

**CALIFORNIA EARTHQUAKE AUTHORITY**

Financial Statements  
December 31, 2010 and 2009

*With Independent Auditors' Report Thereon*

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## Independent Auditors' Report

To the Governing Board  
California Earthquake Authority

We have audited the accompanying balance sheets of the California Earthquake Authority (CEA) as of December 31, 2010 and 2009, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the CEA'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 in the United States of America. Those standards require that we plan and perform the audits 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.

As more fully described in Note 2 to the financial statements, pro forma premium tax in the amount of \$11.4 million and the corresponding contribution by the State of California in the amount of \$11.4 million were recognized in the financial statements for the year ended December 31, 2009 due to a correction of an error in the premium tax calculation related to the prior periods since the CEA's inception in 1997 through 2008. In our opinion, the cumulative effect of this correction to premium tax and the corresponding contribution should have been recognized in periods prior to 2009 to conform with generally accepted accounting principles in the United States of America. The cumulative effect of this correction from inception has a material impact on the 2009 financial statements, though in the judgment of management, the annual impact of this correction was not material to any of the separate financial statements back to inception.

In our opinion, except for the effects on the 2009 statements of revenues, expenses, and changes in net assets of the matter discussed in the preceding paragraph, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the California Earthquake Authority as of December 31, 2010 and 2009, and the changes in its financial position and cash flows for the years then ended in conformity with generally accepted accounting principles in the United States of America.

Management's Discussion and Analysis, on pages 3 to 9, is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedules of participating insurer capital contributions, participating insurer premiums written, participating insurer unearned premiums, participating insurer commissions and participating insurer operating costs, on pages 25 to 29, are presented for purposes of additional analysis and are 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.

*Larson & Rosenberger LLP*

Glendale, California  
August 17, 2011

# CALIFORNIA EARTHQUAKE AUTHORITY

## Management's Discussion and Analysis

### History and Financing

This discussion provides an assessment by management of the financial position, revenues, expenses, changes in net assets, cash flows and liquidity of the California Earthquake Authority (CEA). Readers are encouraged to consider the information presented in conjunction with the financial statements as a whole, which follow Management's Discussion and Analysis.

Following the unprecedented losses from the 1994 Northridge earthquake, many insurance companies either stopped or severely restricted selling new homeowners' insurance policies in California. The insurer response was largely due to state law that requires insurers to offer earthquake insurance when selling or renewing residential property insurance.

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 three member Governing Board consisting of the Governor, the Treasurer, and the Insurance Commissioner or their designees. The Speaker of the Assembly and the Chairperson of the Senate Rules Committee or their designees serve on the Governing Board as nonvoting members. The Governing Board establishes premium rates, subject to the prior approval of the Insurance Commissioner. The Governing Board is advised by an 11 member advisory panel, consisting of members of the public, consumers and insurance industry representatives.

The CEA uses its capital (net assets) to leverage approximately \$9.840 billion in claims-paying capacity at December 31, 2010. The CEA's claims-paying capacity is determined from the CEA's net assets, reinsurance coverage, available letters of credit, debt, and post event prospective participating insurance company assessments. The CEA derives its capital from participating insurer capital contributions and from increases in net assets generated from the sale of earthquake insurance policies. The CEA is exempt from federal income tax and from state insurance-premium tax. California Insurance Code section 10089.44 provides, in pertinent part, that "... premiums collected by the authority 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 authority."

The CEA has approximately 811,317 policyholders at December 31, 2010, most of whom insure single-family dwellings through the CEA. The CEA offers a base residential earthquake policy to homeowners, which includes coverage for the insured dwelling and limited coverage for contents and loss-of-use if the residence is uninhabitable due to an earthquake. The CEA also offers policies to condominium unit owners and renters. For an additional premium, CEA policyholders can significantly increase insured limits on contents and for loss of use, and homeowners can lower their CEA policy deductible from 15 percent to 10 percent.

By law, the CEA staff is limited to 25 employees who are subject to civil service provisions and contract employees. Because of its limited staff size, the CEA uses an extensive network of contract vendors to perform functions on behalf of the CEA.

# CALIFORNIA EARTHQUAKE AUTHORITY

## Management's Discussion and Analysis (Continued)

### Using the Report

While the CEA is an instrumentality of the state, the State of California's General Fund is not liable for CEA claims, losses, or other liabilities. However, the CEA meets the definition of a governmental organization, as defined by accounting principles generally accepted in the United States of America. The CEA's financial statements for the years ended December 31, 2010 and 2009 have been prepared using accounting standards applicable to governmental entities. This financial report consists of three financial statements with accompanying notes. The balance sheets, prepared on the accrual basis of accounting, include all assets, liabilities and net assets of the CEA. The statements of revenues, expenses, and changes in net assets, also prepared on the accrual basis, take into account all revenues and expenses for the CEA regardless of when cash is received or paid. The statements of cash flows reflect the actual cash receipts and disbursements for a specified period of time.

### Condensed Balance Sheets

The CEA's assets, liabilities and net assets as of December 31 are summarized as follows:

	2010	2009	2008
<b>Assets</b>			
Cash and investments	\$ 4,273,041,274	\$ 4,002,726,319	\$ 3,647,869,259
Premium receivable, net	49,595,737	52,838,052	73,323,947
Unearned ceded premiums	-	-	28,016,192
Deferred policy acquisition costs	40,674,396	40,154,994	41,235,858
Other assets	18,697,215	22,519,031	69,942,077
Total assets	<u>\$ 4,382,008,622</u>	<u>\$ 4,118,238,396</u>	<u>\$ 3,860,387,333</u>
<b>Liabilities and Net Assets</b>			
Unearned premiums	\$ 302,862,221	\$ 298,994,745	\$ 303,428,212
Revenue bonds payable	189,000,000	220,500,000	252,000,000
Other liabilities	8,207,794	8,503,359	9,609,054
Total liabilities	<u>500,070,015</u>	<u>527,998,104</u>	<u>565,037,266</u>
Net assets:			
Restricted, expendable	168,559,583	133,264,871	97,780,077
Unrestricted	3,713,379,024	3,456,975,421	3,197,569,990
Total net assets	<u>3,881,938,607</u>	<u>3,590,240,292</u>	<u>3,295,350,067</u>
Total liabilities and net assets	<u>\$ 4,382,008,622</u>	<u>\$ 4,118,238,396</u>	<u>\$ 3,860,387,333</u>

# CALIFORNIA EARTHQUAKE AUTHORITY

## Management's Discussion and Analysis (Continued)

### Condensed Balance Sheets (Continued)

#### *Assets*

Total assets grew \$263.8 million (6%) in 2010 and \$257.9 million (7%) in 2009. The 2010 and 2009 increases were primarily due to an increase in net assets of \$291.7 million and \$294.9 million, respectively. Cash and investments grew \$270.3 million (7%) and \$354.9 million (10%), in 2010 and 2009, respectively. Investments are managed by external managers under the guidance of the CEA. U.S. Treasuries, short-term investments and cash-equivalent securities comprise 100% of the CEA's investment portfolio.

