In compliance with statutory requirements, the CEA's actuary has opined that the setting aside of these monies into the Mitigation Fund does not impair the actuarial soundness of the CEA. The transfer and setting aside of those monies into the Mitigation Fund subaccount have been formally approved by the CEA governing board. It is the opinion of the general counsel of the CEA and of the CEA's outside counsel that the monies that are resident in the Mitigation Fund subaccount within the CEA are by statute not available to pay policyholder or other claims against the CEA. Accordingly, equity related to the Mitigation Fund has been segregated in the accompanying balance sheets and statements of equity.

As of December 31, 1999 and 1998, respectively, the balance sheets of the CEA include the following amounts related to the Mitigation Fund:

		1999	1998
Cash and cash equivalents	$	2,824,217	1,801,692
Interest receivable		—	3,421
Accounts payable		(199,850)	(81,818)
	$	2,624,367	1,723,295

(9) Proposed Legislation (Unaudited)

Three bills were introduced in the California Legislature in 1999 that, if enacted, could have some impact on the CEA, though no impact should rise to the level of a material effect. Of the three bills, only one has made its way through the full legislative process and become law; the other two remain pending in the second year of the current legislative session.

(a) AB 964 (Aroner)

Passed by the Legislature and signed by the Governor, this bill became law on January 1, 2000. It directly affects the CEA in two respects:

1. First, the legislation provides that (in effect) a particular earthquake-only insurer related to a CEA member company is not required to join the CEA. The CEA did not expect that entity to join, so little impact, if any, is anticipated.
2. Second, the legislation requires the CEA to draw up a plan by July 1, 2000 for the Earthquake Loss Mitigation Fund to go statewide on an expedited basis and then to report to the Legislature on mitigation status. Until the mitigation efforts are actually extended statewide, however, little impact on the CEA is anticipated.

(b) SB 622 (Speier)

(SB 622 remains pending though inactive.)

The CEA policy and the California statutory fire policy require that any action on the policy be brought within a year after the inception of the loss. SB 622 provides that the inception of loss in an earthquake policy does not occur until appreciable damage occurs which is or should be known to the insured. The bill was approved by the Senate and by the Assembly Insurance Committee but did not come to a vote in the Assembly. It was placed in the inactive file and could be revived during the 2000 Legislative year.

In its latest version, the bill should have no fiscal effect on the CEA, because in the CEA's view, the bill largely codifies existing law.

(c) AB 481 (Scott)

(AB 481 remains pending on re-referral to the Senate Insurance Committee.)

Present law requires residential property insurers to offer earthquake coverage to their policyholders when they buy a homeowners policy and every two years thereafter, on renewal. AB 481 originally provided that insurers would be permitted (but would not be required) to offer earthquake insurance to their policyholders at any time.

The bill did not become law in 1999, and it has been amended this year. In its present form this bill (along with a separate Senate bill with similar provisions) would permit a residential policyholder to request earthquake insurance at any time. Most CEA participating insurers already permit their policyholders to request earthquake insurance at any time. If passed in its present form, this bill may result in slightly increased sales of CEA policies.

Schedule 1

CALIFORNIA EARTHQUAKE AUTHORITY

Schedule of Participating Insurer Assessments

	December 31, 1999	
	Assessment	Assessment receivable
Allstate Insurance Company	$ 145,612,517	—
Farmers Insurance Company	143,280,000	—
State Farm Insurance Company	249,188,275	—
United Services Automobile Association	58,992,512	—
Liberty Mutual Insurance Company	6,812,984	2,952,293
California Fair Plan	15,029,487	—
California State Automobile Association	39,013,493	—
GuideOne (formerly Preferred Risk)	123,133	55,410
Automobile Insurance Exchange of Southern California	14,443,651	—
Armed Forces	783,685	352,658
CNA/Continental	13,924,609	6,266,073
Prudential Insurance Company	11,531,456	6,534,491
Mercury Insurance Company	1,292,688	840,247
Total	$ 700,028,490	17,001,172

	December 31, 1998	
	Assessment	Assessment receivable
Allstate Insurance Company	$ 145,612,517	—
Farmers Insurance Company	143,280,000	—
State Farm Insurance Company	249,188,275	—
United Services Automobile Association	58,992,512	—
Liberty Mutual Insurance Company	6,812,984	4,201,340
California Fair Plan	15,029,487	—
California State Automobile Association	39,013,493	—
Preferred Risk	123,133	80,036
Automobile Insurance Exchange of Southern California	14,443,651	—
Armed Forces	783,685	509,395
CNA/Continental	13,924,609	9,050,995
Prudential Insurance Company	11,531,456	8,840,782
Mercury Insurance Company	1,292,688	1,098,785
Total	$ 700,028,490	23,781,333

See accompanying independent auditors' report.