Premium receivable balances decreased \$3.2 million (-6%) and decreased \$20.5 million (-27.9%) in 2010 and 2009, respectively. The 2010 decrease in premium receivables was due to the normalization of this balance as compared to 2009. The 2009 decrease in premium receivables was due to the normalization of this balance as compared to 2008 which was due to the new data system. The CEA does not anticipate any unusual collection problems with respect to outstanding premium balances.

The CEA does not have a prepaid reinsurance premium payable for 2010 since all reinsurance contracts expired on December 31, 2010 and all reinsurance premiums were earned as of the contract expiration.

Deferred policy acquisition costs, consisting of unearned participating insurer commissions and operating costs, are deferred and amortized ratably over the terms of the underlying policies. Deferred policy acquisition costs increased \$0.5 million (1%) in 2010 that correspond with the increase in policies that were not effective at the end of 2010. Deferred policy acquisition costs only decreased \$1.1 million (-2.6%) during 2009 that correspond with the decrease in policies that were not effective at the end of 2009. The operating cost reimbursement rate during 2010 and 2009 was the same at 3.43%.

#### *Liabilities*

Unearned premiums represent the pro-rata portion of the premiums written related to the remaining term of policies in force. Unearned premiums increased \$3.9 million (1%) and decreased \$4.4 million (-1.5%) in 2010 and 2009, respectively. The 2010 increase was due to the increase in premiums on policies that were not effective by the end of 2010. The 2009 decrease was due to the decrease in premiums on policies that were not effective by the end of 2009.

Revenue bonds payable decreased by \$31.5 million (-14%) in 2010 resulting from the annual 10% principal reduction payment. The bonds were initially issued in June 2006, totaling \$315 million. The revenue bonds bear interest at a fixed rate of 6.196% and mature in 2016 requiring annual 10% principal reduction payments.

Other liabilities include claims and claims expense reserves, which are not significant since California has not suffered a major earthquake during the CEA's existence. Other liabilities remained at relatively the same amount for 2010 as for 2009 with a decrease of \$.3 million (-3.5%) in 2010. The main reason for the decrease in 2010 was due to revenue bond interest payable being lower as the outstanding principle decreased causing the interest to decrease as well.

# CALIFORNIA EARTHQUAKE AUTHORITY

## Management's Discussion and Analysis (Continued)

### Condensed Balance Sheets (Continued)

#### Net Assets

The CEA classifies its net assets into two components, restricted-expendable and unrestricted net assets. Restricted net assets include the net assets of the Earthquake Loss Mitigation Fund (Mitigation Fund), unspent bond proceeds restricted for payment of claims as defined in the debt agreements offset by underlying debt, funds held for debt service by the revenue bond trustee and investment income earned on the bond proceeds restricted as pledged revenue for debt service. The Mitigation Fund was created by statute and related funds must be used solely for the establishment and operation of earthquake mitigation programs. The remaining net assets of the CEA are classified as unrestricted. The CEA's net assets grew \$291.7 million (8%) and \$294.9 million (9%) in 2010 and 2009, respectively. The 2010 increase was comprised primarily of an underwriting profit of \$249.3 million, and premium tax contributions from the State of California of \$13.9 million. The 2009 increase was comprised primarily of an underwriting profit of \$258.6 million, and premium tax contributions from the State of California of \$25.1 million.

### Condensed Statements of Revenue, Expenses, and Changes in Net Assets

The CEA's operating results are presented in the following table:

	<u>2010</u>	%	<u>2009</u>	%	<u>2008</u>	%
Underwriting income:						
Premium written	\$ 603,127,689	100%	\$ 585,520,749	100%	\$ 546,307,715	100%
Less premium ceded – reinsurance	<u>(221,788,128)</u>		<u>(194,697,154)</u>		<u>(185,054,138)</u>	
Net premium written	<u>381,339,561</u>	63%	<u>390,823,595</u>	67%	<u>361,253,577</u>	66%
Change in net unearned premiums	<u>(3,867,476)</u>		<u>4,433,465</u>		<u>(45,805,600)</u>	
Net premium earned	<u>377,472,085</u>	63%	<u>395,257,060</u>	68%	<u>315,447,977</u>	58%
Expenses:						
Claims and claims expense	75,036		137,637		32,410	
Mitigation fund expenses	424,711		376,472		440,730	
Other underwriting expenses	<u>127,677,823</u>		<u>136,168,302</u>		<u>109,024,673</u>	
Total expenses	<u>128,177,570</u>	21%	<u>136,682,411</u>	23%	<u>109,497,813</u>	20%
Underwriting profit	249,294,515	41%	258,574,649	44%	205,950,164	38%
Net investment income	22,486,654		10,864,785		127,242,391	
Capital contributions	5,470,000		-		46,500,000	
Other income	<u>14,447,146</u>		<u>25,450,791</u>		<u>11,620,267</u>	
Increase in net assets	291,698,315	48%	294,890,225	50%	391,312,822	72%
Net assets, beginning of year	<u>3,590,240,292</u>		<u>3,295,350,067</u>		<u>2,904,037,245</u>	
Net assets, end of year	<u>\$ 3,881,938,607</u>		<u>\$ 3,590,240,292</u>		<u>\$ 3,295,350,067</u>	

# CALIFORNIA EARTHQUAKE AUTHORITY

## Management's Discussion and Analysis (Continued)

### Condensed Statements of Revenue, Expenses, and Changes in Net Assets (Continued)

The increase in net assets was \$291.7 million in 2010, which resulted in a net profit margin of 48%, and \$294.9 million in 2009, which resulted in a net profit margin of 50%. Net investment income increased \$11.6 million (107%) in 2010. The increase was largely due to \$25.6 million decrease in the change of unrealized investment gains on U.S. Treasuries and a decrease of \$15.2 million in investment income. The CEA's net premiums written decreased \$9.5 million (-2%) in 2010 and increased \$29.6 million (8%) in 2009. The 2010 decrease is due to a \$17.6 million (3%) growth in written premiums while premiums ceded for reinsurance only grew \$27.1 million (14%). The 2009 increase is due to a \$39.2 million (7%) growth in written premiums while premiums ceded for reinsurance only grew \$9.6 million (5%).

The variance in the change in unearned premiums decreased \$8.3 million and increased \$50.2 million in 2010 and 2009, respectively. The 2010 variance is due to an increase in unearned premium caused by a slight increase in premiums for policies not effective at the end of 2010. The 2009 variance is due to a decrease in unearned premium caused by a large decrease in premiums for policies not effective at the end of 2009.

In 2010 and 2009, the CEA's claims and claims expenses were essentially zero due to California not experiencing any significant earthquakes.

In 2010, the decrease in other underwriting expense of \$8.5 million (-6%) was due to a \$0.8 million increase in participating insurer commissions and operating expense, and a \$11.1 million decrease in pro forma premium taxes. The decrease in pro forma premium taxes resulted from the 2009 adjustment for an error in the calculation of the pro forma premiums taxes from the CEA's inception through 2008.

In 2009, the increase in other underwriting expense of \$27.2 million (25%) was due to a \$11.9 million increase in participating insurer commissions and operating expense, and a \$13.8 million increase in pro forma premium taxes. The increase in pro forma premium taxes resulted from the 2009 increase in written premiums and an adjustment for an error in the calculation of the pro forma premiums taxes from the CEA's inception through 2008.

2009 adjustment to pro forma premium taxes:

	(In Millions)
Inception - 1998	\$ 4.5
1999	1.2
2000	.6
2001	.4
2002	.3
2003	.3
2004	.6
2005	1.0
2006	.1
2007	.8
2008	1.6
Total	<u>\$ 11.4</u>

# CALIFORNIA EARTHQUAKE AUTHORITY

## Management's Discussion and Analysis (Continued)

### Condensed Statements of Revenue, Expenses, and Changes in Net Assets (Continued)

Net investment income for 2010 was \$22.5 million, an increase of \$11.6 million (107%) from 2009, due to a \$25.6 million decline in the change of unrealized gains for the CEA's investment portfolio and an all-time low in interest rates for U.S. Treasuries in 2010 as markets moved to purchase and hold U.S. Treasuries.

The CEA intends to hold all investments to maturity unless there is an earthquake or series of earthquakes causing significant damage in California where the CEA needs to liquidate securities to pay policyholder claims.

Other income remained relatively flat in 2010 and 2009.

### Condensed Statements of Cash Flows

Primary sources of cash included cash flows from operations and capital contributions received from participating insurers. The primary use of cash was for operating expenses, repayment of debt, and the purchase of short-term and long-term investment securities.

The cash flows of the CEA are summarized as follows:

	2010	2009	2008
Net cash provided by operating activities	\$ 268,777,962	\$ 328,499,565	\$ 182,507,012
Net cash used in noncapital financing activities	(30,961,093)	(31,104,301)	(31,122,228)
Net cash provided by capital and related financing activities	1,818,807	43,332,709	2,695,377
Net cash used in investing activities	(198,332,217)	(397,870,084)	(2,189,968,563)
Net increase (decrease) in cash and cash equivalents	41,303,459	(57,142,111)	(2,035,888,402)
Cash and cash equivalents, beginning of year	55,153,403	112,295,514	2,148,183,916
Cash and cash equivalents, end of year	<u>\$ 96,456,862</u>	<u>\$ 55,153,403</u>	<u>\$ 112,295,514</u>

Cash from operating activities decreased \$59.7 million (-18%) in 2010 and increased \$146.0 million (80%) in 2009. The 2010 decrease resulted from an increase in payments for reinsurance of \$56.8 million and an increase in payments for operating expenses of \$3.3 million. The 2009 increase resulted from increased cash received from premiums of \$105.2 million, a decrease in payments for reinsurance of \$46.4 million and an increase in payments for operating expenses of \$5.6 million.

Cash used in non-capital financing activities for 2010 and 2009 is a result of the CEA annual principal reduction payment of \$31.5 million for its outstanding revenue bonds.

The change in cash provided by capital and related financing activities was \$41.5 million (-96%) was a result of a decrease of \$41.0 million in capital contribution installments received due to Safeco making its final contribution and the \$0.5 million increase in purchases of equipment during 2010 as compared to 2009. The change in cash provided by capital and related financing activities was \$40.6 million (1,508%) was a result of a \$38.8 million capital contribution installment receivable from Safeco and \$1.9 million decrease in purchases of equipment during 2009 as compared to 2008.

# CALIFORNIA EARTHQUAKE AUTHORITY

## Management's Discussion and Analysis (Continued)

### Condensed Statements of Cash Flows (Continued)

The change in cash flows used by investing activities in 2010 were \$199.5 million, which were a result of continuing the investment philosophy to gradually transition the CEA's investment portfolio from securities maturing in less than 90 days, which are classified as cash-equivalent securities, to short-term and long-term investments. The CEA slowed the transition of cash equivalent securities to longer-term securities because of the all-time low federal funds rate and the possible increase in interest rates in the future. In addition, because of the flatness in the shorter portion of the Treasury bond yield curve, and relatively low spreads for CEA permitted security types other than treasuries, management did not foresee a benefit to increase the duration of the CEA's portfolio. The change in cash flows used by investing activities in 2009 were \$1.8 billion, which was a result of a change in investment philosophy to gradually slow transition of the CEA's investment portfolio from securities maturing in less than 90 days, which are classified as cash-equivalent securities, to short-term and long-term investments. The CEA slowed the transition of cash equivalent securities to longer-term securities because of the all-time low federal funds rate and the possible increase in interest rates in the future. In addition, because of the flatness in the shorter portion of the Treasury bond yield curve, and relatively low spreads for CEA permitted security types other than treasuries, management did not foresee a benefit to increase the duration of the CEA's portfolio.

### Liquidity

The CEA maintains a highly liquid investment portfolio in order to be able to quickly pay claims in the event of a large earthquake. As of December 31, 2010, 28.68% of the portfolio was scheduled to mature in 90 days or less, securities maturing between 91 days and one year accounted for 33.47% of the portfolio, while securities maturing between one to five years accounted for the remaining 37.85% of the portfolio, with a total portfolio modified duration of less than one year. Based on earthquake modelers' results of analyzing the CEA's portfolio, management believes the CEA has sufficient liquidity to meet its obligations as they become due resulting from an earthquake or series of earthquakes. The probability of an earthquake or series of earthquakes occurring that would deplete CEA's liquidity and the associated claims-paying capacity is estimated to be 0.19% in any one year. The CEA pays policyholder claims from its claims-paying capacity. The following depicts the CEA's claims-paying capacity in effect as of December 31, 2010, in millions of dollars:

CEA capital available for claims	\$	3,753
Risk transfer financial products (reinsurance only at December 31, 2010)		3,123
Revenue Bonds		311
Post Earthquake Industry Assessments (2 <sup>nd</sup> Layer)		1,558
Post Earthquake Industry Assessments (New Layer)		1,095
Total	\$	<u>9,840</u>

Under California's Insurance Code, the CEA has the ability to assess the participating insurers on a post-event basis if claim payments to policyholders reach certain levels, as defined. Additionally, the CEA is able to recover amounts under reinsurance contracts when policyholder claims reach certain defined levels.

# CALIFORNIA EARTHQUAKE AUTHORITY

## Balance Sheets As of December 31, 2010 and 2009

	2010	2009
<b>Assets</b>		
Cash and investments:		
Cash and cash equivalents	\$ 48,536,535	\$ 9,116,729
Restricted cash	47,920,327	46,036,674
Restricted investments	313,837,486	311,813,156
Investments	3,862,746,926	3,635,759,760
Total cash and investments	4,273,041,274	4,002,726,319
Premiums receivable, net of allowance for doubtful accounts of \$10,533,225 and \$7,246,648	49,595,737	52,838,052
Risk capital surcharge receivable	1,700,000	-
Assessments receivable	3,190,830	314,019
Interest receivable	12,350,634	20,543,245
Deferred policy acquisition costs	40,674,396	40,154,994
Equipment, net	1,413,255	1,540,153
Other assets	42,496	121,614
Total assets	\$ 4,382,008,622	\$ 4,118,238,396
 <b>Liabilities and Net Assets</b>		
Unearned premiums	\$ 302,862,221	\$ 298,994,745
Revenue bond payable	189,000,000	220,500,000
Revenue bond interest payable	5,829,705	6,801,323
Accounts payable and accrued expenses	2,378,089	1,702,036
Total liabilities	500,070,015	527,998,104
Net assets:		
Restricted, expendable	168,559,583	133,264,871
Unrestricted	3,713,379,024	3,456,975,421
Total net assets	3,881,938,607	3,590,240,292
Total liabilities and net assets	\$ 4,382,008,622	\$ 4,118,238,396