Schedule 2

CALIFORNIA EARTHQUAKE AUTHORITY

Schedule of Participating Insurer Premiums Written and Unearned

	Year ended December 31, 1999 Premiums written	Year ended December 31, 1999 Unearned premiums
Allstate Insurance Company	$ 89,959,942	56,607,581
Farmers Insurance Company	73,953,558	35,304,855
State Farm Insurance Company	147,248,779	73,837,219
United Services Automobile Association	48,030,374	24,386,835
Liberty Mutual Insurance Company	5,515,732	2,783,766
California Fair Plan	10,483,980	4,911,793
California State Automobile Association	10,986,343	5,415,219
GuideOne (formerly Preferred Risk)	29,315	12,613
Automobile Insurance Exchange of Southern California	18,823,642	9,706,079
Armed Forces	684,700	352,183
CNA/Continental	4,991,060	2,918,302
Prudential Insurance Company	4,917,372	2,538,268
Mercury Insurance Company	1,509,032	778,573
Merastar (affiliated with Prudential Insurance Company)	40	31
Golden Eagle (affiliated with Liberty Mutual Insurance Company)	373,720	210,797
Total	$ 417,507,589	219,764,114

	Year ended December 31, 1998 Premiums written	Year ended December 31, 1998 Unearned premiums
Allstate Insurance Company	$ 83,027,008	57,060,962
Farmers Insurance Company	70,321,318	34,114,266
State Farm Insurance Company	136,655,369	66,765,850
United Services Automobile Association	46,829,830	23,338,134
Liberty Mutual Insurance Company	5,616,773	2,659,624
California Fair Plan	13,443,419	5,635,762
California State Automobile Association	10,530,258	4,952,811
Preferred Risk	29,383	12,634
Automobile Insurance Exchange of Southern California	16,135,444	7,981,949
Armed Forces	690,008	334,801
CNA/Continental	4,234,087	2,590,762
Prudential Insurance Company	5,646,966	2,717,575
Mercury Insurance Company	714,470	479,140
Total	$ 393,874,333	208,644,270

See accompanying independent auditors' report.

Schedule 3

CALIFORNIA EARTHQUAKE AUTHORITY

Schedule of Participating Insurer Commissions and Operating Costs

	Year ended December 31, 1999	
	Commissions	Operating costs
Allstate Insurance Company	$ 9,052,905	3,106,196
Farmers Insurance Company	7,289,043	2,513,520
State Farm Insurance Company	14,047,909	4,785,652
United Services Automobile Association	4,704,786	1,614,864
Liberty Mutual Insurance Company	540,219	186,375
California Fair Plan	1,121,700	386,711
California State Automobile Association	1,053,495	362,941
GuideOne (formerly Preferred Risk)	2,936	1,027
Automobile Insurance Exchange of Southern California	1,712,367	583,724
Armed Forces	66,796	22,848
CNA/Continental	466,844	160,747
Prudential Insurance Company	510,674	175,142
Mercury Insurance Company	121,265	40,931
Merastar (affiliated with Prudential Insurance Company)	1	—
Golden Eagle (affiliated with Liberty Mutual Insurance Company)	16,336	4,884
Total	$ 40,707,276	13,945,562

	Year ended December 31, 1998	
	Commissions	Operating costs
Allstate Insurance Company	$ 8,908,535	3,205,782
Farmers Insurance Company	7,149,282	2,573,168
State Farm Insurance Company	13,310,211	4,789,285
United Services Automobile Association	4,396,928	1,577,779
Liberty Mutual Insurance Company	526,028	189,258
California Fair Plan	1,302,902	469,140
California State Automobile Association	1,078,071	388,192
Preferred Risk	3,075	1,116
Automobile Insurance Exchange of Southern California	1,451,913	520,728
Armed Forces	74,184	26,750
CNA/Continental	367,530	132,237
Prudential Insurance Company	346,010	124,285
Mercury Insurance Company	23,698	8,483
Total	$ 38,938,367	14,006,203

See accompanying independent auditors' report.