*See accompanying notes to financial statements.*

## CALIFORNIA EARTHQUAKE AUTHORITY

### Statements of Revenues, Expenses, and Changes in Net Assets For the Years Ended December 31, 2010 and 2009

	2010	2009
Underwriting income:		
Premiums written	\$ 603,127,689	\$ 585,520,749
Less premiums ceded	(221,788,128)	(194,697,154)
Net premiums written	381,339,561	390,823,595
Change in unearned premiums	(3,867,476)	4,433,465
Net premiums earned	377,472,085	395,257,060
Expenses:		
Claim and claims expense	75,036	137,637
Participating insurer commissions	59,970,221	59,038,013
Participating insurer operating costs	20,567,165	20,695,908
Reinsurance broker commissions	4,800,040	5,000,002
Pro forma premium taxes	13,908,239	25,055,093
Financing expenses, net	8,861,561	9,572,948
Mitigation fund expenses	424,711	376,472
Other underwriting expenses	19,570,597	16,806,338
Total expenses	128,177,570	136,682,411
Underwriting profit	249,294,515	258,574,649
Net investment income	22,486,654	10,864,785
Other income	538,907	395,698
Contributed capital	5,470,000	-
State of California premium tax contribution	13,908,239	25,055,093
Increase in net assets	291,698,315	294,890,225
Net assets, beginning of year	3,590,240,292	3,295,350,067
Net assets, end of year	\$ 3,881,938,607	\$ 3,590,240,292

*See accompanying notes to financial statements.*

# CALIFORNIA EARTHQUAKE AUTHORITY

## Statements of Cash Flows For the Years Ended December 31, 2010 and 2009

	2010	2009
<b>Cash Flows from Operating Activities:</b>		
Cash received from premiums	\$ 606,370,004	\$ 606,006,642
Cash payments for premiums ceded - reinsurance	(223,488,128)	(166,680,962)
Cash payments for operating expenses	(114,103,914)	(110,826,115)
Net cash provided by operating activities	268,777,962	328,499,565
 <b>Cash Flows from Noncapital Financing Activities:</b>		
Repayment of revenue bonds	(31,500,000)	(31,500,000)
Other income	538,907	395,699
Net cash used in noncapital financing activities	(30,961,093)	(31,104,301)
 <b>Cash Flows from Capital and Related Financing Activities:</b>		
Capital contributions received from participating insurers	2,593,189	43,563,244
Acquisition of equipment	(774,382)	(230,535)
Net cash provided by capital and related financing activities	1,818,807	43,332,709
 <b>Cash Flows from Investing Activities:</b>		
Proceeds from maturities of investments	4,120,423,879	3,409,183,060
Purchases of investments	(4,389,600,177)	(3,892,353,936)
Net investment income	70,844,081	85,293,454
Change in securities receivable	-	7,338
Net cash used in investing activities	(198,332,217)	(397,870,084)
 Net increase (decrease) in cash and cash equivalents	41,303,459	(57,142,111)
Cash and cash equivalents, beginning of year	55,153,403	112,295,514
Cash and cash equivalents, end of year	\$ 96,456,862	\$ 55,153,403
 <b>Reconciliation to statement of net assets:</b>		
Cash and cash equivalent	\$ 48,536,535	\$ 9,116,729
Restricted cash	47,920,327	46,036,674
	\$ 96,456,862	\$ 55,153,403

*See accompanying notes to financial statements.*

# CALIFORNIA EARTHQUAKE AUTHORITY

## Statements of Cash Flows (Continued) For the Years Ended December 31, 2010 and 2009

	2010	2009
Reconciliation of operating income to net cash provided by operating activities:		
Underwriting profit	\$ 249,294,515	\$ 258,574,649
Adjustments to reconcile underwriting profit to net cash provided by operating activities:		
Depreciation on equipment	901,265	844,020
Pro forma premium tax expense	13,908,239	25,055,093
Changes in operating assets and liabilities:		
Premiums receivable	3,242,315	20,485,895
Risk capital surcharge receivable	(1,700,000)	-
Deferred policy acquisition costs	(519,402)	1,080,864
Other assets	79,119	(17,986)
Unearned premiums	3,867,476	(4,433,467)
Unearned ceded premiums	-	28,016,192
Revenue bond interest payable	(971,618)	(971,617)
Accounts payable and accrued expenses	676,053	(134,078)
Net cash provided by operating activities	\$ 268,777,962	\$ 328,499,565

### **Non-cash Investing, Capital and Financing Activities**

Net unrealized appreciation in the fair value of investments, which is included as a component of net investment income in the Statements of Revenues, Expenses and Changes in Net Assets, was \$(12.0) million and \$(37.6) million in 2010 and 2009, respectively. Premium tax contributed by the State of California and recognized as a component of expense in the Statements of Revenues, Expenses, and Changes in Net Assets was \$13.9 million and \$25.1 million in 2010 and 2009, respectively.

*See accompanying notes to financial statements.*

# CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements  
December 31, 2010 and 2009

## 1. Reporting Entity and Summary of Significant Accounting Policies

### *Reporting Entity*

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. 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 three member Governing Board consisting of the Governor, the Treasurer, and the Insurance Commissioner or their designees. The Speaker of the Assembly and the Chairperson of the Senate Rules Committee or their designees serve on the Governing Board as nonvoting members. The Governing Board is advised by an 11 member advisory panel, consisting of members of the public, consumers and insurance industry representatives.

CEA policies are sold to policyholders by participating insurers of the CEA. Insurance companies admitted to write residential property insurance in California and who elected to become participating members of the CEA sign Insurer Participation Agreements with the Insurance Commissioner and 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 policy issuance, premium collection, and claims adjustment. Under the agreements, the CEA reimburses participating insurers for non-claims related costs incurred by these companies in servicing CEA policies. The operating cost reimbursement is 3.43% of written premium. The producer commission is equal to 10% of written premium of all new and renewal CEA policies. Additionally, participating insurers receive reimbursement for expenses associated with servicing CEA claims equal to 9% of paid claims. As of December 31, 2010, there are 20 participating insurers of which just 15 insurers are writing CEA policies. Four participating insurers account for 77% of CEA's written premiums.

The CEA has eligibility requirements that compel the CEA to issue and renew policies if the insured structure has no pre-existing, non-cosmetic earthquake damage and the policyholder has a companion policy of residential property insurance from a participating insurer.

In the event that a natural disaster program is enacted by Congress, the Advisory Panel is required to prepare a plan to dissolve the CEA or to conform the sections of the California Insurance Code regarding the CEA to the federal program and recommend an action plan to the CEA Governing Board and the California State Legislature.

### *Basis of Accounting*

While the CEA is an instrumentality of the state, the State of California's General Fund is not liable for CEA claims, losses, or other liabilities. However, the CEA meets the definition of a governmental organization, as defined by accounting principles generally accepted in the United States of America.

# CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued)  
December 31, 2010 and 2009

## 1. Reporting Entity and Summary of Significant Accounting Policies (Continued)

### *Basis of Accounting (Continued)*

The CEA is accounted for as an enterprise fund and is financed and operated in a manner similar to that of a private business enterprise. The CEA uses the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under this method, revenues are recorded when earned and expenses are recorded when incurred. 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.

In accordance with governmental accounting standards, the CEA applies all applicable statements issued by the Governmental Accounting Standards Board (GASB). The CEA applies all private-sector standards of accounting and financial reporting issued prior to November 30, 1989, unless those standards conflict with or contradict guidance of the GASB. In addition, the CEA has elected to apply pronouncements issued by the Financial Accounting Standards Board after November 30, 1989, unless those pronouncements conflict with or contradict guidance of the GASB.

### *Revenue Recognition*

Premiums are recognized as earned on a pro rata basis over the policy contract period. All premium rates charged by the CEA must be approved by the State of California Insurance Commissioner before use. Unearned premiums represent amounts written which relate to coverage in future periods.

Premiums paid or accrued by the CEA under reinsurance agreements are accounted for as a reduction in the related premium revenue earned and amortized over the remaining reinsurance contract period. Unearned ceded premium is the pro rata portion of premiums ceded applicable to the unexpired period of reinsurance coverage.

### *Cash and Cash Equivalents*

For purposes of the statement of cash flows, the CEA considers investments in certificates of deposit, U.S. treasuries, commercial paper, corporate bonds, and bankers' acceptances with original maturities of three months or less, to be cash equivalents. Restricted cash and cash equivalents are comprised of unspent bond proceeds, debt service sinking funds and monies transferred to the Earthquake Loss Mitigation Fund (Mitigation Fund).

# CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued)  
December 31, 2010 and 2009

## 1. Reporting Entity and Summary of Significant Accounting Policies (Continued)

### *Investments*

Investments consist primarily of certificates of deposit, U.S. treasuries, commercial paper, corporate bonds, and bankers' acceptances, as authorized by California Insurance Code (Code) section 10089.6. All investments are reported at fair value in the balance sheets. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, and is determined from published data provided by the exchanges, computerized pricing sources, securities custodians, and other authoritative sources. The CEA is permitted to invest in securities eligible in California Government Code section 16430. Restricted investments are comprised of unspent bond proceeds and monies transferred to the Mitigation Fund.

### *Risk-Capital Surcharge*

Under California Insurance Code sec. 10089.16(d), effective July 1, 2008, the CEA Governing Board must calculate a risk-capital surcharge one year after the date that a new participating insurer first places or renews business into the CEA. The law provides that each annual risk-capital surcharge must equal the CEA's increased cost of providing or securing capacity to insure the new participant's excess earthquake-insurance risk. Safeco Insurance Company of America ("Safeco") was the first participating insurer to join the CEA after risk-capital surcharge law took effect.

CEA staff analyzed Safeco's earthquake-insurance risk profile as of December 31, 2009, and determined that the addition of Safeco's business was more likely to produce losses for the CEA, or was likely to produce greater losses for the CEA, than would a book of existing CEA business of similar size. Therefore, the Governing Board required Safeco to pay a first annual risk-capital surcharge in the amount of \$1,700,000. Since the intent of the risk-capital surcharge was to offset the increased cost to CEA of providing capacity to insure Safeco's excess earthquake-insurance risk for that one-year period, the CEA recorded the risk-capital surcharge as a reduction of premium ceded for reinsurance for the year ended December 31, 2010.

### *Deferred Policy Acquisition Costs*

Acquisition costs, consisting of participating insurer commissions and operating costs, are deferred and amortized over the terms of the underlying policies. Deferred acquisition costs are limited to the estimated recoverable value of such costs. The determination of estimated recoverable 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.

### *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. Estimates are revised as more information becomes available. Since the CEA's inception, there has not been a major earthquake. If a major California earthquake were to occur, there would be a significant increase in the reserve for claims and claim adjustment expenses. The CEA does not have any unpaid claims reported as of December 31, 2010.

# CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued)  
December 31, 2010 and 2009

## 1. Reporting Entity and Summary of Significant Accounting Policies (Continued)

### *Claims and Claim Expense Reserves (Continued)*

If the CEA's Governing Board determines that the CEA's net assets, bond proceeds, additional participating insurer capital contributions and reinsurance proceeds are exhausted and that no source of additional funds is available to the CEA to pay policyholder claims, the Governing Board is required to develop a plan for approval by the State of California Insurance Commissioner to pay policyholder claims on a pro rata or installment basis. In such circumstances, the insurance code states that the commissioner shall order the CEA to cease renewing or accepting new earthquake insurance policies.

### *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. 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. As of December 31, 2010, participating insurer capital contributions totaled \$756 million and were 99.58% funded.

### *Participating Insurer Assessments*

The California Insurance Code (Code) states that, subject to certain maximum limits as set forth in the Code, the CEA has the power to make additional assessments of participating insurers in the event of a major California earthquake, subject to the approval of the State of California Insurance Commissioner. The CEA's ability to make certain additional assessments for the 1st industry assessment layer pertaining to the participating insurers expired December 1, 2008. However, during 2007 the CEA worked with the state legislature and participating insurers to establish a new industry assessment layer, which commenced on December 1, 2008, with a current maximum assessment of \$1.095 billion. The CEA continued to retain its 2<sup>nd</sup> industry assessment layer of \$1.558 billion.

As of December 31, 2010, participating insurers have a cumulative residential property insurance market share of approximately 76% of the total residential property insurance market in California. If participating insurers withdraw their participation in the CEA such that the cumulative residential property insurance market share is less than 65%, the Insurance Commissioner is required by law to make recommendations to the California Legislature for the continuation or termination of the CEA.

### *Net Assets*

The CEA classifies its net assets into two components, restricted-expendable and unrestricted net assets. Restricted net assets include the net assets of the Mitigation Fund, unspent bond proceeds restricted for payment of claims as defined in the debt agreements and funds held for debt service by the revenue bond trustee offset by underlying debt, and investment income earned on the bond proceeds restricted as pledged revenue for debt service.

# CALIFORNIA EARTHQUAKE AUTHORITY

## Notes to Financial Statements (Continued) December 31, 2010 and 2009

### 1. Reporting Entity and Summary of Significant Accounting Policies (Continued)

#### *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.

#### *State of California Premium Tax*

California Insurance Code section 10089.44 provides that “Notwithstanding any other provision of law, premiums collected by the authority 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 authority.”

### 2. Correction of Error

State premium tax contributions were \$13,908,239 and \$25,055,093 for the years ended December 31, 2010 and 2009, respectively. Higher premium taxes in 2009 are a result of recalculation of pro forma premium taxes for the years 1997 through 2008. Since inception of the CEA through December 31, 2009, state premium tax contributions totaled \$140,695,240 which reflect the adjustments for the years 1997 through 2008.

### 3. Cash and Investments

As of December 31, 2010 and 2009, the CEA had the following cash and investments:

	December 31, 2010					
	Investment Maturities (in Years)					
	Less than 1	1-2	2-3	3-4	4-5	Total
U.S. treasuries	\$ 2,271,005,195	\$ 1,351,634,751	\$ 176,346,556	\$ 33,686,100	\$ 55,692,624	\$ 3,888,365,226
U.S. agencies	307,225,721	-	-	-	-	307,225,721
U.S. gov’t money market funds	25,250,003	-	-	-	-	25,250,003
Cash	2,238,595	-	-	-	-	2,238,595
Commercial paper	49,961,729	-	-	-	-	49,961,729
Total	<u>\$ 2,655,681,243</u>	<u>\$ 1,351,634,751</u>	<u>\$ 176,346,556</u>	<u>\$ 33,686,100</u>	<u>\$ 55,692,624</u>	<u>\$ 4,273,041,274</u>
	December 31, 2009					
	Investment Maturities (in Years)					
	Less than 1	1-2	2-3	3-4	4-5	Total
U.S. treasuries	\$ 3,072,690,825	\$ 691,995,169	\$ 156,279,221	\$ 46,593,000	\$ -	\$ 3,967,558,215
U.S. agencies	7,900,000	-	-	-	-	7,900,000
U.S. gov’t money market funds	26,051,324	-	-	-	-	26,051,324
Cash	1,216,780	-	-	-	-	1,216,780
Total	<u>\$ 3,107,858,929</u>	<u>\$ 691,995,169</u>	<u>\$ 156,279,221</u>	<u>\$ 46,593,000</u>	<u>\$ -</u>	<u>\$ 4,002,726,319</u>

# CALIFORNIA EARTHQUAKE AUTHORITY

## Notes to Financial Statements (Continued) December 31, 2010 and 2009

### 3. Cash and Investments (Continued)

#### *Interest Rate Risk*

As a means of limiting its exposure to fair value losses resulting from rising interest rates, the CEA's investment policy limits all securities purchased to a maximum maturity duration of 181 days, except for U.S. Treasuries. U.S. Treasuries are allowed to have maturities of up to 5 years as long as the CEA's combined portfolio does not exceed a maximum modified duration of 1.75 years. As of December 31, 2010, the CEA's combined portfolio has a maximum modified duration of less than 1 year.

#### *Credit Risk*

The CEA investment policy limits investments in banker's acceptances and commercial paper to issuers with the highest rating category by all rating agencies that rate the issuer. The policy limits investments in corporate bonds to the top three ratings issued by nationally recognized rating services. As of December 31, 2010, 92% of the portfolio consisted of U.S. Treasuries and 8% of the portfolio consisted of U.S. Agency and commercial paper securities.

#### *Concentration of Credit Risk*

There is no concentration of investments in any one non U. S. governmental issuer that represents 5% or more of total investments.

#### *Investment Income*

Total investment income is comprised of interest, realized gains and losses, and unrealized gains and losses due to changes in the fair value of investments held at year end. Investment income earned on unspent bond proceeds are offset against related interest expense and classified as financing expenses, net on the statement of revenues, expenses, and changes in net assets.

Investment income for the years ended December 31, 2010 and 2009 were as follows:

	<u>2010</u>	<u>2009</u>
US agency securities and government money market accounts	\$ 594,901	\$ 82,880
US treasuries	39,716,242	55,387,371
Other short-term investments	<u>97,723</u>	<u>34,868</u>
Interest income	40,408,866	55,502,119
Change in fair value of investments	(12,049,809)	(37,644,911)
Less investment expenses	<u>(1,775,133)</u>	<u>(1,674,388)</u>
Total investment income	<u>\$ 26,583,924</u>	<u>\$ 16,182,820</u>

# CALIFORNIA EARTHQUAKE AUTHORITY

## Notes to Financial Statements (Continued) December 31, 2010 and 2009

### 3. Cash and Investments (Continued)

#### *Investment Income (Continued)*

The following is a reconciliation of investment income to the statements of revenues, expenses, and changes in net assets:

	2010	2009
Investment income included in financing expenses	\$ 4,097,270	\$ 5,318,035
Net investment income	22,486,654	10,864,785
Total investment income	\$ 26,583,924	\$ 16,182,820

The change in fair value of investments for the years ended December 31, 2010 and 2009 is calculated as follows:

	2010	2009
Fair value of investments at the end of year	\$ 4,176,584,412	\$ 3,947,572,916
Add: Proceeds of investments matured	4,120,423,879	3,409,183,050
Add: Amortization of premium (discount)	28,114,993	33,538,211
Less: Cost of investments purchased	(4,389,600,177)	(3,892,353,936)
Less: Fair value of investments at the beginning of year	(3,947,572,916)	(3,535,573,745)
Change in fair value of investments	\$ (12,049,809)	\$ (37,633,504)

#### *Fair Value of Financial Instruments*

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.

### 4. Long-Term Debt

The CEA issued its first long-term debt, \$315 million in fixed rate revenue bonds on July 20, 2006 to enhance claims paying capacity. The following reflects activity in the long-term debt accounts during the years ended December 31, 2010 and 2009, respectively:

	2010	2009
Balance at January 1,	\$ 220,500,000	\$ 252,000,000
Payments made in July	(31,500,000)	(31,500,000)
Balance at December 31,	\$ 189,000,000	\$ 220,500,000

# CALIFORNIA EARTHQUAKE AUTHORITY

## Notes to Financial Statements (Continued) December 31, 2010 and 2009

### 4. Long-Term Debt (Continued)

The net proceeds from the revenue bonds were deposited into the Claims Paying Account and were used to purchase investments according to CEA's investment policy and procedures. 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.

The bonds are payable from future pledged policyholder premiums. The bonds bear interest at 6.169% and are federally taxable. Interest is payable semi-annually, beginning January 1, 2007. The bonds are due July 1, 2016, but are subject to annual mandatory sinking-fund payments as indicated below. The bonds are subject to optional redemptions at any time prior to maturity, in whole or in part, at the option of the CEA. The CEA is subject to certain bond covenants, the most restrictive of which requires a debt service coverage ratio, as defined, of 3:1.

Future scheduled debt service payments, including mandatory sinking fund payments, for the CEA's long-term debt are as follows as of December 31, 2010:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 31,500,000	\$ 10,687,793	\$ 42,187,793
2012	31,500,000	8,744,558	40,244,558
2013	31,500,000	6,801,323	38,301,323
2014	31,500,000	4,858,088	36,358,088
2015	31,500,000	2,914,853	34,414,853
2016	31,500,000	971,617	32,471,617
Total requirements	<u>\$ 189,000,000</u>	<u>\$ 34,978,232</u>	<u>\$ 223,978,232</u>

### *Fair Value*

The estimated fair value of the CEA's long-term debt, based on quoted market prices for the same or similar issues at December 31, 2010 is as follows:

Carrying amount	\$ 189,000,000
Fair value	206,633,700

# CALIFORNIA EARTHQUAKE AUTHORITY

## Notes to Financial Statements (Continued) December 31, 2010 and 2009

### 5. Reinsurance

The CEA cedes risk to reinsurers under catastrophe excess-of-loss reinsurance contracts for purposes of limiting its maximum exposure. All contracts provide coverage for losses as well as allocated loss adjustment expenses. Although the ceding of risk 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. To date, losses have been recovered only under the supplemental coverages reinsurance contracts. In the event that legislation is enacted by the State of California that has the effect of increasing a reinsurer's exposure to loss under the reinsurance contract, a reinsurer has the right to cancel the reinsurance contract.

The 2010 and 2009 aggregate excess reinsurance contracts allowed for an adjustment of premium, based on the average aggregate insurance in force and the exposure adjustment limit, as defined in the contracts. As of December 31, 2010, in accordance with these terms, the CEA did not have any premium adjustment expense against the contract. During 2010, the CEA continued to cede insurance to reinsurers under the catastrophe excess-of-loss reinsurance contracts providing maximum limits of \$3.1 billion at varying attachment points.

Effective January 1, 2011, the CEA entered into reinsurance contracts that provide a maximum limit of \$2.9 billion. The contracts are 12-month contracts.

### 6. Statutory Compliance

The State of California Insurance Code limits the 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 premiums written 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 payments of agent commissions. Operating expenses, as determined by the CEA, totaled \$9.4 million and \$8.0 million for the years ended December 31, 2010 and 2009, respectively, and did not exceed 3% of premiums written.

### 7. Commitments and Contingencies

The CEA is a defendant in various legal actions arising from the normal course of business. Management does not believe that the ultimate disposition of these actions will have a material adverse effect on CEA's financial position or results of operations.

# CALIFORNIA EARTHQUAKE AUTHORITY

## Notes to Financial Statements (Continued) December 31, 2010 and 2009

### 7. Commitments and Contingencies (Continued)

The CEA leases office facilities and equipment under various non-cancelable operating lease agreements that expire through December 2016. Rental expense associated with the lease agreements was \$486,983 and \$669,738 for the years ended December 31, 2010 and 2009, respectively. Future minimum rental payments under these agreements are as follows:

	<u>Amount</u>
2011	\$ 661,609
2012	707,239
2013	722,736
2014	717,232
2015	727,069
Thereafter	184,490
Total	<u>\$ 3,720,375</u>

### 8. Mitigation Fund

California Insurance Code (Code) Section 10089.37 created the Earthquake Loss Mitigation Fund (Mitigation Fund) as a “sub-account of the CEA”. According to statute, the Mitigation Fund must be used solely for the establishment and operation of an earthquake loss mitigation program. The Code requires the CEA to annually transfer an amount equal to the lesser of 5% of investment income or \$5 million to the Mitigation Fund if deemed actuarially sound by a consulting actuary. The transfer and setting aside of those monies into the Mitigation Fund sub-account 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 reside in the Mitigation Fund sub-account within the CEA are by statute not available to pay policyholder or other claims against the CEA.

As of December 31, 2010 and 2009, the balance sheets include expendable restricted net assets related to the Mitigation Fund totaling \$24,302,326 and \$22,701,714, respectively. The expendable restricted net assets of the Mitigation Fund as of December 31, 2010, include the potential annual transfer amount of \$2,019,253, which is subject to actuarial review and formal approval of the CEA’s Governing Board as discussed in the previous paragraph.

### 9. Retirement Plan, Deferred Compensation and Post-Employment Benefits

#### *Defined Benefit Plans*

The State of California sponsors a defined benefit pension plan covering all CEA civil-service employees. The benefits are based on the highest 12 consecutive months compensation during their employment. The state’s funding policy is to make the minimum annual contributions required by applicable regulations and charges the CEA for its allocable share of such contributions based on a percentage of payroll. The CEA has no legal obligation for benefits under this plan.

# CALIFORNIA EARTHQUAKE AUTHORITY

Notes to Financial Statements (Continued)  
December 31, 2010 and 2009

## 9. Retirement Plan, Deferred Compensation and Post-Employment Benefits (Continued)

### *Defined Contribution Plans*

The CEA sponsors a defined contribution savings plan for contract employees. Employees contribute 5% of compensation. The CEA contributes 12.71% of the employee's compensation. The contributions are funded semi-annually and allocated to the CEA based on employee contributions. The CEA has no legal obligation for benefits under this plan.

### *Post-Employment Benefits*

The CEA has no obligations to former employees for benefits after their employment other than compensation related to earned vacation and severance. The liability for earned but untaken leave, such as vacation, personal leave days, or holiday credit, has been accrued to contract employees.

## 10. Subsequent Events

Management has evaluated subsequent events through August 17, 2011, which is the date the financial statements were available to be issued. No events have occurred subsequent to December 31, 2010 requiring recording or disclosure in these financial statements.

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**SUPPLEMENTARY INFORMATION**

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## CALIFORNIA EARTHQUAKE AUTHORITY

### Schedule of Participating Insurer Capital Contributions From Inception through December 31, 2010

State Farm General Insurance Company	\$ 254,636,730
Allstate Insurance Company	145,612,517
The Fire Insurance Exchange (Farmers)	143,280,000
United Services Automobile Association <sup>1</sup>	58,992,512
California State Automobile Association Inter-Insurance Bureau <sup>2</sup>	39,013,494
Safeco Insurance Company of America <sup>3</sup>	46,500,000
California FAIR Plan Association	15,029,487
Interinsurance Exchange of the Automobile Club	14,443,651
CNA/Continental <sup>4</sup>	13,924,611
Prudential <sup>4</sup>	11,531,455
Liberty Mutual Fire Insurance Company <sup>5</sup>	6,699,434
Foremost Property and Casualty Insurance Company	4,614,304
Mercury Casualty Company	1,427,783
Armed Forces Insurance Exchange	783,685
GuideOne (formerly Preferred Risk) <sup>4</sup>	123,133
Merastar <sup>6</sup>	-
Homesite Insurance Company of California	-
Pacific National Insurance <sup>4</sup>	-
Encompass Insurance Company	-
Glen Falls Insurance Company <sup>4</sup>	-
Commerce West Insurance Company	-
Total	\$ 756,612,796

<sup>1</sup>Includes Garrison Insurance Company

<sup>2</sup>Includes ACA Insurance Company

<sup>3</sup>Joined the CEA as of December 1, 2008

<sup>4</sup>Not currently writing residential property insurance in California

<sup>5</sup>Includes Golden Eagle Insurance Company

<sup>6</sup>Withdrew from the CEA as of May 1, 2009

## CALIFORNIA EARTHQUAKE AUTHORITY

### Schedules of Participating Insurer Premiums Written For the Years Ended December 31, 2010 and 2009

	2010	2009
State Farm General Insurance Company	\$ 212,325,217	\$ 210,715,352
Allstate Insurance Company	96,452,143	98,163,445
The Fire Insurance Exchange (Farmers)	78,443,512	74,429,404
United Services Automobile Association <sup>1</sup>	79,572,597	75,655,533
California State Automobile Association Inter-Insurance Bureau <sup>2</sup>	25,464,527	21,402,761
Safeco Insurance Company of America <sup>3</sup>	31,060,641	31,039,563
California FAIR Plan Association	4,546,230	4,481,010
Interinsurance Exchange of the Automobile Club	38,604,396	36,736,630
CNA/Continental <sup>4</sup>	-	-
Prudential <sup>4</sup>	-	-
Liberty Mutual Fire Insurance Company <sup>5</sup>	14,328,376	13,473,540
Foremost Property and Casualty Insurance Company	2,343,520	1,761,347
Mercury Casualty Company	14,158,005	12,804,714
Armed Forces Insurance Exchange	757,218	700,799
GuideOne (formerly Preferred Risk) <sup>4</sup>	-	-
Merastar <sup>6</sup>	-	-
Homesite Insurance Company of California	339,398	321,509
Pacific National Insurance <sup>4</sup>	-	-
Encompass Insurance Company	4,720,884	3,822,379
Glen Falls Insurance Company <sup>4</sup>	-	-
Commerce West Insurance Company	11,025	12,763
Total	\$ 603,127,689	\$ 585,520,749

<sup>1</sup>Includes Garrison Insurance Company

<sup>2</sup>Includes ACA Insurance Company

<sup>3</sup>Joined the CEA as of December 1, 2008

<sup>4</sup>Not currently writing residential property insurance in California

<sup>5</sup>Includes Golden Eagle Insurance Company

<sup>6</sup>Withdrew from the CEA as of May 1, 2009

## CALIFORNIA EARTHQUAKE AUTHORITY

### Schedules of Participating Insurer Unearned Premiums As of December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
State Farm General Insurance Company	\$ 105,588,276	\$ 106,141,539
Allstate Insurance Company	46,613,133	48,958,977
The Fire Insurance Exchange (Farmers)	39,311,113	38,414,939
United Services Automobile Association <sup>1</sup>	39,926,665	38,518,213
California State Automobile Association Inter-Insurance Bureau <sup>2</sup>	12,798,895	11,009,533
Safeco Insurance Company of America <sup>3</sup>	19,376,804	18,924,219
California FAIR Plan Association	2,348,100	2,360,131
Interinsurance Exchange of the Automobile Club	18,934,223	18,067,271
CNA/Continental <sup>4</sup>	-	-
Prudential <sup>4</sup>	-	-
Liberty Mutual Fire Insurance Company <sup>5</sup>	7,300,964	7,118,808
Foremost Property and Casualty Insurance Company	1,176,529	938,303
Mercury Casualty Company	6,887,490	6,110,966
Armed Forces Insurance Exchange	390,380	364,168
GuideOne (formerly Preferred Risk) <sup>4</sup>	-	-
Merastar <sup>6</sup>	-	-
Homesite Insurance Company of California	207,392	205,232
Pacific National Insurance <sup>4</sup>	-	-
Encompass Insurance Company	1,997,526	1,856,652
Glen Falls Insurance Company <sup>4</sup>	-	-
Commerce West Insurance Company	4,731	5,794
Total	<u>\$ 302,862,221</u>	<u>\$ 298,994,745</u>

<sup>1</sup>Includes Garrison Insurance Company

<sup>2</sup>Includes ACA Insurance Company

<sup>3</sup>Joined the CEA as of December 1, 2008

<sup>4</sup>Not currently writing residential property insurance in California

<sup>5</sup>Includes Golden Eagle Insurance Company

<sup>6</sup>Withdrew from the CEA as of May 1, 2009

## CALIFORNIA EARTHQUAKE AUTHORITY

### Schedules of Participating Insurer Commissions For the Years Ended December 31, 2010 and 2009

	<b>2010</b>	<b>2009</b>
State Farm General Insurance Company	\$ 21,302,966	\$ 21,813,184
Allstate Insurance Company	9,887,460	10,258,062
The Fire Insurance Exchange (Farmers)	7,760,842	7,909,515
United Services Automobile Association <sup>1</sup>	7,821,373	7,578,732
California State Automobile Association Inter-Insurance Bureau <sup>2</sup>	2,369,216	2,136,660
Safeco Insurance Company of America <sup>3</sup>	3,063,071	1,974,006
California FAIR Plan Association	456,091	468,855
Interinsurance Exchange of the Automobile Club	3,776,632	3,586,902
CNA/Continental <sup>4</sup>	-	-
Prudential <sup>4</sup>	-	-
Liberty Mutual Fire Insurance Company <sup>5</sup>	1,415,848	1,404,541
Foremost Property and Casualty Insurance Company	211,440	177,255
Mercury Casualty Company	1,338,999	1,193,484
Armed Forces Insurance Exchange	73,164	73,341
GuideOne (formerly Preferred Risk) <sup>4</sup>	-	-
Merastar <sup>6</sup>	-	125
Homesite Insurance Company of California	33,766	34,309
Pacific National Insurance <sup>4</sup>	-	-
Encompass Insurance Company	458,143	428,068
Glen Falls Insurance Company <sup>4</sup>	-	-
Commerce West Insurance Company	1,210	974
Total	\$ 59,970,221	\$ 59,038,013

<sup>1</sup>Includes Garrison Insurance Company

<sup>2</sup>Includes ACA Insurance Company

<sup>3</sup>Joined the CEA as of December 1, 2008

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<sup>6</sup>Withdrew from the CEA as of May 1, 2009

## CALIFORNIA EARTHQUAKE AUTHORITY

### Schedules of Participating Insurer Operating Costs (Net of Deferred Acquisition Costs) For the Years Ended December 31, 2010 and 2009

	<b>2010</b>	<b>2009</b>
State Farm General Insurance Company	\$ 7,304,976	\$ 7,662,103
Allstate Insurance Company	3,389,823	3,558,746
The Fire Insurance Exchange (Farmers)	2,660,705	2,780,750
United Services Automobile Association <sup>1</sup>	2,681,722	2,659,966
California State Automobile Association Inter-Insurance Bureau <sup>2</sup>	812,630	750,321
Safeco Insurance Company of America <sup>3</sup>	1,050,973	690,370
California FAIR Plan Association	156,372	164,679
Interinsurance Exchange of the Automobile Club	1,296,553	1,266,732
CNA/Continental <sup>4</sup>	-	-
Prudential <sup>4</sup>	-	-
Liberty Mutual Fire Insurance Company <sup>5</sup>	486,460	494,743
Foremost Property and Casualty Insurance Company	72,328	62,179
Mercury Casualty Company	459,853	418,321
Armed Forces Insurance Exchange	25,091	25,769
GuideOne (formerly Preferred Risk) <sup>4</sup>	-	-
Merastar <sup>6</sup>	-	45
Homesite Insurance Company of California	12,127	12,650
Pacific National Insurance <sup>4</sup>	-	-
Encompass Insurance Company	157,136	148,193
Glen Falls Insurance Company <sup>4</sup>	-	-
Commerce West Insurance Company	416	341
Total	\$ 20,567,165	\$ 20,695,908

<sup>1</sup>Includes Garrison Insurance Company

<sup>2</sup>Includes ACA Insurance Company

<sup>3</sup>Joined the CEA as of December 1, 2008

<sup>4</sup>Not currently writing residential property insurance in California

<sup>5</sup>Includes Golden Eagle Insurance Company

<sup>6</sup>Withdrawn from the CEA as of May 1, 2009